

CMUA
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Handbook on Public Agency Power Options



Strategic issues your community should consider
in pursuing public agency power options



California Municipal Utilities Association

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Table of Contents

Table of Contents	i
Introduction.....	1
What is CMUA	2
1.0 Why the interest in exploring Public Agency Power	3
2.0 The Benefits of Public Agency Power	4
3.0 Does Public Agency Power make sense for your community?	6
4.0 A Brief History of the Restructuring of California’s Utility Industry	7
4.1 Direct Access	8
4.2 Aggregation.....	8
4.3 Municipal Utilities and AB 1890.....	8
4.4 The consequences of AB 1890	9
5.0 How do Public Agency Power rates compare with investor owned utilities?	11
5.1 Rate Data Comparison	11
5.2 Sacramento Bee Rate Comparison.....	11
6.0 If the choice is Public Agency Power, which model is best for your community?	12
6.1 The Traditional Public Utility: Owning the distribution system	12
6.1.1 Acquire the system from the existing utility.....	13
6.1.2 Build a separate distribution system	13
6.1.3 Take ownership of systems only in new developments.....	13
6.2 Legal forms of Publicly Owned Utilities	14
6.2.1 Forming a City Municipal Utility	15
6.2.2 Forming a Municipal Utility District (MUD)	16
6.2.3 Forming a Public Utility District (PUD).....	18
6.2.4 Forming an Irrigation District (ID).....	18
6.3 Partnering with existing Public Power entities	19
6.3.1 Adding electricity services to an ID, PUD or MUD.....	19
6.3.2 Annexation into an existing service territory.....	19
6.3.3 The role of Joint Powers Agencies	20
7.0 Determining the Feasibility for Public Power options involving ownership.....	21
7.1 Pre-feasibility study	21
7.2 Feasibility study	21
7.3 Components of feasibility studies.....	22
8.0 Political considerations for municipalization efforts	25
8.1 - Step 1	26
8.2 - Step 2	26
8.3 - Step 3	27
8.4 - Step 4	28
8.5 - Step 5	29
8.6 - Step 6	30

9.0	New concepts in Public Power: No ownership of the distribution system	30
	9.1 Facilitator of Energy Efficiency.....	30
	9.2 Facilitator of Renewable Energy	31
	9.3 Community Choice Aggregator.....	31
10.0	Exit Fees.....	33
11.0	Summary	34
	Glossary of Terms.....	35
	Appendix – Resources and Bibliography	37

Introduction

Public Power is a generic term used throughout the country to refer to publicly owned electric distribution utilities. The California Municipal Utilities Association (CMUA) is a statewide association of publicly owned utilities. While we believe the term “*consumer owned utilities*” to be more descriptive than the term “*Public Power*,” we will use the term “*Public Power*” throughout this Handbook because it is so commonly used throughout the industry. The term “*municipal utility*” is also used generically to mean any public agency in the electric utility business. In fact there are city owned utilities (both Charter and General Law cities) municipal utility districts (not general purpose city governments), public utility districts and irrigation districts that are in the electric utility business.

CMUA developed this Handbook in response to the numerous inquiries from communities that want to learn more about establishing municipal utilities or exploring other public agency power options. This Handbook is meant to give citizens and local governments an overview of the considerations and steps that should be addressed when exploring various types of public agency power or programs. Because every community is unique, this Handbook does not anticipate every question. It is intended only to provide a roadmap for exploring the issues surrounding public agency power options. This Handbook is not intended to rebut the charges against public power put forth by the Investor Owned Utilities or their national association, the Edison Electric Institute. Responses of that nature are available from the American Public Power Association at www.appanet.org or (202) 467-2900.

Establishing a publicly owned utility requires detailed technical and financial analysis and should not be entered into casually. A good public ownership option in one community will not necessarily serve the interests of another community. Keep this in mind as your community looks at the pros and cons of establishing a municipal utility or other public agency power programs.

What is CMUA?

The California Municipal Utilities Association (CMUA) is an association representing more than 60 publicly owned water, electric and gas utilities in California. Among CMUA's members are publicly owned electric distribution utilities, including various types of public agencies which provide electric service to consumers: *Charter Cities*, *General Law Cities*, *Irrigation Districts*, *Municipal Utility Districts* and *Public Utility Districts*. Each of these agencies share common attributes, such as being required to adhere to open meeting laws and public record laws. At the same time, however, their structures differ significantly as directed by their enabling statutes or city charters. All locally owned electric distribution utilities are governed by locally elected bodies, not by the California Public Utilities Commission (CPUC). This means that local elected officials set rates and policies.

Collectively, publicly owned utilities serve approximately 25-30% of the electric demand of California and own significant transmission assets that together amount to more than 40% of the high voltage electricity transfer capacity in and out of California.

Publicly owned utilities vary in size from the Los Angeles Department of Water and Power (LADWP), which serves more than three million, to the City of Briggs, which serves about two thousand people. They also vary greatly in other ways. For example, the City of Vernon is a completely industrial city, while other publicly owned utilities serve in rural areas or have primarily residential service territories. Due to differences in size and other social and geographic characteristics, publicly owned utilities vary greatly in what they do to serve their community interests and needs. Their programs vary with each service territory because the elected officials have local control over the operation of the utility and are therefore able to tailor their policies to local conditions.

When California's energy markets failed in 2000-2001, the ability of locally elected officials to design programs that met the needs of their service territories proved to be the true value of local control. As a result, publicly owned utilities weathered the energy storm in much better condition than the state's investor owned utilities (IOUs).

1.0 Why the interest in exploring Public Agency Power Options?

A resurgence of interest in public power options is emerging as a direct result of the failure of the 1996 legislation (AB1890) to restructure the electric utility industry in California without increasing costs to ratepayers.

Local elected officials in California are concerned over the disastrous economic effects to citizens and businesses caused by the market volatility and scarcity that resulted from restructuring the electric utility industry. Their constituents are concerned with the costs of the for-profit electric utilities and feel vulnerable to a market subject to wild fluctuation and outright manipulation. They also know that electricity is not just another commodity, but is vital to just about any business or personal activity. They recognize the public policy merit in undertaking the planning and provision of power to benefit the interests of the people and businesses they represent. And, they see that local, community focused decision-making about electric service by a public agency has worked well in providing reliable electricity at the lowest possible cost.

Publicly owned utilities are, by and large, in much better financial condition than the investor-owned utilities because local control works. This fact was evident in the recent energy crisis in California. As communities look for ways to stabilize electricity prices in an uncertain electricity market and for ways to control their own destiny, new focus is being given to forming new publicly owned utilities. There is also strong interest in exploring non-traditional concepts such as Community Choice Aggregation and identifying other means of maintaining local control over energy decision making. While forming a public power system will not automatically solve a community's short-term problem with the California electricity market, it may make sense as a longer-term alternative for a community. Once a community owns the distribution assets (the poles and wires) that serve its constituents, it obtains control over electric power decision-making and can pursue a variety of options, such as the purchasing of electricity through power supply contracts or the building or buying of generation facilities. Also, the local public power utility can make decisions about maintaining, upgrading or expanding the local distribution system to ensure or enhance reliability and exercise local control over electric rates and service policies. Public power programs that promote renewable energy, energy efficiency or Community Choice Aggregation also provide some local decision making related to energy choices, but these options afford less control than actually owning the utility that provides the energy and distribution services to a community. This Handbook describes the variety of public entity structures that exist for local policy makers to choose from if they decide their community should take control of its electricity future.

2.0 The Benefits of Public Power Agency

The benefits of public power have been well documented by the American Public Power Association (APPA). APPA is the national service organization for more than 2,000 community-owned electric utilities that serve more than 40 million Americans. APPA was created in 1940 as a non-profit, non-partisan organization. Its purpose is to advance the public policy interests of its members and their consumers, and provide member services to ensure adequate reliable electricity at a reasonable price with the proper protection of the environment.

APPA has excellent information on its website on the history of public power and the benefits public power can bring to a community. Visit the website at www.appanet.org to learn more about public power. Deborah Penn, the Vice President of Information Services at APPA, is also available to answer general questions about forming municipal utilities. She can be reached at (202) 467-2956 or debenn@appanet.org.

The following is a list of long-term benefits public power can bring to a community. For more detailed information, visit the APPA website at www.appanet.org:

- Well-documented lower electricity rates for both residential and business customers.
- Rates decided by a Board made up of officials who are locally elected and accountable to its citizens.
- Equal or greater reliability for the distribution system.
- Efficient service at the lowest cost---consistent with reliability, community goals and sound business practices.
- Responsiveness to customer concerns - every citizen is an owner with a direct say in policies. Board meetings are always open to the public.
- Emphasis on long-term community goals in strategic decision-making.
- Quick response from work crews located in the community.
- Not-for-profit status, resulting in lower costs and no mixed allegiance between the needs of customers and the profit of stockholders.
- Greater portion of revenues stay in the community because municipal utilities buy local products and services. The local utility purchases from local businesses and uses the local financial institutions.
- Local employment. Creation of jobs for businesses who provide services to the utility.
- Improved local government efficiency through sharing of personnel, equipment and supplies.

- Local management and operations - yielding added community leadership for innovation and development.
- Recognized commitment to conservation, safety and the environment.
- Access to tax-exempt financing for building new distribution facilities.
- Opportunity for efficiency through integrated utility operations (e.g., operation with electric, water, sewer, garbage, gas, cable, telecommunications).
- Local control over special programs (energy conservation, tree planting, rooftop solar installations, economic development rates for certain customer classes, etc.).
- Local control over the electric distribution system aesthetics and design.
- No economic bias toward high cost, capital-intensive techniques or technologies because publicly owned utilities do not earn a rate of return on investments like the investor owned utilities.
- Primary mission of providing least-cost, reliable service rather than maximizing profits.
- Innovative techniques and technology to meet energy needs.
- A competitive standard against which the service of all distribution utilities may be measured.
- Business development opportunities because of the low cost of public power.

3.0 Does Public Agency Power make sense for your community?

If you can answer “Yes” to any of the following questions below, chances are your community would benefit from exploring public power options. It’s important to think long term when you ask these questions. Public power options may not bring lower rates immediately, but certainly will increase local control and create the potential for lower rates over the long run. These are the issues most talked about when communities decide to look at public power:

- Does your community want to have more local control over decision-making related to energy issues?
- Does your community want lower electrical rates and your current utility’s rates are high or are expected to increase substantially in the future?
- Would the citizens and business interests in your community support a non-profit electric utility that would help keep local electric revenues in the community?
- Is your community unhappy with the reliability of the electrical distribution system serving it?
- Is your community asking for ongoing unique programs that reflect community values, such as special economic development rates to attract new business, energy efficiency programs tailored to residential and business customers, tree planting programs, electric vehicle programs, solar energy, wind energy, and other “green” energy options?
- Has your incumbent utility been unresponsive to the customer service needs of the residential and commercial customers in your community?
- Does your community have the ability to build coalitions among the business community, neighborhood organizations, service groups and elected officials to see the municipalization process through to conclusion? (Municipalization efforts are usually lengthy, sometimes lasting 3 to 5 years.)
- Are there low cost alternative energy resources available to you from:
 - Another neighboring municipal electric system, irrigation district or joint power agency composed of other municipal systems willing to explore a public power partnership?
 - Access to a Federal “preference” power source? (These sources are rare, but closed military bases may have power allocations available for use by the Local Redevelopment Agency.)
 - An industrial user who is considering a cogeneration plant to use steam as a means of production and is willing to sell the electricity from the plant?
 - A rural electric co-operative utility?
 - A reliable wholesale power marketer who is interested in your community?

4.0 A Brief History of the Restructuring of California's Utility Industry

Before a community decides if it wants to pursue a public power option rather than stay with its incumbent utility, it is important to understand where the energy market is today and how the energy market was restructured in 1996. Historically, California's investor-owned utilities (IOUs)--Pacific Gas and Electric (PG&E), Southern California Edison (SCE) and San Diego Gas and Electric (SDG&E)--were vertically integrated. That is, they owned their own power plants and supplied electricity to customers through their own transmission and distribution systems. Competitive markets for energy generation did not exist. In 1996, the California State Legislature passed AB 1890, the bill that restructured California's electric utility industry. The passage of AB 1890 required that IOUs open their systems to competition and encouraged IOUs to divest a great deal of their generation assets (i.e. power plants). The legislation established a Power Exchange to provide a competitive auction for purchasing energy and an Independent System Operator (ISO) to provide oversight of the statewide transmission system (still owned by the investor owned utilities) so that all competitors would have fair access to the wires and the customers.

This action essentially "unbundled" the three components necessary to delivering electricity to customers in California: 1) Generation, 2) Transmission and 3) Distribution. **Generation** is the production of electricity. **Transmission** is the moving of electricity at a high voltage over transmission lines and often over long distances. **Distribution** is the process of "stepping down" the voltage of the electricity and distributing it to customer locations where it can be safely consumed. By unbundling the previously vertically integrated utility systems, the theory was that competition among firms generating electricity would drive down retail rates for consumers.

Investor owned utilities (IOUs) accepted AB 1890 because they were given assurances that costs related to their potentially stranded (or uneconomic) generating assets would be fully recovered. Because AB 1890 opened utility systems to retail competition (i.e. *Direct Access*), it was feared that older plants would not be able to compete with newer more efficient power plants and the old investments would be "stranded". AB 1890 provided a transition period to let the IOUs pay off these old generation facilities while the market transitioned to competition. The IOUs were allowed to collect a Competition Transition Charge (CTC) to pay off these old power plants. To pay the CTC in a market that was transitioning to competition, IOU rates were frozen for a period of five years. At the same time, residential and small commercial customers received a 10% rate reduction paid for by the proceeds of a long term bond.

The IOUs were encouraged to sell their generation facilities (power plants), and many were sold at above book value making a profit for their investors. In theory, while they would lose some future revenue from electricity (generation) sales, the IOUs would continue to derive income from the transmission and distribution facilities they owned and used to deliver the power to customers. Since the California Public Utility

Commission (CPUC) allows for a profit (10-12%) to be added to distribution rates, IOUs were allowed a continuing profit on these distribution systems.

4.1 Direct Access: The retail competition element of restructuring

In exchange for paying the CTC on their bills for five years, customers were promised *Direct Access* to all energy providers. That is, customers were promised they would be free to choose the company they wanted to buy their energy from and they could enter into agreements that would potentially provide lower rates. The theory was that various energy providers would compete for customers and consequently drive down the cost of energy. Large customers would reap the benefits of competition by “shopping around” for an energy provider who would bring the best price to the table. It was anticipated that the competition for large customers would have a “trickle down” impact and result in lower rates for all consumers in California.

4.2 Aggregation

Another expectation of restructuring the utility industry was that the *Direct Access* provisions of AB 1890 would also open up opportunities for *Aggregation*. That is, an entity could aggregate the electricity needs (loads) of various customers to create one bulk load. This entity could then explore contract relationships with energy providers to supply energy for customers whose electricity needs were aggregated. *Aggregation* appeared to be an attractive model for communities that wanted to gain some control over energy choices. In practice, only large commercial and industrial customers were able to negotiate low cost energy purchases because the size of their loads (or electricity need) gave them bargaining power and because the 10% rate reduction made it difficult to provide aggregation benefits to residential customers. In this new environment, cities, counties, or entrepreneurs could aggregate their own loads or the loads of business and residential customers and consequently become a single, large consumer that might be attractive to energy suppliers. It was anticipated, that after the rate freeze was over and the mandated 10% reduction for residential customers expired, aggregation would become an attractive option for various private aggregators and public agencies.

4.3 Municipal Utilities and AB 1890

Municipal utilities were treated differently from investor owned utilities (IOUs) under AB 1890. When AB 1890 was being considered, CMUA vigorously fought for the right of public power entities to continue to keep local control over their assets. The Legislature agreed with the argument that locally owned utilities should have that choice. The Legislature’s recognition of the wisdom of local control enabled the locally owned utilities to provide stable electricity rates to their customers. Because municipal utilities are not governed by the CPUC, they are therefore able to 1) set their own rates and energy policies, 2) build their own generating capacity, and/or 3) enter into long-term power purchase contracts. This ability to have local control over energy decision-making gave public power communities the tools to navigate through the unpredictable energy

market. Municipal utilities were also given the option to either participate in *Direct Access* (allowing customers to choose an alternative Energy Supplier) or leave their service territories closed to other energy providers. As a result, some municipal utilities opened up their service territories to competition while others did not.

4.4 The consequences of AB 1890

The results of AB 1890 are history. The Power Exchange, designed to offer a competitive market for purchasing electricity, was disbanded and filed for bankruptcy. Energy prices soared out of control. In 1999, consumers in the investor owned utilities (IOUs) service territories spent approximately \$7 billion on electricity. In 2000, they spent \$27 billion--almost four times as much as the previous year. The cost for electricity was projected to rise to \$70 billion in 2001 prior to the Federal Energy Regulatory Commission (FERC) implementing price caps on wholesale electricity prices. Even with the price caps, the overall cost in the IOU service territories in 2001 was almost \$27 billion. As a consequence, over a two-year period, electric restructuring cost resulted in \$40 billion loss to California in a market that should have cost no more than \$7 billion a year. Because the investor owned utilities (IOUs) had sold most of their power plants, and because they had not engaged sufficiently in long term energy procurement, they were forced to buy energy on the spot market at costs sometimes more than 12 times the historic price. During this period of soaring energy prices, the IOUs retail rates were frozen under the terms of AB 1890. During the peak summer months, the IOUs were acquiring as much as a third of their total energy supplies from the volatile daily spot market. As a result, the investor owned utilities went billions of dollars into debt. When the companies who now owned the power plants were concerned the IOUs might not pay them, they refused to sell power to the IOUs. California experienced several rotating outages during this time due to the inability of the IOUs to pay their debts and it looked like more outages would come.

While Edison and PG&E still had frozen rates, citizens in the San Diego Gas and Electric service territory were no longer under the rate freeze. San Diego customers had the spot market prices for electricity passed through in their bills for a couple of months in the summer of 2000. Amid claims of small business closures and a great deal of ratepayer revolt, the Legislature acted to reinstate the rate freeze in San Diego. In response, the Governor declared a "State of Emergency." The Legislature stepped in and passed legislation to authorize the California Department of Water Resources (DWR) to purchase wholesale power for the customers served by the investor owned utilities. The IOUs continued to provide billing and collection services via contracts with DWR. While energy prices were frozen on customers' bills, wholesale energy prices continued to soar. The California Public Utilities Commission (CPUC) authorized a modest rate increase, but that increase did not cover the enormous energy bills that IOUs were paying for wholesale power. The Legislature intended that the power purchases made by DWR would be funded from a multi-billion dollar bond issue the State would initiate after the crisis passed. Both Pacific Gas and Electric (PG&E) and Southern California Edison (SCE) entered into talks with the CPUC to develop a plan to keep them out of

bankruptcy. After numerous meetings, PG&E decided its best strategy would be to file for bankruptcy. In contrast, SCE and the CPUC developed a plan to keep SCE out of bankruptcy court.

In summary, Californians endured rolling blackouts in 2000 not because there was a shortage of electricity, but because the investor owned utilities couldn't pay their bills after wholesale energy prices ran out of control. Most recently, there have been many accusations that various energy companies engaged in anti competitive practices in order to make huge profits from the IOUs on the sale of electricity in California. While those accusations can be debated, it is clear that the

market structure developed in California did not have adequate controls against anti competitive practices. During this time, the California Public Utilities Commission raised rates by close to 40% to help pay for the cost of electricity which was spiraling out of control. Regrettably, the Federal Energy Regulatory Commission (FERC) did not step in to establish wholesale price caps for electricity until after the State Department of Water Resources was already paying almost four times more for energy in 2000 than it had in 1999.

Because the Department of Water Resources (DWR) had stepped into the role of buying power for customers in California, the CPUC suspended *Direct Access* and *Aggregation* on September 20, 2001. With that decision, the benefits of "customer choice" and "aggregation" promised by deregulation were suspended indefinitely. As a result, communities began to compare the rates of investor owned utilities with the rates of public utilities and wondered if local control of energy decision making might give them more control over managing the volatility of the newly restructured energy market and provide the potential for lower rates.

5.0 How do power rates compare with investor owned utilities?

CMUA is often asked to provide information on the difference between the rates of publicly owned utilities and investor owned utilities. Included in this document are rate comparisons done by APPA in 1996, 2000 and 2001, along with an informal poll conducted by the *Sacramento Bee* in 2001.

The source of information for the APPA rate comparisons is the US Energy Information Administration, Form EIA-861. The information submitted by utilities to the US Energy Information Administration during the initial years of deregulation (1997-1999) do not provide an accurate picture of rate comparisons because investor owned utilities' rates were frozen by the CPUC for a significant portion of this time period when the Department of Water Resources was purchasing energy for its customers. By 2000, most private and public utilities had stabilized their rates and therefore the best rate comparisons are the years before 1996 and after 2000.

The *Sacramento Bee* obtained its information by calling each of the utilities listed and asking this question: "What would the monthly bill be for a typical resident who used 750 kilowatt-hours of power, the average usage of customers living in the state's capital?" CMUA includes this information because it is the only other objective rate comparison information that CMUA has seen in print.

5.1 Rate Data Comparisons



rkw state trends.xls

5.2 Sacramento Bee Rate Comparison



BEE RATE
COMPARISON ARTICI

6.0 If the choice is Public Agency Power, which model is best for your community?

There are a variety of public power options that communities in California can consider in their efforts to increase local decision-making on energy issues, pursue lower rates and develop programs that reflect community values. The best model of public ownership for your community will be the one that meets the specific circumstances of your community and the requirements of your residents and businesses.

Generally, there are two basic approaches when entering into the public power business. The first approach WOULD require taking ownership of the poles and wires to operate as a fully integrated vertical utility. The second approach WOULD NOT require taking ownership of the electrical distribution system from the incumbent investor owned utility.

Regardless of the approach, one major uncertainty and potentially significant expense your community will need to consider is the potential for “*exit fees*.” *Exit fees* are associated with 1) the “under collections” of the investor owned utilities when they were purchasing energy from the spot market, (that is, the amount by which their energy purchase costs exceeded their income from customer rates because of the rate freeze) 2) the remaining elements of the Competition Transition Charge (CTC), and 3) the costs of the power contracts negotiated by the Department of Water Resources for the benefit of IOU customers to keep power flowing to California during the energy crisis. Exit fees are discussed further on in the Handbook and may apply to both strategies. Another overriding consideration discussed later in the Handbook is the political effect that IOU opposition might have in your community.

6.1 The Traditional Public Utility: Owning the distribution system

There are more than 2000 publicly owned electric distribution utilities throughout the nation. There are 31 such systems in California. There are basically four ways to get into the electric distribution business:

- 6.1.1 A community can acquire existing distribution wires from the investor owned utility by using a local agency’s power of eminent domain or negotiating a purchase price for the distribution system.
- 6.1.2 A community can build a completely new distribution system to serve its customers.
- 6.1.3 A community can acquire the distribution systems installed by developers in new developments by having the developer transfer the assets directly to your public utility.
- 6.1.4 A community can use a combination of the three approaches described above.

The means by which a distribution system may be acquired or developed are discussed below, along with the issues that should be taken into consideration in deciding whether

this option would be attractive for your community in the short or long term.

6.1.1 Acquire the existing poles and wires from the existing utility

Poles and wires can be acquired either by negotiated purchase with the existing utility or by the use of eminent domain. If a newly formed municipal utility wants to acquire the existing poles and wires of the existing utility, there are a variety of steps that must be taken. Those steps are outlined further under the section dealing with feasibility studies. Cities should be aware that this approach is an expensive step and most likely will be vigorously opposed by the existing utility. However, if a community decides to acquire the poles and wires from an existing utility and is successful in doing so, there are a variety of ways to provide services to those customers without hiring new staff.

Several communities are considering arrangements whereby the public agency enters into an agreement with an existing public power entity or private energy-consulting firm to provide the distribution services for its new customers. This model is also being considered in building new power plants that could potentially provide a lower cost power alternative for a newly formed city utility.

6.1.2 Build a separate distribution system

This path is an option to explore if the facilities that serve your area are old and due for replacement or if it makes financial sense to just build the new infrastructure. Under this approach, a city (or special district) would not have to go to court to acquire the distribution facilities from the incumbent utility, which could save millions of dollars in court costs. However, as a rule, citizens do not usually support the construction of additional overhead power lines in their communities because of aesthetic reasons. In addition, building a new distribution system is often more expensive than acquiring an existing distribution system. There may, however, be circumstances under which building a new distribution system is a viable alternative. Those are the types of issues that are addressed in the feasibility study discussed later.

6.1.3 Providing service to new developments

Another option is to establish a municipal utility that would only serve new developments in the city. The investor owned utility could be expected to wage a public relations and political campaign against such a move, but on the other hand, an eminent domain legal battle would be avoided. In this model, the city would build its own electrical infrastructure that would provide retail electricity to those customers in new developments. The city would also need to obtain interconnection and transmission rights and purchase energy to serve its new customers. These issues are discussed more fully in the Feasibility Study section.

Since developers are usually required by incumbent utilities to build the necessary infrastructure for new developments and then deed those facilities to the

incumbent utility, the city or special district could ask the developers to deed the facilities to the city or special district if the city or special district has established an electric utility. The city or special district would still need to build the infrastructure and obtain the necessary regulatory approvals to interconnect with transmission lines, and would be assuming operation and maintenance (O&M) responsibilities for the distribution system acquired from the developer. Under this approach, a city or a special district could get the distribution system for free when it is built, instead of trying to buy it later from the incumbent utility in a legal battle.

Another added benefit to this option is that developers usually have to pay a “transfer tax” of approximately 30-34% when they transfer the distribution facilities from their development to the incumbent utility. This is because the incumbent utility must pay taxes on all the assets it acquires and the incumbent utility includes these taxes in the transfer. If the city or special district received the distribution facilities, there would be no “transfer tax” since cities and special districts do not have to pay taxes on their assets. This approach would save developers a significant amount of money and give a new city utility or special district access to a new distribution system at a low cost. On the other hand, this approach could also promote accelerated growth in a city or county. Further, there could be a situation where one part of a city or special district would be served by the municipal utility at a different rate structure than the other part of the city served by the incumbent utility.

6.2 Legal forms of Publicly Owned Utilities

If your community decides it wants to take ownership of the electrical distribution system and operate a fully integrated vertical utility, it must choose the best organizational structure to operate the public utility. There are four types of legal formats for publicly owned utilities in California. They include cities, municipal utility districts, public utility districts, and irrigation districts. Each are public agencies, subject to all of the common laws of public agencies, such as open meeting requirements and public records requirements. They also have significant differences, depending on their enabling legislation, such as the limits for submitting projects to public bid. Generally, the options fall into these categories:

- 6.2.1 Forming a City Municipal Utility as a department of an existing city
- 6.2.2 Forming a Municipal Utility District (MUD)
- 6.2.3 Forming a Public Utility District (PUD)
- 6.2.4 Forming an Irrigation District (ID)

6.2.1 Forming a City Municipal Utility as a department of an existing city

The California Constitution gives cities the right to “establish, purchase and operate works to furnish its inhabitants with light, water, power, heat, transportation, and telephone or means of communication.” By a majority vote of the City Council, a city may establish a municipal utility within the existing city structure to provide a variety of electrical services. (*Note: A “municipal utility” is significantly different from a “municipal utility district” or MUD. The description of a MUD is provided later in this Handbook.*)

Cities have several options when forming a municipal utility. A city can establish a new municipal utility department or it can simply add electricity to the services currently offered through the existing city water department and/or city sewer department.

Counties do not have the right under the California Constitution to provide electrical services on their own except in the case where the State Legislature passes a law to allow a County to provide electrical service. While cities may establish their own municipal utilities or join with other public agencies to form a Joint Power Agency (JPA) to provide electrical services, counties do not have the same rights. Counties can either consider establishing a new MUD or PUD or work in partnership with an existing MUD, PUD or Irrigation District (ID).

There are some significant differences between *General Law* cities and *Charter* cities. A *Charter* city should always review its Charter to see what powers and limitations might relate to the city providing electrical services. Not all *Charter* cities have the same powers or limitations, so a legal review of a city’s Charter is always necessary before considering getting into the power business. It is also important to note that any restrictions found in the city Charter can be changed by a vote of its citizens.

While both a *Charter* city and a *General Law* city can establish a municipal utility by a majority vote of its City Council, a *Charter city* can go one step further and, by a vote of its citizens, amend its Charter to establish a separate entity to handle its utility needs. However, the more common approach is for the City Council to establish an appointed body (i.e. Utilities Commission) that acts as an Advisory Board to the City Council. In this manner, the City Council retains ultimate authority on energy decision-making for the community.

Another difference between *Charter* cities and *General Law* cities is that the provisions of city Charters take precedence over state laws unless there is an overriding statewide concern on a given issue. Laws passed by the State Legislature always apply to *General Law* cities, whereas *Charter* cities retain the right to determine if new laws related to “municipal affairs” are inconsistent with the existing city Charter.

Once a municipal utility is formed, the City Council must decide what it wants the new utility to undertake. There are multiple variations on what a city can do as a municipal utility. The options listed below can be mixed and matched depending on what the city's goals are. The newly formed municipal utility could:

- Acquire the distribution system from the existing utility and provide distribution services. This can be accomplished either through negotiated sale or through the use of eminent domain.
- Build its own distribution system to serve the public agency's buildings or other load in the community.
- Install and acquire only the electrical facilities for new developments in the community.
- Build its own generation (power plants) in partnership with other public entities or private energy companies.
- Work in partnership with other existing public entities (JPA, MUD, PUD, ID) that provide power services.
- Develop innovative energy programs to meet citizens' needs. This can range from energy efficiency programs to renewable energy programs that promote the development of renewable power. The city could also act as a *Community Choice Aggregator* for city-managed accounts and/or residential accounts and business accounts

6.2.2 Forming a Municipal Utility District (MUD)

A Municipal Utility District (MUD) can be created in the political jurisdictions of any two or more public agencies (with or without unincorporated territory) or any public agency and unincorporated territories of a county. The establishment of a MUD is also contingent on voter approval of the proposition by a majority of voters within each public agency or unincorporated territory. A further requirement is that the number of registered voters in the approving public agencies and territory be not less than 2/3rds the number of registered voters within the district as proposed to the voters. It is important to note the approval of a MUD *does not* require a 2/3rds affirmative vote, but it does require that the proposition be voted on by 2/3rds of the registered voters in the entire district as proposed to the voters.

The process to establish a MUD is more complex than the process for establishing a city municipal utility. There are many legal requirements that must be addressed in forming a MUD. MUD formation is usually initiated by a resolution from the legislative bodies of half or more of the agencies involved, *or* by petition of 10% of the registered voters presented to the Board of Supervisors of the County containing the largest number of voters in the proposed District. In each case, the measure must first be reviewed and approved by the Local Area Formation Committee (LAFCO) before the Board of Supervisors places it on the ballot. The LAFCO process is described in length in the following section and also applies to Public Utility Districts and Irrigation Districts.

LAFCO requirements for establishing a new MUD are significant and the review process is a lengthy one. This does not mean forming a MUD is not a good public power alternative for a community. It does mean extra planning and work effort is needed to establish a MUD to ensure that all legal requirements can be fulfilled. If this were the option being considered by your community, it would be wise to develop a checklist of requirements and a timeline for various approvals needed in order to put the MUD on the ballot.

The application to LAFCO for the formation of a MUD must either include a petition signed by at least 10% of the registered voters living within the boundaries of the proposed district, or, alternatively, the application can be initiated by resolution by the Board of Supervisors of the County containing the largest number of voters of the proposed district. The petition must state the kind of utility that is being formed, as a MUD can provide a wide variety of services, including power, water, light, heat, transportation, telephone services or any other means of communications, and garbage and sewer services. It must also contain a Service Delivery Plan that includes 1) a map and description of the boundaries of the proposed district, 2) an in-depth detailed description about how the new district proposes to offer services and 3) why this approach is preferable to existing conditions.

After the request has been made to the LAFCO Commission, LAFCO will send a copy of the proposal to the California Public Utilities Commission (CPUC) for comment. The CPUC is required to submit a response to LAFCO within 90 days stating whether the proposed service by the new district would substantially impair the ability of the incumbent utility currently in place to provide adequate services at reasonable rates within the remaining service territory of the investor owned utility. The LAFCO will also conduct public hearings on the proposal.

After hearing public testimony and considering the response from the CPUC, the Local Area Formation Commission will approve, modify, or deny the proposed formation. If it is approved, the LAFCO Commission will adopt terms and conditions for the formation and establish a sphere of influence for the new district. No changes can be made to the proposed formation once LAFCO has approved it. After the LAFCO action, the Board of Supervisors must call for an election.

Once on the ballot, the MUD formation proposal must be approved by a majority of voters in each of the public agencies involved in the vote. Once the election has taken place, a review of the vote count in each of the public agencies will be completed. The new MUD will consist of those public agency areas in which a majority of its voters voted in favor of the proposition, so long as the number of voters within those approving agency areas is at least two thirds the number of voters in the district as originally proposed.

A MUD is normally governed by a five member Board of Directors. The MUD service area is usually divided up into five districts and Board members are elected from each district. When the MUD initiative is first put on the ballot, however, the entire service area will elect all Board Members. As a consequence, proponents of a MUD must be prepared to submit the boundaries for the entire service area and the boundaries for each of the five Wards when the proposal is submitted to LAFCO and the Board of Supervisors. By a majority vote, the Legislature may expand the number of Board Directors for a MUD. This is the case for the Sacramento Municipal Utility District (SMUD) who now has a Board made of seven Directors.

For complete details on MUD formation, review Public Utilities Code Sections 11501-14403.5 at the following website:

<http://www.leginfo.ca.gov/cgi-bin/calawquery?codesection=puc&codebody=&hits=20>

6.2.3 Forming a Public Utility District (PUD)

A Public Utility District (PUD) generally includes only unincorporated areas, whereas a MUD normally includes a city. Formation of a PUD can be initiated by petition of the electors in the unincorporated areas that would make up the PUD and is also subject to the LAFCO review process described previously. The establishment of a PUD is contingent on voter approval of the proposition by a majority of voters within each public agency or unincorporated territory. In a PUD vote, a majority of the voters in each unincorporated territory must approve the proposition.

For complete details on PUD formation, review Public Utilities Code Sections 15501-18055 at the following website:

<http://www.leginfo.ca.gov/cgi-bin/calawquery?codesection=puc&codebody=&hits=20>

6.2.4 Forming an Irrigation District (ID)

An Irrigation District (ID) can be established by petition of the requisite number of voters in the proposed district to the County Board of Supervisors. ID Formation is subject to LAFCO review and a majority of the voters included in the district must approve the proposition.

For complete details on ID formation, review Division 11 of the Water Code Sections 20500-29975 at the following website:

<http://www.leginfo.ca.gov/cgi-bin/calawquery?codesection=wat&codebody=&hits=20>

6.3 Partnering with existing Public Power entities

Another option in addition to the four organization structures described above is the joining up with an existing public entity to help bring electricity to your community. Communities exploring power options may also consider the following:

- 6.3.1 Add electricity to the services provided by an existing Irrigation District (ID), Public Utility District (PUD) or Municipal Utility District (MUD).
- 6.3.2 Request that an existing neighboring Municipal Utility, MUD, PUD, or ID annex your community into its service territory.
- 6.3.3 Work in partnership with other public entities to form a Joint Powers Agency or join an existing Joint Powers Agency (JPA) that could provide electricity, manage a distribution system and/or develop power resources to serve your community load.

6.3.1 Adding electricity services to an existing ID, PUD or MUD

Under the California Constitution, Irrigation Districts, Public Utility Districts and Municipal Utility Districts have the right to provide electrical service to its members. Not all IDs, PUDs and MUDs currently provide electrical service. Many only provide water or sewer services. If your community wants to be served by a public agency, one option not to be overlooked is asking the existing Irrigation District Board, Public Utility District Board, or Municipal Utility District Board to provide electricity services for the community.

6.3.2 Annexation into an Existing Service Territory

Another option is to request that an existing neighboring city owned utility, MUD, PUD or Irrigation District (ID) annex your community into its service territory. Under this approach, a city, county, local area or public agency would ask a city municipal utility, MUD, PUD or Irrigation District (ID) to expand its sphere of influence to serve its community. The boundaries of the city or the county wanting to be annexed need not be contiguous with the MUD, PUD or ID, or even located within the same county.

Annexations must go through the LAFCO process. A MUD, PUD or ID cannot furnish electric service to an area being served by another utility unless: 1) the LAFCO approves the annexation proposal after consideration of a report from the CPUC on the impacts of the proposed annexation to the serving utility, and 2) the voters within the proposed territory approve the annexation by a majority of voters in the proposed service area. Before the LAFCO would begin the process of reviewing the proposed annexation, the city or county would need to have in place an agreement with the MUD, PUD or ID, laying out the terms and conditions of the annexation and the plan for providing services. For example, in

1984, the city of Folsom was annexed into the Sacramento Municipal Utility District (SMUD) only after the Folsom City council requested annexation, an agreement was developed between Folsom and SMUD for the terms of the annexation, the LAFCO Commission approved the request and the ballot measure was approved by 72% of the voters.

A major difference between establishing a *new* MUD, PUD or ID as opposed to asking for annexation to an existing entity is that your city or county wouldn't have to start from scratch to obtain electrical power and to offer programs tailored to your community's needs. An existing MUD, PUD or ID would have a clear track record on whether it was able to provide increased reliability, offer unique programs that meet community needs, and deliver on the potential for lower rates. Also, many existing MUDs, PUDs or IDs have the technical, financial and legal expertise to help your community fight the public relations and legal battles that will surely come from the investor owned utility once it knows you want to be released from its territory.

6.3.3 The Role of Joint Powers Agencies (JPA)

Two or more public agencies can agree to exercise any of their common powers jointly through a Joint Powers Agency or Authority (JPA). The California Constitution gives cities the authority to provide electric services both within and outside city limits. Cities can work in partnership with other public entities to form a Joint Powers Agency (JPA) that can provide electricity, manage a distribution system and develop power resources to serve its communities. A JPA that has only cities as its members would not be subject to Local Area Formation Committee (LAFCO) requirements. Because counties do not have the right under the California Constitution to provide electrical services, counties in general cannot join a JPA whose purpose is to provide electrical service, unless special provisions are made by the state Legislature.

It does not take a vote of the local electorate to establish a JPA. However, an advisory vote from the community would be prudent if several public entities decided they wanted to establish a JPA for the purpose of providing retail electric services. A majority of the elected officials in each of the public entities must vote to establish or join a JPA. The governing board for a JPA is made up of the public entities that established or later joined the JPA.

Once formed, a JPA would have many resources to draw on to provide electrical services to its constituents. The Northern California Power Agency (NCPA) and the Southern California Public Power Authority (SCPPA) are two examples of public entities that work in partnership with communities to provide power resources. A variety of electric services could also be gained from an existing city municipal utility, Municipal Utility District, Public Utility District or an Irrigation District. Like a city municipal utility, the JPA Board must decide which energy related responsibilities it wants the new JPA to undertake and can

consider all the service options described in the previous section on the city municipal utility model.

NCPA and SCPPA currently provide services that include negotiating power purchases, development of generation projects, transmission scheduling, interchange management services to power marketers and legislative and regulatory services. They also possess competence in energy market strategy and can add organizational depth to assist cities or newly formed JPAs in tackling the responsibilities of supplying and delivering electrical services to its constituents. MUD/PUDs or Irrigation Districts that currently provide electrical services can also assist with these services and provide O&M for distribution systems, billing services, energy efficiency programs, etc. They can also offer unique programs they already have in existence to your JPA.

Several newly formed municipal utilities are now working closely with JPA's, MUDs, Irrigation Districts or private energy companies to 1) secure energy supply needs for municipal buildings, 2) pursue aggregation strategies for residential and commercial customers in the community, 3) implement unique renewable and energy efficiency programs and 4) seek strategic opportunities in the energy market.

7.0 Determining the feasibility of electrical distribution system ownership

7.1 Pre-feasibility study

Undertaking a pre-feasibility study is a good way to begin to examine various options available to your community before a full-blown feasibility study on municipalization is undertaken. (Municipalization is the general term used to describe the process of taking ownership of the electrical distribution system from the incumbent utility.)

Several cities and counties have conducted pre-feasibility studies to determine the best public power organizational structure for their communities, the risks involved with each option, a description of the implementation process for each option and a general overview of the legal and financial impacts of establishing a city municipal utility, JPA, MUD, PUD, ID or requesting annexation into an existing service territory. Much information can be gained by reading the pre-feasibility studies that have been done in the last several years for other communities that have investigated these alternatives.

7.2 Feasibility Study

If your community decides to continue down the path of choosing an option that would require taking the existing poles and wires from the investor owned utility (IOU), an in-depth Feasibility Study will be needed to address the legal, technical and financial issues involved with the decision. The following is a suggested guide for the basics of what should be included in a Feasibility Study. It is by no means exhaustive and each

community should further define what information it thinks is necessary in order to proceed with Municipalization. (Note: Many of these questions might also be addressed in a pre-feasibility study before a full blown feasibility study is undertaken.)

Several cities, counties and public agencies have paid for Pre-feasibility and/or Feasibility Studies exploring public agency power options. These studies are available to you as public information and can be helpful in deciding what your community might want to include in an RFP for a feasibility study. You may also want to contact the City of Corona, City of San Marcos, City of Industry, City of Davis, City of Hercules, the East Bay Municipal Utility District (EBMUD), County of San Francisco and the Coachella Valley Association of Governments for additional information on their efforts to explore public agency power options. The following are Internet links to pre-feasibility or feasibility studies that communities have paid for and contain helpful information on alternatives to consider:

City of Davis (Pre-feasibility study performed by Navigant Consulting, Inc.)
www.city.davis.ca.us/pw/

East Bay Municipal Utility District (Pre-feasibility study performed by RW Beck, Inc.)
http://www.ebmud.com/current_events/energy_services/public_power/default.htm

City of Corona (Feasibility Study performed by EES Consultants)
<http://www.discovercorona.com/depts/electric/pdf/FinalCoronaFeasibilityStudy.pdf>

7.3 Components of feasibility studies

Basic feasibility studies address the technical, fiscal, legal and financial questions surrounding establishing a public power organizational structure and operating as a fully integrated vertical utility. Such questions include:

- Publicly owned utility organizational structures and the pros and cons of each type.
- Identification of the electrical facilities to be acquired or constructed for the new municipal utility. This would include a boundary map of the proposed area and the facilities to be acquired. It is important to determine which transmission, sub-transmission or substation facilities must be acquired.
- An assessment of the general condition of the facilities looking at age, condition and the state of the technology.
- Exploration of reconfiguring the system. That is, alternatives to severing from the investor owned utility and points of interconnection with the existing transmission grid in the event you want to build your own distribution lines.
- Determine if it makes sense to buy the facilities or just rebuild the distribution system. Explore the question as to whether the incumbent utility, is entitled to direct damages if a municipality constructs a separate

- distribution system. Inverse condemnation awards are extremely difficult to obtain.
- Principles of valuation for the system. Investor owned utilities will not readily surrender their distribution facilities and therefore these facilities must be acquired by negotiating a purchase price with the investor-owned utility or by taking the property through eminent domain.
- A qualified and detailed Appraisal Report of the value of the distribution facilities that will need to be acquired from the incumbent utility. There are various ways to determine the value of a distribution system. The two main cost-based approaches are Original Cost Less Depreciation (OCLD) and Replacement Cost Less Depreciation (RCLD). The choice between them is often the centerpiece in the fight over compensation. OCLD is the amount the utility paid for the property when it was purchased. From this is subtracted the value of the property that has been recouped over the years by the utility through the depreciation component of the rates charged to its ratepayers. RCLD determines what it would cost to build the system new at current prices, then subtracts an amount for depreciation corresponding to the percentage of depreciation carried on the utility's books for existing property. Since there has been a substantial amount of inflation over the years, the RCLD method produces much higher compensation values than OCLD. RCLD is, of course, preferred by the investor-owned utility. There have been a number of cases where RCLD has been chosen as the valuation standard, but much of this has been based on state case law from general, (i.e. non-utility) eminent domain literature. On the other hand, OCLD, which has been used and accepted as the proper standard for ratemaking of investor-owned utilities, is a fair standard because it does not produce a windfall gain for the incumbent investor-owned utility. For more information on this issue, contact Deborah Penn at APPA and ask for a paper written by Michael F. Sheehan Ph.D. that discusses these two types of system evaluations (debpcenn@appanet.org or (202) 467-2956).
- Whatever the method used, be sure your consultant can defend various estimates of the utility property value. This will be the part of the Feasibility Report that will be criticized the most, so it is very important to make sure these numbers are accurate and defensible. This detailed valuation of the distribution system will also be critical to support bond financing that is likely to be required for the acquisition of the distribution system.
- Identification of state and Federal stranded cost recovery rules.
- Determination of severance costs or stranded costs involved in acquisition.
- Identification of all applicable state and local laws governing the establishment and operation of the municipal entity. Regulatory jurisdiction, approvals and proceedings that will be required.
- Analysis of transmission access rules and legal aspects of bulk power supply acquisition.

- Identification of what the electrical load will be for the boundary area. Project the total annual power supply requirements for the area for the next 10-20 years.
- Explore power supply alternatives, both short-term and long-term opportunities. Include costs for transmission and explore the availability of federally owned or licensed hydroelectric facilities. (These hydro resources are rare, but nonetheless should be explored.)
- Develop costs for power supply and transmission over a 10-20 year period and a projection of the rates that must be charged to cover embedded costs, operating costs and power supply and transmission costs.
- Review State and Federal laws respecting the issuance of tax-exempt bond financing and how the laws apply to the model you are considering.
- Constitutional Debt limitations should be reviewed.
- Laws associated with the ability to condemn and the ability to obtain transmission access.
- Each city has its own unique Franchise Agreement with the investor owned utility. Be sure to have a legal review of the Franchise Agreement.
- Develop a business model that can be used to test the economics of ownership and operation for various assumptions related to acquisition costs, power supply costs, severance costs or other key variables.
- Projection of financing costs. (Don't forget operational costs such as billing, accounting, customer services, administration, insurance, etc.)
- Alternatives for financing start-up costs, exit fees, and distribution acquisition should be explored.
- Laws applicable to municipal utility financing should be reviewed to determine the best way to pay for the distribution facilities that must be acquired from the incumbent utility. There are different rules that apply to *Charter cities vs. General Law cities*.
- The federal Omnibus Budget Reconciliation Act of 1987 restricted use of tax exempt financing to purchase distribution facilities of investor-owned utilities. For the most part, state and local governments cannot use tax-exempt financing to acquire nongovernmental "output facilities" but there are some exceptions. (For more information, contact Deborah Penn at APPA (debenn@appanet.org) or (202) 467-2956).
- While tax-exempt financing *cannot* be used to purchase existing distribution systems, tax-exempt financing *can* be used to build new distribution facilities.
- Before a city can condemn the distribution facilities of the investor owned utility, it must withstand a legal challenge to prove conclusively that the acting governmental agency use is a more necessary use than the current use. This is called a "rebuttable presumption." That is, the public entity must prove that its need for the system is greater than the incumbent utility.

8.0 Political considerations for municipalization efforts

California communities that pursue options involving taking the poles and wires from the incumbent utility (generally called “municipalization”) are in for a political struggle. Investor owned utilities (IOUs) have made it clear they will fight vigorously to keep their distribution systems and to prevent publicly owned utilities from forming, even if they are only to serve new, previously undeveloped areas. Media reports and public records show that IOUs will not only attack the idea of municipalization itself, they will also spend millions of dollars to defeat the municipalization effort, occasionally even attacking the leaders of the local control effort. CMUA’s experience leads us to believe a community should not develop a municipalization strategy without first understanding the political dynamics of municipalization.

CMUA has observed the tactics used by the investor owned utilities (IOUs) to defeat municipalization in numerous communities throughout the State. We can objectively say that it is not an easy path to take control of the energy related decision-making in your community away from the incumbent utility. Since there are no laws that limit the amount of stockholder money an IOU can spend to fight public power options, and since public agencies are not allowed to spend any money on ballot issues, an IOU has a large financial advantage in any election. Stopping municipalization efforts is considered a necessary and justified business expense. For example, in 2001, PG&E reported to the Fair Political Practice Committee that it spent over \$1 million in ratepayers’ dollars to defeat two San Francisco ballot measures related to municipalization. And, in 2002, PG&E spent another \$2 million dollars to defeat a second municipalization ballot measure.

One can understand why the investor owned utilities (IOUs) would fight vigorously to keep their distribution assets. Distribution in the regulated electric utility industry is very profitable. The California Public Utilities Commission (CPUC) provides for a significant return on all costs related to distribution assets. In 2001, the CPUC set the Return On Investment or (ROI) for distribution assets owned by Investor Owned Utilities in the range of 10-12%. IOUs would prefer not to lose their distribution assets and the guaranteed return on investment that the CPUC provides for them.

The following section reviews the process for establishing municipal utilities and what strategic political considerations should be undertaken along the way. A community needs to be ready and prepared for the opposition that will come from the incumbent utility. While it may be a major political struggle; with sound, responsible management, a municipal system can 1) bring local control to energy related decisions, 2) save literally millions of dollars for a community, 3) develop programs that reflect community values, 4) help attract new business and industry to the area, and 5) be a source of civic pride and evidence of a progressive community capable of achieving goals that benefit its citizens.

Communities pursuing municipalization efforts report they are often told no community has succeeded in establishing a municipal utility in the last 15 years. This is not true. In

2002 alone, the cities of Corona and Hercules successfully launched municipal utilities to serve new customers. The city Hercules is only taking the poles and wires for new developments, while the city of Corona is pursuing condemnation of the entire distribution system that serves its city. Other recent examples of successful municipalization efforts include the Merced Irrigation District formed in 1996 and the annexation of the city of Folsom by the Sacramento Municipal Utility District (SMUD) in 1984.

8.1

Step 1 - Consider why your community wants public power

Each community will have its own reasons for pursuing the options discussed in this handbook. However, the main reason to undertake municipalization should be to gain the advantages of local control over energy related decisions. Having lower rates is certainly a desired outcome, but it is derivative of the larger benefit of local control and may take time to obtain. In the short run, there are numerous factors that will impact the electrical rates for your community as the electric utility industry continues to be restructured. Local control, however, will put you in a much better position to navigate future changes in the electrical industry and ensure your community's electric rates remain as low as possible. It is a fact that California's municipal utilities have fared much better under the deregulated market because they had local control over decision making. History has shown that, over the long run, municipal utilities have lower rates than the investor owned utilities throughout the country.

Beyond the potential for lower rates, another main benefit to municipalization is the ability to develop programs locally that reflect community values. Proponents of publicly owned utilities believe that the citizens in a given community are in the best position to make decisions about energy programs for their community, and that these actions are most effective when taken by a public entity that must keep its meetings open to the public and consider citizens' opinions before making decisions. Consumers have the ability to influence energy resource decisions by electing the utility directors, by advisory votes and by referendum. Investor owned utility customers do not have that degree of control over resource decisions.

Each community will have its own reasons for exploring power options. Be sure to take the time to establish what your community's goals are because your incumbent utility is already working on their arguments as to why local decision-making and ownership is bad for your community.

8.2

Step 2 - Build community support for the public power option

It is very important to have the support of local citizens, businesses and community leaders as the community explores its possibilities. The communities

that have been the most successful in starting such entities have first put their energy into building a grassroots coalition involving citizens and business leaders who will benefit by local control over energy related decisions. Often cities or counties will conduct a poll to determine what their citizens and businesses know about public power and what their interest and concerns might be related to public power. If the community is not familiar with the pros and cons of public power, you may need to hold educational forums before taking action.

Case studies show that one of the first tactics the incumbent utilities have employed once they know public power is being considered, is to take a poll to determine which strategies will be most effective to defeat the municipalization effort. Using this information, the incumbent utility will next organize a citizen's group to oppose the idea of public power. Many times these groups are made up of retired workers from the incumbent utility or people who have been consultants for them. This newly formed citizen group will become the opposition voice, creating the appearance of automatic citizen opposition. In essence, the investor owned utility will use this citizen's group to deliver its message. The only thing that matters to the media will be the message, and not the composition of the group.

Members of this initial opposition group, financed by the incumbent utility, usually try to muster support with their contacts in chambers of commerce, service groups, rotary clubs and school PTAs. Over the years, many of these organizations have received grant funds from their utilities, so they often have an interest in supporting the incumbent utility. If you have not laid the foundation for support among businesses interests, community leaders, and citizens groups, there is little hope that your efforts will be successful.

8.3

Step 3 - Develop a clear message about why local control of power decisions is important for your community. Work with the media to get your message out.

Once your community has made a decision to get its power from a public agency, it is important to develop a simple, clear message about why the choice is good for your community. It's important to keep your message focused because you will be facing a well-orchestrated opposition campaign from the investor owned utility. You may want to focus on the top three benefits for your community and communicate those benefits every time there is a public presentation about the proposal. The American Public Power Association (APPA) has excellent education materials that are very inexpensive and clearly articulate the benefits of your decision.

Set up a regular dialogue early on with the media so you can keep them informed of how things are going and address any misconceptions. Give them plenty of people to call on for quotes regarding publicly owned utility power. The best

people to speak out on the proposal are the local folks who will be impacted by the proposal--citizens, business owners, community leaders, neighborhood groups, etc. There are also numerous people on the local and national level who can answer questions about publicly owned utility issues. Deborah Penn and Alan Richardson at APPA are good resources. They can be reached at (202) 467-2956 or by e-mail at debenn@appanet.org. You can also contact Jerry Jordan, Executive Director of the California Municipal Utilities Association for assistance on these issues in California at (916) 441-1733 or by e-mail at jordan@cmua.org. CMUA can also provide other resources and contacts to answer questions.

8.4

Step 4 - Conduct a feasibility study that will provide the legal, fiscal and technical information your community will need to make a decision

An extensive, detailed and well-administered feasibility study is important to any community that wants to seriously explore the viability of establishing a publicly owned utility. This is especially true if the approach being considered is one that involves taking the poles and wires from the incumbent utility. As mentioned earlier, at a minimum, the feasibility study should address potential costs involved, a broad range of legal issues and any technical items related to the electrical distribution system itself. Often elected officials will commission a feasibility study in order to help them decide whether a municipalization strategy should be put before the public for a vote.

Because municipalization involves so many legal, technical and political issues, it is important to consult your public agency attorney or an attorney familiar with publicly owned utility law. It is also important to choose a feasibility study consultant who has a strong reputation and track record for doing this type of work. Your feasibility study will be scrutinized and picked apart by not only your incumbent utility's consultants and lawyers, but also by the entire investor owned community. Therefore, every projection and estimate must be made by reputable, objective, independent outside experts with no conflicts of interest. Have your consultant carefully document the legal and economic feasibility of the proposal. You can expect strong criticism of the feasibility study as soon as it is released. Make sure your consultant is prepared to explain and defend the numbers in the feasibility study and is prepared to respond promptly to any erroneous assumptions set forth in technical reports provided by the investor owned utility.

Experience has shown that the biggest pitfall community's fall into is underestimating the resources that will be used against them by the investor owned utilities. Many communities have gotten caught off guard when their incumbent utility made outrageously false claims about the future cost of power or the value of the distribution system. Other communities have been surprised at the enormous pressure put on their elected officials to back away from public

utility options and the hundreds of thousands of dollars poured into a campaign by the incumbent utility to defeat a ballot measure. Remember, the stakes are high for the incumbent utility, and a loss can be quite costly.

8.5

Step 5 - Be prepared to sustain your efforts if your community gets to the point of a public vote on municipalization

The public vote on municipalization may come in the form of a ballot initiative put before voters in your community during an election or it might be an item on the Agenda for a City Council or Board of Supervisors' meeting. You can expect pressure from the investor owned utility to increase whenever a public vote is taken.

A common strategy of the IOUs is to claim that the proposal will significantly increase electric rates for citizens and the community will be forced into debt buying the facilities from the incumbent utility. You can also expect inflated claims about the value of the distribution system. Some incumbent utilities will threaten lawsuits and warn that they will drag out a legal battle until your community's treasury is empty. These strategies are used to create fear and doubt with citizens, making them think it's best not to change the ways things are.

It is critical to have the Feasibility Study conducted by a consultant who is objective, has a strong reputation and a track record for doing this type of work. When the incumbent utility warns of financial doom for the community, let the consultant defend the numbers in the Feasibility Study and debunk the notion the city is exposing its citizens to financial ruin. Agree to disagree with the investor owned utility. Citizens and business leaders are smart. Encourage them to examine the information provided by the Feasibility Study and the incumbent utility's response and decide for themselves who they believe. This is also why it is so important to have the public power effort led by local leaders, citizens' groups and businesses groups who can articulate what they believe the benefits are to the community. In the end, your citizens must weigh the information in the Feasibility Study with the information provided by IOU to decide if the benefits associated with your proposal outweigh the risks to the community.

If your Feasibility Study has been thorough and your actions based on technical and legally sound judgment, your community will be prepared for the legal challenge that will come from the incumbent utility once a municipalization effort is approved by the voters. Don't expect the incumbent utility to readily agree to a negotiated sale of its facilities even after a strong public vote for municipalization. Be prepared to take the initiative and file a condemnation suit. A legal battle will most likely ensue, but your chances of winning will be stronger if your Feasibility Study has been well documented and legal issues have been well researched.

8.6

Step 6 - Stay informed about issues related to publicly owned utilities at the State and Federal levels to monitor legislation that may impact your community's ability to establish a publicly owned utility entity.

Experience has shown that as more communities express interest and begin to explore strategies, IOUs will attempt to change existing laws at the State and Federal levels to make municipalization more difficult. This makes it very important for your community to stay informed about publicly owned utility issues at the State and Federal levels. Elected Officials are impacted by their constituents and the people who make contributions to their campaigns. If your community and its leaders want options to have power through public agencies continue to be available, your community and its elected officials, citizen leaders and business interests will need to stay engaged with State and Federal Elected Officials who have the power to pass legislation that can impact such options. CMUA tracks publicly owned utility issues at both the State and Federal levels and can alert your community when significant issues arise.

9.0 New concepts in publicly owned utilities that do not involve acquisition of the distribution system

After learning the challenges of fighting to acquire the electrical distribution system from the incumbent utility, some communities may opt for an approach that does not require a legal battle. Several communities are now exploring the following options that do NOT require ownership of the electrical distribution system. As mentioned previously, CMUA believes these strategies do not provide as much local control and therefore could diminish the benefits that would be realized by a community. Under these models, the incumbent investor-owned utility would continue to provide distribution services but your community could:

- 9.1 Act as a Facilitator of Energy Efficiency Measures.
- 9.2 Act as a Facilitator of Renewable Resources.
- 9.3 Act as a *Community Choice Aggregator*. As an Aggregator, work with an *Energy Supplier* to develop a power plant in your community that can be used to a) serve the electricity needs or load of your public facilities or b) serve the electricity needs of the aggregated load you are serving as a *Community Choice Aggregator*.

9.1 Facilitator of Energy Efficiency

The easiest way to reduce electric bills is to consume less energy. A public agency should always first make sure it is taking advantage of the numerous state programs that promote and fund energy efficiency measures. In fact, your public agency can lead by example and promote conservation by simply using less energy in its own facilities. Taking the next step, as a Facilitator of Energy Efficiency, the public agency could expand its efforts and undertake strategies to assist local residents, businesses and

agencies to secure funding from the incumbent utility for energy efficiency projects that meet the specific needs of its community. Alternatively, the public agency could decide to provide low cost financing on its own to promote energy efficiency strategies for residential and business customers.

9.2 Facilitator of Renewable Energy

Renewable resources reduce this country's reliance on fossil fuels and benefit the environment. However, at the current time, renewable energy strategies will not provide significant cost savings in energy bills. Still, a community may decide it wants to use its resources to invest in renewable energy to demonstrate a community's values. Public agencies can set an example by investing in renewable energy projects for their own facilities and facilitating the use of renewable energy by its residential and commercial customers. Under this approach, the public agency could undertake efforts to assist local residents, businesses and agencies to promote and develop renewable energy resources in its community through loan programs. The public agency could facilitate low-cost financing for renewable energy projects such as solar, wind, geothermal or biomass energy resources. Citizens, businesses or the local public agency could own and operate the renewable resources depending on how the program was structured. This strategy has little risk and could bring significant environmental benefits to a community.

9.3 Community Choice Aggregator

Aggregation is a strategy both cities and counties were pursuing before Direct Access was suspended by the California Public Utilities Commission (CPUC) on September 20, 2001. However, during the last Legislative Session, the Community Choice Aggregation bill, AB 117 (Migden), was passed by the State Legislature and signed by the Governor. AB117 provides cities and counties with the right to serve as Community Choice Aggregators for their communities. According to this legislation, everyone in the community is enrolled in the Aggregation Program in one fell swoop, although, each individual customer may "opt out" and not to be included in the Community Aggregation Program. AB117 requires that an "exit fee" be assessed for the aggregated load (electricity needs) of the community that will no longer be supplied by the investor owned utility. Thus, each customer will have to pay the fee.

Under the *Community Choice Aggregation* option, the city or county or public agency would be the *Energy Supplier* to its community load and secure or build its own generation assets to provide the energy needed for its residential and business customers. If the city or county didn't want to build its own energy resources, the public agency could actively negotiate long-term contracts with an *Energy Supplier* to supply the load the public agency had aggregated in its community. Under this option, contracts with customers for energy purchasing would be directly between the city or county and the residential and business customers whose loads were aggregated.

There is some risk with this model as the public agency would be the responsible party for securing the energy needs for its customers. A public entity that thought it could build long-term generation resources at reasonable market prices might pursue this option as a way to stabilize prices for its community over a 10 to 20 year period. Additionally, if the city or county secured a large enough community load, it is possible an *Energy Supplier* would be willing to offer a long term agreement to the city or county that would stabilize energy prices and provide a small discount. It is important to note that *Community Choice Aggregation* is much more dependent on the energy market and does not include the ability of the public agency to manage a vertically integrated utility.

Finally, the amount of “exit fees” associated with the Department of Water Resources power contracts must be addressed before a *Community Choice Aggregation* Programs can begin. The legislation that created the opportunity for *Community Choice Aggregation* required that an appropriate “exit fee” be attached to any customer participating in the *Community Choice Aggregation* Program. It is anticipated that the California Public Utilities Commission will institute a rulemaking proceeding in early 2003 to develop rules for *Community Choice Aggregation* Programs.

The *Community Choice Aggregation* option would not require the city or county to acquire the electrical distribution system to provide services. Initially, the energy savings associated with these strategies for the customers would most likely be small depending on the exit fees associated with the Department of Water Resources’ long term contracts. Additionally, acting as an *Electric Service Provider* could expose the city or county to some minimal risk if too many of the customers who made up the aggregated load decided to opt-out of the program and receive default service from the IOU.

As communities explore *Community Choice Aggregation*, power plant development in partnership with an *Energy Supplier* is a strategy that some communities are exploring. In this model, a county, city or public agency would make available a site for a power plant and then work in partnership with the *Energy Supplier* to address neighborhood concerns. The public jurisdiction would also facilitate permits and take steps to meet standards that have been set in local and state laws. In exchange, the community could: 1) receive low cost power for its facilities and its citizens and businesses as a *Community Choice Aggregator*, 2) receive a yearly payment to the general fund, and/or 3) a combination of both. Several cities are currently exploring this option. The risk involved in this approach centers around how serious and financially secure the *Energy Supplier* developing the power plant is. If the *Energy Supplier* gets into financial trouble and is unable to deliver on the power plant, the city or county running their *Community Choice Aggregation* Program will be put into risk.

10.0 Exit Fees

All of the options previously discussed will be impacted by what the California Public Utilities Commission, the Legislature and ultimately the courts decide about “exit fees.”

Exit fees are the fees associated with the IOU under collections, the remaining Competition Transition Charge (CTC) and power contracts the Department of Water Resources (DWR) was forced to negotiate in order to keep power flowing to the investor owned utilities (IOUs) when they faced financial instability because of the uncontrolled increases in wholesale energy prices. Many energy companies were unwilling to sell power to the IOUs because they did not think they would receive payment for the energy they delivered. When DWR negotiated energy contracts and provided assurances that energy companies would be paid, power was provided to the investor owned utilities. It was anticipated the costs for the DWR contracts would be paid off by spreading these costs over the existing customer base of the investor owned utilities over a period of 10-15 years.

Any of the strategies previously outlined could some argue significantly erode away the customer base that must pay off the under collections, CTC and DWR power contracts. As a result, the investor owned utilities have asked the CPUC to impose an exit fee on any load removed from their service territories (whether through aggregation, direct access or Municipalization) until the DWR contract costs are paid off. As mentioned previously, exit fees were included as part of the legislation that created *Community Choice Aggregation* and the exit fees associated with *Community Choice Aggregation* will be determined in the CPUC in 2003.

However, many have questioned whether new load (vs. existing load) should be exempt from exit fees since such customers would not have been in existence when any of the costs were incurred and therefore, they argue, new customers shouldn't have to bear those costs. Additionally, CMUA has questioned whether the CPUC has the right to impose exit fees on municipal customer load since the CPUC does not regulate municipal utilities. Others argue that if new municipal utilities or Community Choice Aggregators are exempt from paying exit fees, the remaining customers would be forced to pay extra to cover those newly exempted customers and this would not be fair. There are several hearings being conducted at the CPUC to address these questions. It is anticipated the CPUC or Legislature will develop what it believes to be a fair and reasonable “exit fee” associated with DWR contracts sometime in 2003. This is an issue your community should monitor closely if you are considering any of the public power strategies in this Handbook.

11.0 Summary

The California Constitution gives cities the right to determine who provides electricity service to its constituents. Whether a community wants to provide electricity itself or “franchise” it out to an IOU is a question each community should consider. Many California communities have chosen to undertake utility operation. Most of the water distribution in the state is provided by public agencies. As mentioned before, there are currently 31 publicly owned utilities operating successfully in California. Seven are more than one hundred years old and the newest is the Merced Irrigation District that was formed in 1996. Nationwide, there are more than 2,000 consumer owned electric systems

and there are approximately 200 communities throughout the country currently looking at forming municipal utilities. As this Handbook goes to print, more than 25 communities in California are exploring establishing some form of a publicly owned utility. Publicly owned power is not a new concept and it has benefited many communities throughout the United States. Changing the provider of your community’s electric service from an IOU to a public agency is a significant challenge and should not be entered into casually. However, a well managed publicly owned utility can bring significant benefits to a community, including local control over energy related decisions, the potential for lower rates and unique programs that reflect community values. Weighing all the factors outlined in this Handbook, each community must decide for itself the best approach to have electricity provided to its community.

Glossary of Terms

Definitions

AB1890: Assembly Bill 1890 was the California legislation that enabled the restructuring of the electric utility industry.

American Public Power Association (APPA): The national service organization for more than 2,000 community-owned electric utilities that serve more than 40 million citizens throughout the United States.

Charter cities: Cities that were established through a Charter document.

California Public Utilities Commission (CPUC): The State agency that sets policy and rates for the investor owned utilities.

California Department of Water Resources (DWR): The State agency that stepped in to purchase wholesale power on behalf of the investor owned utilities when prices soared out of control.

Community Choice Aggregation: A public agency that aggregates the electricity needs of its residential and business customers so that it can shop around for the best electricity prices.

Competition Transition Charge (CTC): A charge established by AB1890 to help investor owned utilities pay off stranded assets.

Direct Access: The ability of electric retail customers to chose an alternative energy provider.

Distribution: The infrastructure necessary (poles and wires) to “step down” the voltage of electricity and distribute it to customer locations where it can be safely consumed.

Edison Electric Institute: The national association for investor owned (for-profit) utilities throughout the United States.

Exit fees: The fees associated with the investor owned utilities under collecting during the energy crisis when rates were frozen, the remaining Competition Transition Charge and the power contracts the Department of Water Resources negotiated in order to keep power flowing to the investor owned utilities during the energy crisis.

Feasibility Study: A study undertaken to determine the legal, technical and financial issues surrounding establishing a publicly owned utility.

Federal Energy Regulatory Commission (FERC): The Federal Commission with jurisdiction over wholesale electric sales, transmission rates and anti-competitive effects of “market Power” or dominance by large market participants.

General Law cities: Cities that were established under the general law of the Legislature.

Generation: The production of electricity.

Investor owned utilities (IOUs): For-profit utilities owned by shareholders who receive dividends based on the profits made by the utility.

Public Power: A generic term used throughout the country to refer to publicly owned electric distribution utilities.

Municipalization: A generic term used to describe the process of taking ownership of the distribution poles and wires that serve a community away from the incumbent utility.

Municipal utility: A generic term used to describe a public agency in the electric utility business.

Transmission: The lines conveying electricity at a high voltage from generators to distribution companies.

Abbreviations

APPA American Public Power Association
CPUC California Public Utilities Commission
DWR California Department of Water Resources
CTC Competition Transition Charge
FERC Federal Energy Regulatory Commission
IOUs Investor owned utilities

Appendix

Resources and Bibliography

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