REMAPPING DEBATE
Asking "Why" and "Why Not"

A prescription for Long Island: fixing the sins of privately owned utility operators with more privatization

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February 13, 2013 — Hurricane Sandy, which blew through the New York metropolitan area late last October, left millions of households and businesses in the region in the dark. Few places were unplugged for as long as the service territory of the Long Island Power Authority (LIPA), the state owned electric power distribution company where 1 million of its 1.1 million customers on Long Island lost power as a result of the storm.

In response to inadequate performance by LIPA and other utilities, New York Governor Andrew Cuomo created a commission to investigate the preparation and response of utilities to Sandy and other recent weather events. This "Moreland Commission," co-chaired by Robert Abrams, former New York State attorney general, and Benjamin Lawsky, the head of the state's Department of Financial Services, released its interim report in early January. It called the state's Public Service Commission (PSC), which regulates most utilities in the state, a "toothless tiger" and suggested strengthening its powers.

For LIPA — which currently goes unsupervised by the PSC or any other state regulator — the commission recommended privatization. Gov. Cuomo echoed the Moreland Commission's advice two days later in his State of the State address, saying the authority "has never worked, it never will…we want to privatize the Long Island service."

A BRIEF EXPLANATION OF THE MAIN ELEMENTS OF A UTILITY

There are three parts to modern electric systems: generation (power plants), transmission (high voltage lines connecting power plants with local utilities), and distribution (local poles and wires connecting businesses and residences). In New York State, like many places in the United States, those three phases in electric production and distribution are frequently (but not always) owned by different entities (which can be public or private).

In electricity distribution — the segment of the market in which LIPA predominantly operates — roughly 70 percent of Americans are served by investor-owned utilities. 15 percent, meanwhile, are served by publicly owned and operated systems, frequently referred to as "public power" or "munis" because many are owned by an individual municipality, though they can encompass much larger areas as well (especially in the west). This sub-segment includes LIPA, the city of Los Angeles and Austin, Texas, as well as three villages on Long Island itself (Rockville Centre, Freeport, and Greenport).

The final segment of power distribution in the U.S. is provided by rural electric cooperatives, nonprofit member-owned and governed utilities set up primarily in the 1930s and 1940s and which serve rural and exurban areas that investor-owned utilities deemed uneconomical to provide with electricity.

These calls for privatization are curious — in part because of Long Island's miserable history with investor-owned electric utilities. The Long Island Lighting Company (LILCO), a private company, served the Island until 1998, when its poor performance, high rates, and deep indebtedness (partially due to its Shoreham nuclear plant debacle) culminated in the state's purchase, through LIPA, of LILCO's electric transmission and distribution infrastructure, as well as its sizable debt. (See box on the next page titled, "LILCO and LIPA.")

Moreover, though LIPA is publicly owned, it outsources virtually all of the operation of the electric grid — the line work, customer service, etc. — to National Grid. As an aide to Gov. Cuomo told the New York Daily News shortly after Sandy, "The facts are the utility is National Grid…They are contracted with LIPA." National Grid is a privately owned British utility.

In Massachusetts, where National Grid operates fully on its own as an electric utility, the company was recently fined $18.7 million by the state's Department of Public Utilities for "systematic failures" related to its slow restoration times in the wake of Hurricane Irene and an October snow storm in 2011.

Thus, the Moreland Commission's privatization recommendation is really better described as a *re-privatization* plan (viewed from the perspective of what had existed in LILCO days) or a *full-privatization* plan (viewed from the perspective of the largely private operation of National Grid today).

If that proposal itself is ironic given the history of electric power provision on Long Island, most startling is what the commission left out — what exactly a utility, whether private or public, should do. What are the values it should hold? How should it balance them? And what are the best ways to realize those values?

Such an omission, Matthew Cordaro, a former utility executive and current co-chair of Suffolk County's LIPA Oversight Committee (established by the county in 2010), told Remapping Debate, "doesn't surprise me…The Moreland Commission's job was to justify the governor's conclusions" that LIPA should be privatized.

The value(s) of electricity

"Utilities always say that 'our job is to provide affordable, reliable electricity,'" said John Farrell, a senior researcher with the Institute for Local Self-Reliance and director of its work on "democratic energy." They say this, Farrell added, because "that is pretty much what they have been told to do" by regulators and legislators.

Other energy watchdogs and industry representatives Remapping Debate spoke with concurred with Farrell: the basic values that electric utilities should be pursuing are affordability, reliability, and sustainability, though the latter, many agreed, only recently became important and has not been made an equal to the others.

In recent decades, "affordable" power has meant for most utilities a commitment to some "social equity" goals, notably providing power to low income households at a lower rate, said Sharon Beder, a professor in Australia and author of "Power Play," a book on global energy deregulation. Gerald Norlander, the executive director of a consumer utility watchdog in New York State called the Public Utility Law Project, said that low-income customers of many utilities in New York State are entitled to a cut on their base charge (a discount paid for by a slightly higher charge on other consumers).

LILCO and LIPA

Sandy was not the first time that Long Islanders have endured a hurricane, nor the first time that a storm has revealed the weakness in an electric utility on the island. In September 1985, Hurricane Gloria left 750,000 customers in the dark for up to 12 days, prompting another Governor Cuomo — Andrew's father, Mario — to tell reporters that the Long Island Lighting Company (LILCO), the utility providing service to Long Islanders at that time, "can't run anything."

Least of all, it seemed, a nuclear power station. Built by LILCO between the early 1970s and the early 1980s, the Shoreham nuclear plant was protested vigorously by many Long Islanders uneasy about the safety of operating a nuclear plant on an island with few easy evacuation routes. In 1989, the Long Island Power Authority, established by then-Gov. Cuomo and the legislature in 1986 to buy LILCO assets, assumed ownership of the Shoreham plant for $1 and began decommissioning the plant before it ever produced commercial power (it ran only briefly for testing).

In 1998, however, with continued high rates for customers (partially as a result of the debt incurred in building the Shoreham plant) LIPA finally bought all of LILCO's distribution and transmission facilities, as well as all of the $6 billion in Shoreham-related debt (which it could service at a much lower rate through tax-exempt municipal bonds).

Though publicly owned LIPA took over, LILCO never really ceased to provide electric service on Long Island for two reasons.

First, though LIPA bought most of LILCO's electric assets (and debts), its power-generation plants and all of its gas business were sold to Brooklyn Union Gas, another investor-owned utility that had already been servicing parts of Long Island with natural gas. Upon merging, it was renamed KeySpan Energy (the company briefly went by the name "MarketSpan" during the summer of 1998). In 2007, a British investor-owned utility, National Grid, purchased KeySpan. Through a long-term "power supply agreement" LIPA continues to buy electricity from these LILCO descendants.

Second, LIPA never managed its own day-to-day operations, instead contracting them out to KeySpan (and then National Grid) through a "management services agreement." As New York Public Interest Research Group lawyer Larry Shapiro told The New York Times in May 1998 as LIPA assumed ownership, "This is 'meet the new boss, it's the old boss' routine. The same cast of characters is running this, and what you have really had here is a complicated refinancing that, while changing the ownership, retains the old LILCO to supply power and operate the system."

In short: LILCO became KeySpan became National Grid, which still provides electric service on Long Island.

Reliability

The goal of affordability, however, needs to be balanced against what is required to provide reliable service: as few outages as possible. Beder told Remapping Debate, for example, that this requires "having enough reserve power…planning ahead so that there isn't a shortage of electricity available for the demand." Especially for distribution utilities, "The other aspect is ongoing maintenance of equipment, and both of those are influenced by ownership."

The lesson, Patrick Lavigne, a spokesperson for the National Rural Electric Cooperative Association, the trade association for electric cooperatives, said simply, is "affordable, *unreliable* power isn't worth anything."

Paul Pallas, the superintendent of the Electric Department of the municipally-owned power system of Rockville Centre (a village on Long Island) and the president of the New York Association of Public Power, told Remapping Debate that reliability requires repairing and replacing equipment, responding quickly to outages, and performing preventative maintenance, like tree-trimming on an "aggressive" schedule. Municipal utilities, Pallas said, are more likely to meet these reliability standards, he claimed, because they are "directly answerable to the communities they serve rather than shareholders…[and] can provide that service better than an investor-owned utility."

Sustainability

Ensuring reliability may not add to the bottom line, but as Tyson Slocum, director of the energy program at Public Citizen, a consumer advocacy organization, said, "I think most people don't mind paying more for something if they are getting more in return."

John Farrell said that he saw moving to cleaner energy sources as a "moral imperative," though currently, he suggested, there is a wide range in how seriously utilities take this value in their operations.

Beyond meeting sustainability goals through the centralized generation of clean power (large scale wind and solar installations), Farrell suggested "utilities are going to find themselves needing to readjust their way of thinking about providing their electricity service, that reliable and affordable are going to be increasingly clean but there is also going to be a kind of paradigm shift in the way they are used to delivering electricity that involves a lot more cooperation with their ratepayers" in the creation of a distributed generation network for renewable power (such as small residential rooftop solar panels and small wind turbines).

How then should LIPA meet these goals?

For Tyson Slocum at Public Citizen, achieving a balance between affordability, sustainability, and reliability requires wrestling with "the primary issue with any utility[:] governance. Is it run in a manner that is accountable ultimately to consumers?"

Slocum concluded that though "it is clear that LIPA has not been well run and it has not been well managed," privatization is "not an automatic solution" for establishing an accountable utility operation. The question is whether it failed "because it is publicly run or is it because public institutions have done a bad job ensuring that it is an accountable entity?"

The Moreland Commission's solution for LIPA — its full privatization and regulation by the PSC — pointed to one answer for such a transformation. It suggested that the "synergy benefits" of shared staff and equipment resulting from the sale of LIPA to an existing electric utility company constitute an efficiency gain that would "keep rates after a sale in line with currently projected rates." Additionally, removing LIPA and National Grid's dual management structures would help ensure that "plans are in place for storm response and other contingencies." Still, they acknowledged, "There would be several costs that would increase due to a privatization."

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According to Matthew Cordaro, however, privatization for the Moreland Commission amounts to more of a "declaration" than a well-argued position. "The benefits of privatization are not definitely supported [in the Commission's report]." Indeed, beyond the bare assertions that privatization would yield "synergies" and improved accountability, the Interim Report's five-paragraph privatization section focused on claiming that a complex "securitization" deal could allow LIPA's outstanding bonds to continue to be serviced efficiently while still making it attractive for potential private owners.

Also key to the Moreland Commission's plan for LIPA is a beefed up PSC, currently seen by the Commission as understaffed and without either the necessary oversight authority to ensure that utilities are prepared for storms or the ability to charge fines that could meaningfully affect utility behavior. (Right now, for example, fines for failing "to provide safe and adequate service" are capped at $100,000 per day and there is a high burden of proof to impose them. The Commission recommended increasing this cap and making it easier to impose these fines, so that a utility would pay based on a percentage of its revenues. For a LIPA-sized utility this would mean some $750,000 per day.)

"As long as [a] corporate utility has very effective and accountable regulators overseeing its operations," Tyson Slocum explained, "it can do a good job. But it comes down to whether there are regulators ensuring that."

In New York, Gerald Norlander said, “basically the PSC has wanted to work things out with the utilities. And the problem is that in some of their models for regulation, they depend on setting performance criteria and ‘dinging’ the utility when they don’t hit it, and all of that has been done by agreement” with the utility.

LIPA’S SPECIAL PROBLEMS

If the adequate regulation of private utilities generally is far from assured, the privatization of LIPA comes with some specific problems, as well. As the result of the Shoreham debt, LIPA’s assets ($3.5 billion) are worth only about half of its debts ($7 billion), making it potentially unattractive to a buyer.

Additionally, should it be privatized, it would likely face higher borrowing costs than with its current bond arrangement, requiring rate increases (a 2011 report commissioned by LIPA suggested that privatization could increase rates by 12 percent).

Gov. Cuomo has said that it would be possible to “do a sale and a rate freeze for a number of years” but observers such as Crain’s New York Business have responded skeptically: “The next time you hear officials saying [privatization] won’t result in any rate increases, remember that what they really mean is ‘not right away.’”

Finally, though the Moreland Commission acknowledged the “challenge” of privatizing LIPA in a way that “minimizes” increases in rates (see “LIPA’s special problem”), it never grappled with another central pressure on rates: the need for an investor-owned utility to turn a profit.

“With a corporate-run utility,” Tyson Slocum told Remapping Debate, “there is this constant schizophrenic relationship you have between your legal duties to customers and your financial duties to shareholders…In an ideal world, you would want to merge your shareholders and your customers and that is what municipal power and public power entities do.”

Sharon Beder provided an illustration of what she saw as a conflict of interests: what investor-owned utilities describe as gains in “efficiency” actually means for customers “less maintenance, less staff, [and] less replacing equipment before it breaks down.” She added, “The extra profits [often] made from that have not lowered rates but actually gone into the pockets of shareholders.”

Remapping Debate requested interviews with the co-chairs of the Moreland Commission, Benjamin Lawsky and Robert Abrams, but neither returned calls or replied to emailed questions, including, whether a privately owned utility’s need for profit had an impact on its ability to balance affordability, reliability, and sustainability.

What about a fully public LIPA?

The Moreland Commission interim report laid out just such an alternative for reforming LIPA, which would end the subcontractor relationship with National Grid and make LIPA a fully public entity, complete with a unified management structure and its own employees. (In a variation on this option, the Moreland Commission also suggested that LIPA could be made fully public but also placed under the supervision of the New York Power Authority, a state entity that generates electricity from hydroelectric and gas power plants.)

The report, though, ultimately rejected a fully public option — without an explanation as to why beyond stating that there has not been any recent experience in the United States with the one particular type of fully public utility that the Commission considered (one chartered at the state level).

Cordaro, for one, is unpersuaded: “The clarion benefits of public power,” he said, “are obvious,” and include lower borrowing costs due to tax-exempt financing, not having to pay dividends to investors, and “more local control.” In general, he added, the approximately 2,000 publically owned utilities throughout the country “will more earnestly pursue [their] mission and maintain [their] objectives.”

Abrams and Lawsky declined to respond to the emailed question as to whether they felt there were examples of successful fully public electric utilities in the United States and on Long Island.

The Moreland Commission said that, in contrast to privatization, keeping LIPA as a standalone operation would mean forgoing opportunities to achieve economies of scale (“synergies”) that would result from the purchase of LIPA by a utility that could “share staff, facilities, and systems” with it. But the advantages of economies of scale to “affordability” are uncertain. “There is no question that economies of scale of integrated utility systems exist,” Tyson Slocum said, “The question is, are those efficiencies maximized for consumers or shareholders?

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The American Public Power Association (APPA), the public power trade association, drawing on data from the U.S. government’s Energy Information Agency, has reported that public power agencies offer lower rates to residences (per kilowatt hour). On Long Island, residents in Rockville Centre, Freeport, and Greenport pay rates that are significantly lower than LIPAs, and Crain’s Business Observer has argued that if a privatization deal goes through it would certainly mean a rate increase for LIPA customers. (The lower rates for the village-owned utilities on Long Island stems in part from their ability to buy cheap power from NYPA and from not servicing the debt LIPA customers must service.)

Paul Pallas, of Rockville Centre, suggested that though “the costs per capita, per customer should go down in theory [with a larger utility],…you need a certain number of people to work on the lines, etc. you can’t spread them out too thin, you still need boots on the ground. I mean, an electric utility is not an Internet business, you’ve got to have somebody to work on the poles and wires.”

How reliable can public power be?

As to reliability, the record seems to suggest that public power is easily as good as investor-owned utilities. A comparison of outage data compiled by researchers at the Ernest Orlando Lawrence National Laboratory (which examined investor-owned utilities) and by the APPA suggest that public power has about half as many outages (such data, however, must be used cautiously, as record keeping and the types of systems operated by power companies can vary dramatically).

Furthermore, though the Moreland Commission did not suggest that LIPA could become fully public *and* also receive oversight from the PSC, according to Cordaro, "There is no reason why [LIPA] has to be privatized to regulate it. In fact, I would advocate that."

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In 2008, then-Governor David Paterson vetoed a bill that would have required LIPA to be subject to regulatory review by the PSC for rate increases, because, he argued, making LIPA subject to PSC rules would "impair and diminish" the value of agreements with bond holders. Gov. Cuomo, in February 2012, signed a bill that made LIPA subject to management audits every five years, but some legislators and critics suggested that the law did not go far enough in establishing oversight. In an emailed question to Larry Schwartz, the governor's secretary and key staffer assigned by the governor to "engage elected officials" to "form a consensus" on the "best option" for LIPA, Remapping Debate asked, "If an oversight entity, such as the Public Service Commission could be made effective in respect to a private utility operator, as Gov. Cuomo proposed in his State of the State address, why couldn't it be made effective with respect to a fully public electric utility?" Schwartz did not reply.

Rockville Centre, one of the three villages that owns and operates its own electric utility on Long Island, by contrast, *is* both regulated by the PSC and accountable to village board of trustees. According to Pallas, the Rockville Centre Electric Department superintendent, "my customers have a direct line to me and the village board and I think that is a big incentive" for providing reliable service. He told Remapping Debate, for example, that 60 percent of the village lost power. While very substantial, that was far less than the 90 percent of LIPA customers overall who lost power. And, Pallas said, the village was able to restore all its distribution lines after seven days — much quicker than many parts of the LIPA service area.

The Moreland Commission argued that fully public utilities would have difficulty creating compensation structures that would either reward "improvements in efficient operation and customer service" or attract top candidates for employment (although it did acknowledge that incentive compensation structures do exist in public utilities outside of New York).

Does this mean that publicly owned utilities will invariably have problems? Tyson Slocum thought not: "To argue that municipally-run systems will be inherently prone to not investing in the future is just a preposterous argument that flies in the face of real-world experiences with some municipal utilities in the United States." Though public power is not a guarantee of being the best system, he added, "[it] is like saying that, well, the cities of Los Angeles, Austin, Texas, Seattle, and Sacramento, they all should have frequent blackouts by now."

Farrell concurred: "The fact that municipal utilities can…be competitive with private companies even though most of them are tiny, certainly puts the lie to that idea that you need a big utility in order to get to those values of affordable and reliable, plus you have the benefit of being accountable when you are local."

A mixed record on sustainability

On sustainability, public power agencies have a mixed record, said Farrell, noting that there is a "long history" of rural cooperatives and municipally-owned electric utilities "looking to buy coal power at the cheapest possible price." At the same time, however, recent successful efforts at creating a public power entity in Boulder, Colorado, have been motivated by the desire of residents to receive more renewable power.

Sharon Beder, the author of "Power Play," argued that "if government is making the decision about sourcing energy or what sort of plant the next [one] will be…it can put sustainability in as part of its decision making process, and it can just do it." By contrast, she said investor-owned utilities tend to encourage renewable energy development through "market instruments," a process that she described as "very indirect" because it is not integral to the mission of the utility.

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Having your cake and eating it too

Since launching the Moreland Commission and declaring his support for privatization in his State of the State address, Gov. Cuomo has encountered some skepticism from Long Island politicians and residents who argue that privatization is likely to bring higher rates to the Island and may not resolve the service issues that residents have faced at the hands of LILCO and LIPA.

Matt Cordaro, the Suffolk County LIPA Oversight Committee co-chair, had a suggestion for the governor, though. Cuomo sees privatization “as the fastest way to cut the cord and get out,” Cordaro said, but “he should know that there is a better way of doing that.” Making LIPA fully public and run by Nassau and Suffolk counties “is feasible and possible and very easy to accomplish,” and it allows Gov. Cuomo to get the state out of the electricity distribution business.

“I claim he can have his cake and eat it too.”

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