Boulder Municipalization Study Issue # 6:

Lessons learned from other municipalities

October 3, 2013

Background and Paper Outline

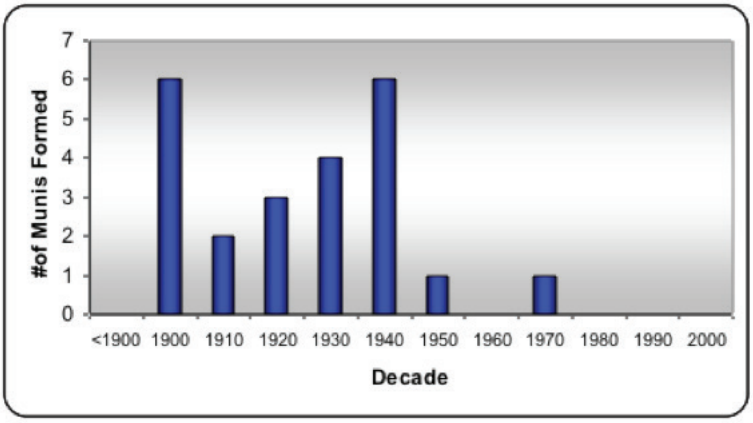
This paper examines certain challenges cities around the country have faced and are facing in association with forming new municipal electric utilities through municipalization. Of particular importance are those challenges arising out of the attempted taking of an existing utility business, coupled with feasibility assumptions that fail to materialize. Few electric utilities have formed in the last half century, and results from recently formed municipal utilities have fallen short of expectations.

Very few utilities have formed in the past 40 years

While numerous cities have examined establishing an electric utility, few have succeeded in the pursuit. In fact, there are nearly 3,200 electric utilities in the United States, with most having been formed before World War II. About 85 new electric utilities were created in the past 40 years, with most of these either voluntary sales or formed to serve very small, new communities and specialty situations (such as towns in Alaska, casinos, or large entertainment or industrial complexes).

The history of municipal electric utilities in Colorado mirrors that of the U.S. in that most of its 29 municipal utilities, according to available records, were formed prior to the 1940s. The most recent municipal electric utility in the state was formed nearly 40 years ago. Starting a new municipal utility today in Colorado is quite different from how existing systems were created and now operate. Many received the benefit of inexpensive, federally subsidized hydropower from sources such as the Western Area Power Administration (WAPA), which would not be available to a new municipal utility. More importantly, these existing city utilities depend very heavily on inexpensive coal for their energy.

Formation of Colorado municipal electric systems by decade.



Source: American Public Power Authority (APPA) data on utility formation dates.

Examples of recent utility experiences

In the last several decades, nearly all attempts to form a new municipal electric system have failed. The causes of failure range from financial difficulties to political realities. In fact, Boulder has considered municipalization at least four times since 1948. And, in 1970, a Boulder committee investigating municipalization strongly recommended *against* forming a city utility:

> *"In the absence of any compelling need for City ownership, and the uncertain results which would flow from such ownership, it would be in violation of our traditional protection of the private enterprise system and an unwarranted assault upon the revenues of other taxing authorities for the City to condemn the Public Service Company's distribution system."*
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> Report by the City Special Utility Study Committee regarding the Feasibility of Acquisition and Operation of the Electric Distribution System by the City of Boulder, March 9, 1970*

Some might be surprised to learn that, in 2008, after a couple of years of studying municipalization, Boulder's city manager and staff recommended city council renew the franchise with Xcel Energy, stating, "There are benefits to entering into a franchise agreement with Xcel Energy."

This conclusion is consistent with the fact that few utilities in the United States have formed in the manner Boulder is currently pursuing—a contested acquisition of an existing utility through condemnation. Recent cases illustrate the difficulty of forming a new electric utility under even the most favorable of circumstances.

For example, Jefferson County, Wash., which began operating its new utility in early 2013 to serve about 18,000 customers, is struggling to match the incumbent's utility rates, programs and service quality. This is despite gaining access to existing low-cost hydropower and engaging in a negotiated transaction with the utility, Puget Sound Energy (PSE).

> "'What I'm saying is, if it's winter, can you turn anyone's power off if they have children? What's the process for that?' asked Crump. Crump was concerned after he recently learned the PUD had sent out more than 500 shutoff notices in August." (*PT Leader*, "PUD program for the poor not sparking interest – OlyCAP director worries about winter bills, shutoff notices, loss of revenue from PSE," Sept. 4, 2013)
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> And;
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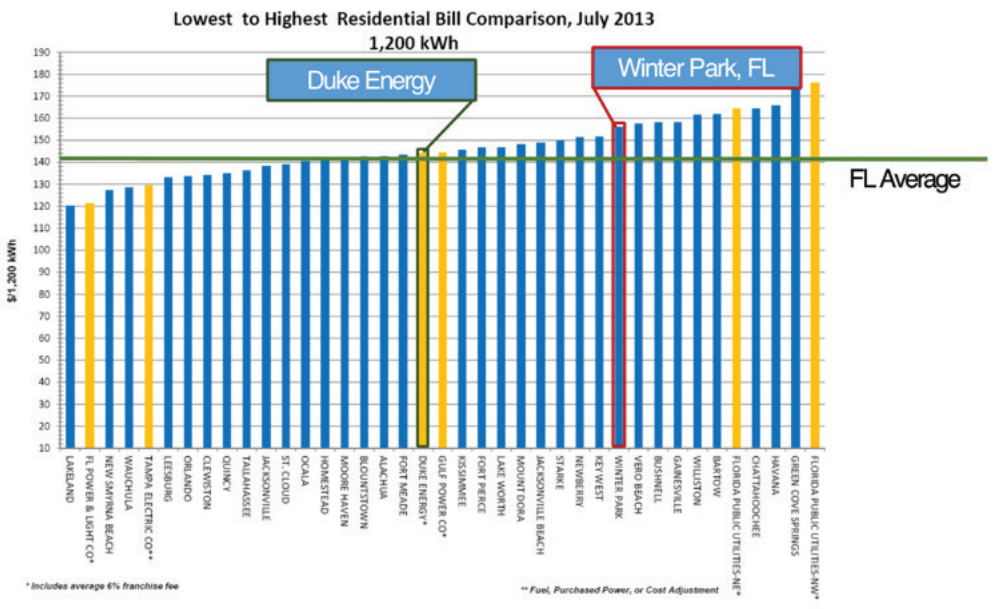
> "Concerns about timely communication during fires and power outages have prompted a meeting between local fire chiefs and Jefferson County Public Utility District 1…the dispatcher said, 'five-plus attempts to make PUD contact' and 'put on hold.'" (Allison Arthur and Tristan Hiegler of the *Leader*, "PUD, fire meet to talk about response issues")

The road to forming a new utility has proven to be a long and costly one as the City of South Daytona, Fla., recently discovered. In 2009, that city's leaders moved forward with a plan to municipalize based on a consultant's study, which predicted the system's value would be $4,282,690, and the total cost would be $9,329,071. After a 2011 court finding that the system value was actually $15,543,603, the city's estimate for the total cost to form a utility had more than doubled to $19,693,603. In 2012, citizens voted to overturn city council's vote to municipalize by nearly two-to-one. The city recently signed a new 30-year franchise and had to absorb millions of dollars in legal and consulting fees it incurred during its failed attempt to form a utility.

Another municipalization example that is often cited, yet not well understood, is Winter Park, Fla., in 2005. What began as a predicted cost of about $15 million for a utility serving 14,000 customers ballooned in three short years to more than $50 million. Even with the inflated price tag, the city's consultants were promising citizens and businesses a municipal electric utility would not only match the incumbent utility's rates, but would begin making money the first year. Instead, within the first years of operations, the city had accumulated $11.6 million in financial losses and was put on "credit watch negative" by rating agencies. Today, Winter Park's rates are above the state average, as shown in this rate comparison of a typical residential bill for municipals (blue bars) and investor-owned utilities (yellow bars). In fact, Winter Park's rates cost a typical residential customer more than $156 a month, or about 10 percent more than the utility it replaced (now Duke Energy).

Florida residential electric bill comparison (source: Florida Municipal Electric Association).



Even mature municipal utilities face financial pressures that cause them to consider getting out of the business. Vero Beach, Fla., serving about 34,000, is in the process of selling its electric utility to investor-owned Florida Power & Light (FPL). Similarly, Philadelphia, Pa., just announced it is planning to divest its natural gas utility, which it has operated for 176 years. And, leaders in Colorado Springs had been considering until just this year the option of selling that city's electric utility due to financial stresses.

But, perhaps one of the most striking stories comes from Glendale, Calif., a utility serving 85,000 customers. The city is a little larger than Boulder, but with an electric fuel mix of only 20 percent renewables and 24 percent coal, one might expect rates to be lower than what Boulder is considering. However, Glendale's electric rates are about 50 percent higher than those Boulder customers pay today, with Glendale's 2013 rates averaging 14.1 cents per kilowatt-hour (¢/kWh) and projections of over 15 ¢/kWh for 2014. The city has had to reduce its capital budgets to near zero while rapidly increasing rates. The cause:

> "It is an ongoing challenge to contain the rising operational and material costs required to make needed improvements that will avoid or reduce power outages, keep us optimally efficient while investing in renewable and newer sources of energy in order to meet state mandates. These imperatives require us to propose a rate increase for the next five years in order to provide the level and quality of service and reliable power that you rightfully expect from us."
> http://www.glendalewaterandpower.com/pdf/DirectMailRateIncreaseLetter.pdf

And, finally, there is the Hercules, Calif., utility (HMU), a tiny municipal system serving 840 customers, which formed a mere 10 years ago in 2003. During the decade since consultants predicted "local control could translate into better customer service, lower rates and a growing revenue base," HMU has consistently run in the red.

> "Today, the utility has become a drain on the city's treasury, and its residential customers pay more than other Hercules residents served by competitors. And Hercules is hardly in a position to subsidize HMU – it's forced it to lay off a third of its employees, including cops."
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> And;
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> "HMU, admittedly, is a huge problem," Municipal Services Director John Stier told a weary council at that June meeting. "We're a little kid playing in a big pen." http://pinole-hercules.patch.com/groups/politics-and-elections/p/hercules-municipal-utility-has-drained-not-charged-city-coffers

The purpose of highlighting the above lessons is not to assert that cities are never able to run successful utilities, but to demonstrate that starting one in the way Boulder contemplates is an uncommon practice, which carries considerable risks and challenges.

Conclusion

Despite Boulder's interest in municipalization and exhaustive studies over the past 65 years, nothing in the national landscape or marketplace has changed that would make a start-up utility more practical or feasible today. No compelling reason gives a new city utility any comparative advantage in entering into wholesale power contracts, running an electric distribution service department, funding reliability investments or, especially, reducing emissions for all of Colorado through increased renewable energy and energy efficiency.

In reality, condemning an existing, well-managed, financially sound, affordable and reliable utility (Xcel Energy) will result in a loss of economies of scale and higher costs, which will be difficult to overcome. And, while some tout city-owned power as being more beneficial for its nonprofit status, in reality, Boulder's plan amounts to a leveraged buyout with tens of millions of dollars a year flowing to Wall Street lenders. In fact, the city plans to largely outsource its power supply and operations to "for-profit" entities, which, unlike Xcel Energy, have no regulation or cap on their rates of return.

By contrast, Xcel Energy's Boulder customers have helped the utility become the nation's number-one wind energy provider (for nine consecutive years, as named by the American Wind Energy Association), and one of the top solar energy providers in the country. Last year, Xcel Energy exceeded all goals to encourage customers to use energy more efficiently and save money. Boulder customers, in particular, have used Xcel Energy rebates to improve significantly their energy efficiency, conservation, and use of renewable energy, installing solar power systems at a rate nearly 30 times the national average. The addition of 450 MW of new wind and 170 MW of new solar will help the company keep its industry-leading position on renewable energy and carbon reduction.

This partnership has worked well for the more than 100 years Xcel Energy has served the Boulder community. We believe continuing that relationship into the future will allow both the City of Boulder and our company to achieve our goals.

*Committee members: Robert S. Ayre, chairman, F. Kendrick Bangs, B.W. Birmingham, William D. Carter, Robert N. Hall, Elizabeth Hawkins, Thomas R. Mason, Harold Short, Richard Waugh