Toledo's Example; Mini-Muni Options

Patrick McGuire, University of Toledo
Published in ***Deregulation Watch Vol.2 #8.***

The specter of electric utility deregulation has paralyzed local officials throughout the nation. Recognizing the elusive benefits wrought by telephone, airline, banking, and cable deregulation, and powerless as the elephants of politics and commerce tussle to get their interests served in a deregulation bills at their state capital, they sit immobilized--fearful that any action they take could make things worse. They worry about firms that may locate (or relocate) elsewhere because of lower rates, and lesser and/or more rapid retirement of stranded investment obligations.

Faced with some of the highest residential and commercial rates in the country, the City of Toledo Ohio has examined options related to electrical supply. Over the last decade, their Electric Franchise Commission has helped create several economic benefits, and recently has identified two strategies which individually or in tandem might render additional benefits--Facilities Acquisition, and Special Improvement Districts. Each strategy takes advantage of the difference between the federal government which has used an economically-based "lost revenues" approach to awarding wholesale stranded investment, and state governments whose political approach has been to pay utilities whatever is necessary to surrender their monopolies, often awarding stranded costs at 100% (or more) of what many analysts had projected as appropriate for retail stranded investment. By contrast, Federal Energy Regulatory Commission administrative justices have found that recovery of 20-30% of the utilities' claims is more appropriate.

Faced with a limited period to recover stranded investment, many utilities have been reluctant to offer special deals to small- and medium-sized firms, instead offering new five year lock-in contracts at higher rates than previous ones. They assume that most companies and agencies will not close a facility when the panacea of deregulated electricity is "around the corner." Many of these firms have their own sub-stations with an under-utilized capacity--having a 20 Mw capacity but using only 10 Mw. Under the Facility Acquisition strategy, the firm leases its sub-station to the city for 10 years for a dollar. The city creates a municipal firm and builds (or condemns part of) a distribution system for serving nearby residential and commercial interests. The city sells current at a lower price now and later, since even after deregulation as an aggregator buying 16 Mw it can get current cheaper than the firm with a 10 Mw load could buy. Meanwhile the city (really the firm and the residents) has paid the lower stranded investment obligation assigned by FERC to wholesale customers.

Many cities are hesitant to commit moneys or fear a voter backlash against government intrusion. The Special Improvement District involves creating a self-taxing district that is granted special powers by a municipality. For example, New York delegated its "Monopoly" police powers to a Times Square Improvement District, which has hired its own police. New York retains all existing obligations including their own police coverage of the district. Using Toledo's Special Improvement strategy, the City delegates its municipal ownership powers to a district created by a group of business people and residents, who set up a municipal electric system. This strategy is most beneficial if the group has access to a high-voltage transmission line and/or an existing sub-station. In Toledo, consultants estimate that a 4 Mw load district might render benefits in the 7-23% range, depending on the customer mix.

Central to FERC's determination of stranded investment obligation are several key questions; did the utility have a reasonable expectation to serve the area? Is the load growing in the remainder of the monopolized service territory? And, how much time is left on the franchise? For a decade, Toledo has had consultants and City committees examining electric issues and municipal ownership of the entire, and then for part of the City. In 1993 we negotiated a new five-year franchise (although the utility claims one in perpetuity), and the growth in load has been strong in the service territory. Like Los Cruces, New Mexico and Alma Michigan--the two lead cases at FERC--we are well positioned to secure lower stranded investment at FERC, and City Council is considering that course of action.

Regardless of previous efforts, the two strategies may benefit a city or town. The prospect of a high level and long period of stranded investment obligation constitutes a disincentive to locating a factory in your town and begin taking current until the obligation is retired. A Special Improvement District might create "an island of post-stranded investment opportunity!" Ovitz Ohio has created a Special Improvement District in a new industrial park. Providing electric and gas service, this "municipal" system has attracted two new large firms; neither will owe stranded investment.

The mere threat to undertake such actions can itself be beneficial. Two large public institutions in the Toledo area met with City officials about a possible facilities acquisition-based system, and each received substantially reductions in their negotiated rates for a fixed contract period. The City of Toledo and Lucas County Port Authority used the threat of creating a facilities acquisition (possibly coupled with a Special Improvement District) in an effort to attract a $300 million steel plant that had reached an impasse with the local utility. The local utility responded with a better economic package than before. Similarly, widespread consideration of these strategies might provide a lever for legislators looking to restore reason to the Stranded Investment bonanza currently being reaped by utilities in state legislatures.

That the rhetoric, organizational dynamics, and fluctuating and elusive opportunity structures of electric deregulation should incapacitate public officials, who have previously paid little attention to electric service, is understandable. After all, the shifting coalitions of players and positions in each state are confusing to most of us who have studied and/or participated in the industry for decades. However, careful reflection may allow public officials to steer their constituents to safe ports, arriving early enough to secure tangible advantage for having chosen to take command of their own fate, rather than simply awaiting the flood of changes and passively riding the currents of change.

Patrick McGuire is an Associate Professor of Sociology at the University of Toledo, and a member of the City's Electric Franchise Committee for a decade. He has published numerous academic articles on utilities, has testified on utility issues in several states, and is co-principal investigator of an National Science Foundation sponsored research project on the origin and structure of the Electric Utility Industry.