



## WISCONSIN LEGISLATIVE COUNCIL INFORMATION MEMORANDUM

### Overview of Wisconsin's Public Utility Regulatory System

The availability of heat, light, and water service are central to modern life. For this reason, an individual, business, or local government that provides one of these services to the public is deemed a “public utility” and is subject to a system of state regulation designed to ensure the availability of service and protect the interests of consumers, public utilities, and their investors.

The state public utility regulatory system that exists today was largely created through the 1907 Public Utilities Law. The features of this system generally include: a broad definition of “public utility”; centralized regulatory authority vested in the Public Service Commission (PSC); monopoly status for public utilities; state control of rates; minimum service standards; public utility authority to take private property for facilities, subject to state approval; and limitations on public utility ownership.

#### **HISTORICAL BACKGROUND**

Until 1907, Wisconsin's public utilities were generally regulated at the municipal level. Municipal governments granted public utilities franchises to operate within municipal boundaries, had authority to inspect utility facilities, and could determine whether service was adequate.<sup>1</sup> Most electric service was provided by private businesses, but some municipalities owned and operated electric utilities. Conversely, most water service was provided by municipalities, but private businesses owned and operated the water public utilities in a few municipalities.

Under this system, there was significant variation in how public utilities were regulated. Some municipalities granted multiple franchises for the same service, driving public utilities to compete against one another. Others used their franchising authority to grant a monopoly to a single public utility. While the franchises in some municipalities expired every few years, others lasted 50 years or more.

Consumer dissatisfaction with the reliability and cost of service led state policymakers to question whether competition should be allowed among public utilities.<sup>2</sup> Competition was

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<sup>1</sup> *Regulation of Railroads and Public Utilities in Wisconsin*, Fred L. Holmes, 1915, p. 225.

<sup>2</sup> *Legislative Control of Public Utilities in Wisconsin*, William L. Crow, *Marquette Law Review*, Vol. 18, Issue 2, February 1934, p. 86.

faulted for harming service reliability by driving public utilities out of business, and inflating the cost of service by encouraging the duplication of expensive infrastructure.<sup>3</sup>

Whether municipal governments were capable of adequately regulating public utilities was also up for debate. As the complexity of public utility service increased, municipalities found themselves lacking necessary technical expertise.<sup>4</sup> As the service territories of public utilities expanded beyond municipal boundaries, consumers living outside of municipalities found themselves paying higher rates to offset the lower rates negotiated by municipalities for their residents.<sup>5</sup>

Through the 1907 Public Utilities Law, state policymakers limited competition among public utilities by granting them monopoly status and replaced municipal control with state regulation. Underlying the 1907 Public Utilities Law was the conclusion that the interests of consumers, industry, and investors were best served by giving monopoly power to public utilities while subjecting them to extensive regulation administered by a state commission. [Ch. 499, Laws of 1907.]

### **THE WISCONSIN PUBLIC UTILITY REGULATORY SYSTEM**

The 1907 Public Utilities Law created the public utility regulatory system that exists today. Key characteristics of this system, each of which is described in more detail below, include:

- A broad definition of “public utility.”
- Centralized regulatory authority vested in the PSC.
- Monopoly status for public utilities.
- Minimum service standards.
- State regulation of rates and other charges.
- Public utility authority to take private property for facility construction, subject to state approval.
- Limitations on public utility ownership.

#### ***A BROAD DEFINITION OF “PUBLIC UTILITY”***

Central to Wisconsin’s public utility regulatory system are the criteria that determine whether an entity is considered a “public utility.” The 1907 Public Utilities Law provided for broad applicability through the establishment of two core concepts that remain in effect today.

First, the definition includes both privately-owned entities and municipally-owned entities, so that municipal public utilities and investor-owned public utilities are generally regulated in the same manner. [Ch. 499, Laws of 1907, and s. 196.01 (5), Stats.]

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<sup>3</sup> *Legislative Control of Public Utilities in Wisconsin*, William L. Crow, *Marquette Law Review*, Vol. 18, Issue 2, February 1934, p. 86.

<sup>4</sup> *Pabst Corporation v. Milwaukee*, 190 Wis. 349, 356.

<sup>5</sup> *State Versus Local Regulation of Public Utilities: a Report to the Wisconsin Legislature by the Railroad Commission of Wisconsin*, March 1925, p. 42.

Second, the definition includes not only entities that own or operate facilities directly used to provide service to the public, but also those used indirectly. The effect of this broad definition is that regulation applies to facilities that are used to furnish a service to a party that, in turn, provides the service to the public.<sup>6</sup> For example, a company that operates a power plant that provides electricity to a company that distributes it to the public is generally included in this definition. To be excluded from this definition, an owner of a facility generally must relinquish control of the facility, such as by leasing it to a distribution company.<sup>7</sup>

In 1937, the definition of “public utility” was narrowed to exclude cooperative associations (“cooperatives”) that provide heat, light, power, or water to their members. [Ch. 365, Laws of 1937.] Cooperatives are not-for-profit organizations owned and managed by members for the purpose of providing service to the members themselves. In the 1930s, a continued lack of access to service in rural areas lead to federal and state efforts to promote the formation of cooperatives to provide these services.<sup>8</sup>

Today, cooperatives continue to be excluded from the definition of “public utility.” Consequently, the state does not regulate the rates charged by cooperatives, although it does exercise control over their large construction projects and service territories. [s. 196.01 (5) (b), Stats.]

#### ***CENTRALIZED REGULATORY AUTHORITY***

The 1907 Public Utilities Law transferred regulatory authority over public utilities from municipalities to the Railroad Commission, which had been created to serve the similar function of regulating the rates and service of the railroads operating in the state. The commission was given its current name, the Public Service Commission, in 1931. [Ch. 183, Laws of 1931.]

The PSC is headed by three commissioners who serve six-year terms, one of whom the Governor designates to serve as the chairperson. [s. 15.79 (1), Stats.] Commissioners are nominated by the Governor and are appointed with Senate approval. [s. 15.06 (1) (c) 1., Stats.] Reflecting the need for technical expertise that had been found lacking in municipal governments, the commissioners are supported in their work by a professional staff of auditors, accountants, engineers, attorneys, planners, and economists.<sup>9</sup>

Municipalities retain the authority to regulate “the quality and character of each kind of product or service to be furnished... by any public utility within the municipality and all other terms and conditions...upon which the public utility may be permitted to occupy the streets.” [s. 196.58, Stats.] However, this authority is subordinate to the authority of the PSC, and does not authorize municipalities to regulate items that are strictly the jurisdiction of the PSC, such as rates.<sup>10</sup>

#### ***MONOPOLY STATUS FOR PUBLIC UTILITIES***

The 1907 Public Utilities Law provided that a public utility could exchange its municipal franchise for an “indeterminate permit” issued by the state. [Ch. 499, Laws of 1907, SEC. 1797m-

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<sup>6</sup> Wisconsin Legislature 1907-08, Public Utilities Regulation, Hearings, and Comments, Pt.1 Brief Explanation of Public Utilities Bills 581S and 933A, p.3.

<sup>7</sup> *Chippewa Power Co. v. Railroad Com. of Wisconsin*, 188 Wis. 246.

<sup>8</sup> *Wisconsin Gets a Power Program: The Story of the Wisconsin Development Authority*, 1938.

<sup>9</sup> PSC Overview, <http://psc.wi.gov/aboutus/organization/PSCoverview.htm>, last accessed on October 28, 2016.

<sup>10</sup> *Milwaukee Electric Railway & Light Co., v. Railroad Commission of Wisconsin*, 153 Wis. 592.

77.] Because few public utilities made the exchange, a 1911 Act mandated the conversion of all franchises to indeterminate permits. [Ch. 596, Laws of 1911; s. 196.54 (2), Stats.]

Under current law, an indeterminate permit authorizes a public utility to provide service, protects it from competition, and subjects it to regulation and termination by the state. [s. 196.01 (3), Stats.]

The PSC is prohibited from authorizing another public utility or a cooperative to provide service where a public utility with an indeterminate permit or a cooperative is already providing a similar service. Additionally, a municipality is prohibited from establishing a public utility if there is already a public utility with an indeterminate permit in the municipality. [ss. 196.495 (1m) (a) and 196.50 (1) (a) and (4), Stats.]

The 1907 Public Utilities Law created two methods for terminating a public utility's monopoly status, which continue to remain available under current law. First, the PSC may authorize another public utility to provide competing service in the area, if the PSC determines that the public convenience and necessity require it. Second, the municipality in which the major part of the public utility is situated may, at its discretion, purchase the public utility for a price set by the PSC and thereby terminate the public utility's indeterminate permit. [ss. 196.50 (1) (a) and 196.54 (4) and (5), Stats.]

#### ***MINIMUM SERVICE STANDARDS***

In exchange for monopoly status, a public utility acquires the obligation to serve all who reasonably request service. [s. 196.37 (2), Stats.] This generally entails offering prospective customers the same type of service that the public utility already provides to customers located nearby.<sup>11</sup> A public utility may not discontinue providing service without first receiving permission from the PSC. [s. 196.81, Stats.]

A public utility must provide its customers with “reasonably adequate service and facilities.” To ensure service adequacy, the PSC exercises control over the service rules that a public utility has with its consumers, sets performance standards, and requires public utilities to report on performance metrics, such as the frequency of service interruptions. To ensure that public utility facilities are adequate, the PSC sets technical standards for equipment and requires public utilities to conduct certain inspection and maintenance activities. [ss. 196.03 (1), 196.19 (2), and 196.20 (1), Stats.]

#### ***STATE CONTROL OF RATES***

Unlike most industries, in which prices are set by service providers competing against one another to offer the lowest competitive price, the rates that a public utility may charge its customers are controlled directly by the state government through the PSC. State law requires public utility rates to be “reasonable” and “just.” [s. 196.03 (1), Stats.]

The PSC has significant discretion in setting rate amounts, but it may not set rates so low that they qualify as confiscating a public utility's property, nor so high that they qualify as “extortionate” or “excessive.”<sup>12</sup>

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<sup>11</sup> *Milwaukee v. Public Service Comm.* (1954), 268 Wis. 116, 120.

<sup>12</sup> *Wisconsin Telephone Co. v. Public Service Commission*, 232 Wis. 274.

In setting rates, the PSC generally uses rate-of-return regulation, in which rates are calculated to produce revenues sufficient to cover a public utility's operating expenses and capital investments (the cost of providing utility service) plus an authorized percentage return that a public utility may earn on its capital investments. However, the PSC is not required to base its rate determinations on a specific formula or set of considerations.<sup>13</sup>

***AUTHORITY OF PUBLIC UTILITIES AND COOPERATIVES TO TAKE PRIVATE PROPERTY FOR FACILITIES, SUBJECT TO STATE APPROVAL***

“Eminent domain” or the authority to condemn (i.e., “take”) private property for public use is based on the state's inherent power to act as the sovereign over the property within its borders.<sup>14</sup> Although it is a governmental power that is generally not held by private entities, the state has conferred this power upon public utilities and cooperatives in instances in which private property is needed for certain facilities.<sup>15</sup> In some instances, PSC approval is required before a public utility may exercise eminent domain authority. [s. 32.02, Stats.]

The state exercises control over the construction of public utility facilities by generally prohibiting a public utility or a cooperative from commencing a construction project unless it first obtains approval from PSC. For the largest projects, a public utility must obtain a Certificate of Public Convenience and Necessity, which involves an extensive review of the project by the PSC. [s. 196.491, Stats.]

For relatively smaller projects, a public utility must obtain a Certificate of Authority, which involves less extensive review by PSC. The PSC may refuse to issue its approval if it finds that a project would: (1) substantially impair the efficiency of the service of the public utility; (2) provide facilities unreasonably in excess of probable future requirements; or (3) add to the cost of service without proportionately increasing the value or quantity of service. [s. 196.49, Stats.]

***LIMITATIONS ON PUBLIC UTILITY OWNERSHIP***

State control of public utility ownership and securities is a key part of the regulatory system. This control is aimed at safeguarding the financial viability of public utilities and preventing ownership arrangements from being used to evade regulation.

To ensure Wisconsin's control over its public utilities,<sup>16</sup> the 1907 Public Utilities Law prohibits a foreign corporation from receiving authorization to own, operate, or control a public utility. [s. 196.53, Stats.] To prevent excessive consolidation of public utilities,<sup>17</sup> state law prohibits a public utility from merging with or acquiring the stock of another public utility without the approval of the PSC. [s. 196.80, Stats.]

Laws enacted in 1911 and 1913, which remain in effect today, give the PSC broad authority over public utility securities. [s. 1753-22, Revised Statutes of 1913.] Before issuing securities, a public utility must apply for permission from the PSC, and the PSC may not approve security issuances that it determines are for improper purposes or for amounts in excess of the public utility's

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<sup>13</sup> *Wisconsin Assoc. of Mfrs. & Commerce, Inc. v. Public Service Com.*, 94 Wis. 2d 314.

<sup>14</sup> *Boom Co. v. Patterson*, 98 U.S. 403, 406 (1879).

<sup>15</sup> Legislative Council IM 2014-06: “Eminent Domain Statutory Authority and Procedures,” (November 6, 2104).

<sup>16</sup> *Alliant Energy Corp. v. Bie*, 330 F.3d 904 (2003).

<sup>17</sup> *Regulation of Railroads and Public Utilities in Wisconsin*, 1915, Fred L. Holmes, p. 242.

capital needs. Furthermore, the PSC may order a public utility to stop paying dividends to its stockholders. [ss. 201.03, 201.05, and 201.11, Stats.]

These measures were enacted to prevent public utilities from issuing securities in excess of the real value of their assets, a practice that was faulted for driving public utilities to increase rates to satisfy investor demands for profits, as well as increasing the expense of obtaining capital to fund construction due to investor distrust of the value of a public utility's securities.<sup>18</sup>

In 1931, state policymakers addressed concerns that public utilities' rates were inflated to cover the cost of excessive payments for services and sales from businesses under the same ownership as the utilities themselves.<sup>19</sup> [Ch. 183, Laws of 1931.] The law, still in effect today, requires public utilities to obtain approval from the PSC for contracts and other arrangements with "affiliated interests," which are generally entities that have a certain amount of ownership in common with the public utility. The PSC may only grant its approval if it finds that the contract or arrangement is reasonable and in the public interest. [s.196.52, Stats.]

In the 1970s and early 1980s, public utilities faced inflation, increasing fuel costs, and a lack of growth in demand for energy. To improve profitability, several investor-owned public utilities expressed interest in investing in nonutility business activities by reorganizing into public utility holding companies, in which the public utilities would be one of several subsidiaries.<sup>20</sup>

Concern that the volatility of the nonutility assets could compromise the viability of public utilities led to enactment of the 1985 Wisconsin Utility Holding Company Act [1985 Wis. Act 79]. The law prohibits the formation of a holding company without authorization from the PSC and sets limits on the maximum value of non-utility assets that may be held by a public utility holding company. [s. 196.795, Stats.]

This memorandum is not a policy statement of the Joint Legislative Council or its staff. This memorandum was prepared by Zach Ramirez, on March 7, 2017.

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<sup>18</sup> *Government Regulation of Security Issues of Public Utility Corporations*, in *Regulation of Public Utilities: Three Discussions*, Halford Erickson, January 1909.

<sup>19</sup> *Progressive Ventures in Commission Regulation*, Martin Glaeser, *Public Utilities Fortnightly*, February 1932.

<sup>20</sup> *Energy Utility Diversification, Holding Companies, and Regulation*, Office of the Chief Economist of the Public Service Commission of Wisconsin, September 1981, P.2.