

Regulating Public Utility Performance:
The Law of Market Structure, Pricing and Jurisdiction

Chapter Two

The Traditional Utility Monopoly

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performance from service providers, whether incumbent or new? We turn now to the ultimate form of performance accountability—the commission’s power to revoke a utility’s franchise and grant it to someone else.

2.A.3. Franchise revocation

“[I]n every grant of franchise is the implied condition that it may be lost by misuse.”⁴⁴ No exclusive franchise is permanent—even South Dakota’s grant of the right to serve “each and every future customer.” What a statute grants, it can take away.⁴⁵

But states do not revoke franchises frequently or lightly. Whether revocation is legal, practical, and wise depends on answers to these questions: Who has the power to revoke? What are the lawful reasons to revoke? What are the necessary procedures? Does the government owe compensation to the departing franchisee? Is there a new franchisee willing, ready, and able to serve, one that will perform better than its predecessor? As discussed next, the answers to the legal questions depend on the franchise’s terms, the statutes creating the regulatory apparatus, and principles of contract law, property law, and constitutional law.⁴⁶

2.A.3.a. Revocation authority

Granting and revoking a franchise is a legislative function.⁴⁷ Some legislatures have delegated both these powers to their commissions: “Implicit in the [commission’s] power to grant a franchise is the power to revoke it for breach of the franchise’s conditions.”⁴⁸ In contrast, Maryland distinguishes between revoking the franchise (which only the Legislature may do, because the Legislature granted the franchise), and revoking the utility’s *right to exercise* the franchise (which the Commission may do, because the Commission polices quality of service). As a Maryland appellate court explained: “Although the economic effect of an order revoking a utility’s right to exercise a franchise could, in some instances, be tantamount to revocation of the franchise itself, it is not necessarily so. The

44. *Redfield Tel. Co. v. Ark. Pub. Serv. Comm’n*, 621 S.W.2d 470, 471–72 (Ark. 1981) (citing *Pub. Serv. Comm’n v. Havemeyer*, 296 U.S. 506 (1936) (upholding Puerto Rico’s power to revoke a utility’s franchise)).

45. See *City of Worcester v. Worcester Consol. St. Ry. Co.*, 196 U.S. 539, 552 (1905) (holding that “the legislature had the right to modify or abrogate the conditions on which the locations in the streets and public ways had been granted, after such conditions had been originally imposed by it”); *Kan. Gas and Elec. Co. v. Pub. Serv. Comm’n of Kan.*, 261 P. 592, 594 (Kan. 1927) (emphasizing that the police power “can neither be abdicated nor bargained away, and is inalienable even by express grant; and that all contract and property rights are held subject to its fair exercise”).

46. For some of the research on this subsection, I am indebted to Tim Mastrogiacomo, a student in my 2011 class on public utility regulation at Georgetown University Law Center.

47. *Redfield Tel. Co.*, 621 S.W.2d at 501.

48. *Valley Rd. Sewerage Co.*, 712 A.2d 653, 659 (N.J. 1998) (quoting N.J. STAT. § 48:2-14 for the proposition that no franchise granted to a public utility by a political subdivision is valid until approved by the Board of Public Utilities); see also VT. STAT. tit. 30, § 231(a) (granting to the Board both powers to grant and revoke).

franchise remains as a valuable asset which, under certain conditions, may be sold and which, in other hands, may again be exercisable.”⁴⁹

2.A.3.b. Revocation justifications

An exclusive utility franchise can take different legal forms: a contract between utility and municipality, a state statute or local ordinance, a state commission order or a state statute. One or more of those documents will determine, implicitly or explicitly, the permissible bases for revocation.

If the franchise is “revocable-at-will,” the government grantor can revoke it for any reason or no reason.⁵⁰ Revocable-at-will does not mean revocable-without-due-process, however. If the revoking entity is a state administrative agency, it must follow state administrative procedure law: the agency must act on a public record, give affected parties an opportunity to be heard, base decisions on substantial evidence and not act arbitrarily or capriciously. If the revoking entity is the legislature, these administrative law requirements do not apply.

If a franchise is not revocable-at-will, the revoking agency must have reasons to revoke—namely, violations of franchise conditions, including obeying all regulatory rules. Connecticut statutes authorize the commission to revoke the franchise right if the utility fails to “provide service which is adequate to serve the public convenience and necessity” or if its rates “are so excessive in comparison to the rates charged by other public service companies providing the same or similar service as to inhibit the economic development of the area . . . or impose an unreasonable cost on the costumers.”⁵¹ Utilities have lost their franchise rights when they—

- had an “‘abysmal’ history of violating legal and environmental requirements” and “a history of making and breaking promises to regulatory agencies”;⁵²
- continued violating the franchise grant’s prohibition against providing electricity for lighting;⁵³
- failed to resolve problems of water quality and inadequate infrastructure, and lacked sufficient financing to correct the problems;⁵⁴

49. See *Highfield Water Co. v. Pub. Serv. Comm’n*, 416 A.2d 1357, 1365 (Md. Ct. Spec. App. 1980) (upholding the Commission’s authority to revoke the right to exercise the franchise), *cert. denied*, 421 A.2d 957 (Md. 1980).

50. See *S. Bell Tel. & Tel. Co. v. City of Richmond*, 98 F. 671, 673 (Va. Cir. Ct. 1899) (“[T]he power of repeal [of the grant] does not depend on either the necessity for it, or on the soundness of the reasons assigned for it.”).

51. CONN. GEN. STAT. § 16-10a.

52. *Valley Rd. Sewerage Co.*, 712 A.2d at 660 (upholding Board’s decision).

53. *Old Colony Trust Co. v. City of Tacoma*, 230 F. 389, 394 (9th Cir. 1916) (upholding revocation decision).

54. *Highfield Water Co.*, 416 A.2d at 136–66 (rejecting utility’s statutory argument that “once the PSC authorizes the exercise of a franchise it loses all control over that exercise”; the effect of such loss of

- failed to resolve numerous customer-service complaints; the failure “could not be attributed to lack of operating funds but rather to the philosophy and ability of the present management and, therefore, customer difficulties with service would persist as long as the present management was associated with the Company;”⁵⁵ and
- “operated with a disregard for good business practices and its statutory obligations as a public utility. . . .”⁵⁶

Not all poor performance leads to franchise revocation. In a multi-year investigation, the Vermont Public Service Board found that executives of Citizens Utility Company had persistently mismanaged the company, violated laws, and disobeyed Board directives. Management was “seriously flawed,” accounting practices were “seriously deficient,” and rates were excessive. Although the Board believed the situation justified franchise revocation, it decided that a forced sale would cause uncertainty and transaction costs as a new company corrected Citizens’ mistakes. The Board instead imposed \$60,000 in fines, ordered a refund, and halved the authorized return on equity, finding that investors should earn no more than ratepayers earn on their passbook accounts. The Board also placed Citizens on “‘a multi-year period of strict regulatory probation,’ during which the Company will be required to reform its accounting procedures, managerial structure, and processes for regulatory compliance.”⁵⁷

What if the poor performance stems from insufficient finances? In Montana, the utility got no break:

No utility should be heard to argue . . . that it cannot and/or will not make the necessary improvements because it does not have the financial resources. If the current management and/or owners . . . are unable or unwilling to discharge their obligations in the operation of the public utility then they should arrange for some other entity to conduct those services.⁵⁸

authority “would be to remove [the PSC’s] ultimate ability to enforce its orders and thus to emasculate its ability to regulate, to perform its legislative duties”), *cert. denied*, 288 Md. 736 (Md. 1980).

55. *Redfield Tel. Co.*, 621 S.W.2d at 471–72 (upholding Commission’s finding that public necessity required revocation of the certificate to serve, or transfer of the plant and certificate to an “able third party”).
56. *Lone Mountain Springs Water Co.*, Utility Div. Dkt. No. 92.9.55, Order No. 5660f, 1994 Mont. PUC LEXIS 4, at ¶ 73 (Mont. Pub. Util. Comm’n Aug. 22, 1994) (warning that if the utility “continues to operate as it has historically, ignoring public utility obligations and good business practices,” the Commission will order it put up for sale).
57. *See Investigation of Citizens Util. Co.*, Docket Nos. 5841/5849, 2004 Vt. PUC LEXIS 63, at *1 (Vt. Pub. Util. Comm’n Apr. 7, 2004). Citizens Utilities Co. later changed its name to Citizens Communications Co. The Board eventually approved the transfer of most of Citizens’ distribution assets to the Vermont Electric Cooperative, and its transmission and generation assets to others. *Id.*
58. *La Casa Grande Water Co.*, Utility Div. Dkt. No. 91.2.3, Order No. 5610d, 1994 Mont. PUC LEXIS 2, at *13 (Mont. Pub. Util. Comm’n Aug. 22, 1994) (quoting previous order).