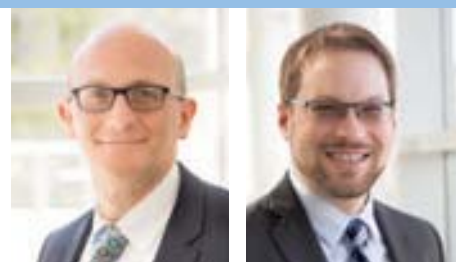


# Municipal Utility Governance: Options and Responsibilities

Attorneys Richard Heinemann and Jared Walker Smith,  
Boardman & Clark, LLP



It is generally understood that a municipality operates its water, electric, and sewer utilities as a public service to community residents, businesses, and industries. But in an era where drinking water concerns, aging infrastructure, and clean energy priorities increasingly capture the public's attention, achieving the full benefits of municipal utility ownership seems more important than ever before. With that end in mind, this article will first describe what municipal public utilities do and the regulatory landscape within which they operate, and then lay out the various governing structures available for running them.

## The Utility Industry and the Role of Regulation

A public utility is classically defined as a business charged with the public interest. In the United States, the principle of utility regulation – the so-called “regulatory compact” – centers on the idea that the public utility is granted the right to serve customers exclusively in its defined territory and earn a fair and reasonable return on its assets in exchange for the obligation to serve all its customers in its territory in a non-discriminatory manner and allow regulators access to the utility's books and records for the purpose of establishing just and reasonable rates.<sup>1</sup> Public utilities may be municipally or investor-owned.

In contrast to investor-owned utilities, municipally owned utilities do not earn their fair and reasonable return for the benefit of shareholders. Instead, municipal utility profits stay in the community, allowing utility assets to

directly meet the needs of local residents and businesses. In Wisconsin, there are approximately 575 municipally-owned water utilities, 81 electric utilities, 1 gas utility, and 600 wastewater utilities.

All public utilities in Wisconsin, except wastewater utilities, are regulated by the Public Service Commission (PSC). In most other states, municipal utilities are regulated by the local unit of government itself, and not by a state commission. The PSC regulates most aspects of water, electric, and gas utility operations. This includes authorizing major construction projects; establishing retail rates with an authorized rate base and reasonable rate of return; enforcing customer service, customer protection and safety rules to ensure reasonable and adequate service; and imposing specialized reporting and accounting systems.<sup>2</sup>

Unlike municipally owned water, electric, and gas utilities, municipal stormwater and wastewater systems are not defined as “public utilities,” which are subject to full PSC regulation.<sup>3</sup> Consequently, municipalities may determine and set rates, rules, and practices governing use of their municipal sewerage systems. The PSC retains limited authority to hear complaints about such rates, rules or practices, and, when warranted, may set them, or provide other relief. While different statutes provide for the formation and operation of municipal sewerage systems, municipalities may still establish a governance system similar to their public utilities.

PSC regulation is a double-edged sword. On the one hand, regulation ensures

greater scrutiny of rates, construction costs and service obligations, which, in theory, is good for customers. It also affords utilities some cover for imposing necessary rate increases required to maintain system reliability and service quality. On the other hand, PSC hearings can be time-consuming, costly, and complicated, requiring expertise and sometimes outside assistance. This is especially true when dealing with complex policy issues where achieving equitable outcomes is not always straightforward.

Wisconsin's municipal water systems, for example, face estimated costs of \$8.5 billion over the next 15 years to meet existing drinking water priorities, such as the replacement of aging infrastructure and the elimination of lead service lines.<sup>4</sup> To actively address these costs through rate setting, utilities must involve the PSC. The PSC recently approved substantial rate increases for the cities of Janesville and Marshfield to finance ongoing replacement of their aging mains.<sup>5</sup> Other communities are implementing new PSC-approved and utility-financed programs to assist residents with the replacement of their lead laterals.<sup>6</sup>

The bottom line is that PSC regulatory oversight means that local governments do not have complete control of their water, electric, and to some extent, sewer and stormwater utilities. This is true regardless of how the municipal utilities are managed and governed.

## Municipal Governance Options

The broadest authority for the management and governance of municipal utility operations derives from statutory home rule.<sup>7</sup> This is an extremely broad grant of authority with respect to the management and control of “the public service” through regulation, license, tax levy, appropriation, and “other necessary or convenient means.” Although this language, as well as Wisconsin case law,<sup>8</sup> would appear to confer free reign to local governments for organizing and managing their utilities, Wis. Stat. § 66.0805 in the municipal utility subchapter specifies the most common governance alternatives: management by a local utility commission and (for cities of the 2nd, 3rd, or 4th class, villages or towns) management through the board of public works or other officers.<sup>9</sup>

## Utility Commissions

Under a utility commission form of governance, a municipality creates a non-partisan utility commission to be responsible for the management and control of utility operations while remaining under the general control and supervision of the governing body. The utility commission may have 3, 5, or 7 commissioners, and is intended to function as a semi-autonomous public body with authority, among other things, to appoint and establish the compensation of a manager, enlist the services of municipal engineers, contract for utility services in its own name, retain its own attorneys, and supervise construction of its own facilities, rather than through the board of public works. Utility commissions, however, cannot tax or borrow; nor do they otherwise constitute a separate legal entity apart from the municipality that created it. Although members of the governing body can be on the commission, they must be in the minority.

According to Wis. Stat. § 66.0805(1), a city exercises its control and supervision by enacting ordinances. But it is not always clear what distinguishes a semi-independent utility commission from other city departments. As a practical matter, it’s a good idea to align city and commission policies and practices when it comes to human resources matters, contracting, bidding, and purchasing. So while a commission may determine what piece of equipment should be purchased, for example, the actual purchase can be made in accordance with the city’s general purchasing policies.

While in practice the lines of authority as between a utility commission and the governing body may sometimes appear blurry, the courts have made it clear that once a utility commission is created, a governing body cannot undo the independence of the commission by, for example, establishing a sub-committee of the council to set wages or usurp other commission responsibilities.<sup>10</sup>

Because utility commissions are designed to be non-partisan in nature, they can be run more like a business. Moreover, the best run commissions benefit from expertise and continuity, which are at a premium in a business that by its very nature is complex and ever-changing. However, it goes without saying that a commission cannot be oblivious to the politics of the municipality – the governing body always retains the right to eliminate the commission it has created.

## Board of Public Works

A board of public works operates in some ways like a utility commission – it is comprised of commissioners, it has certain powers and duties delegated by statute, and its general duty is “to superintend all public works and keep the streets, alleys, sewers and public works and places in repair” under the direction

of the city council. Unlike a utility commission, a Board of Public Works is unique to cities, created pursuant to Wis. Stat. § 62.14.<sup>11</sup> In all cities but cities of the 2nd class, the board of public works commissioners are the city attorney, city comptroller, and city engineer. In 2nd class cities, the commissioners are appointed by the mayor and confirmed by the council. In any city, by a two-thirds vote, the council may determine the board of public works to consist of other officers or persons. A city may also eliminate the board of public works and assign its duties to the council, another committee, or an officer or officers.

While there remains some insulation from the city council and partisan politics, ultimately the board of public works lacks a utility commission’s quasi-independent stature and is subject to greater city council control. For example, a board of public works typically does not have the authority to contract separately from the city or retain its own legal counsel. Nevertheless, because of the flexibility in how a city may select board of public works commissioners, when those selections are made wisely, boards of public works can also benefit from expertise and continuity.

## Other Options

Municipalities have a range of other governance options contemplated by both Wis. Stat. §§ 66.0805 and 62.14. Municipal utilities may be run by a committee of the governing body or a new utility board or other commission not expressly given the powers of a Wis. Stat. § 66.0805 commission.<sup>12</sup> Both a committee and utility board function similarly and have similar considerations to a board of public works. However, since a committee or utility board are non-statutory, the governing body has greater reign to determine how they will function and retains discretion in what powers and duties it assigns to the

committee or utility board. Additionally, the governing body may determine the composition of the committee or utility board members, which may include members of the governing body<sup>13</sup> and local residents. Consequently, a committee or utility board may still allow for building some of the expertise of a utility commission, while retaining more control by the governing body. However, a committee or utility board is less insulated from partisan politics, which means it may not always be inclined to prioritize long-term planning.

If opting for a non-statutory form of utility governance, municipalities should take care to craft the authorizing ordinance and committee or board structure appropriately in order to avoid confusion over scope of authority, encourage retention of expertise, and discourage breakdowns in trust or communication.

A governing body could also decide to exercise direct control over the operation of its municipal utilities. This would maximize control, but it's not clear that the results would be optimal since governing body members are typically generalists without the special expertise typically required to manage complex

utility operations. Moreover, since governing body members are subject to election and must devote substantial time to the operation of every other aspect of the municipality, direct management of a utility by the governing body is rarely the best option.

### Conclusion

Regardless of the governance structure, there are a few principles for governing bodies to keep in mind. While municipal officials must always act for the common good of the municipality, when it comes to municipal utilities, it is especially important to act in essence as a trustee of utility property to ensure that long-term investments made by previous governing bodies are protected for the benefit of the public. If municipal utility decisions are delegated, the governing body should respect the expertise of its advisors, particularly with respect to the details of utility operations, while keeping an eye on the long term.

Governing officials should also have a basic understanding of utility rules of operation, rate setting, and environmental protection. Whenever possible, they should avail themselves of opportunities offered by trade groups and associations such as the Municipal Electric Utilities

of Wisconsin, American Public Power Association, Municipal Environmental Group-Water Division, American Water Works Association, Wisconsin Rural Water Association, and other groups to learn about new technology and policy developments.

With several options available, municipalities should carefully consider which governance structure is likely to yield the best results for their communities.

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#### About the Authors:

Jared Walker Smith is an attorney at Boardman & Clark LLP, where his practice focuses on general municipal, water utility, and real estate law. He is a graduate of St. Olaf College and the UW Law School. Contact Jared at [jsmith@boardmanclark.com](mailto:jsmith@boardmanclark.com)

Richard A. Heinemann is an attorney at Boardman & Clark LLP. He advises a wide range of municipalities and local governments in Wisconsin on all areas of municipal law, with a focus on energy issues. Contact Richard at [rheinemann@boardmanclark.com](mailto:rheinemann@boardmanclark.com)

1. *Munn v. People of State of Illinois*, 94 U.S. 113 (1876).

2. The PSC also has the authority to exercise oversight over all municipalities, not just municipal utilities, when it comes to the regulation of public utility use of municipal rights of way under Wis. Stat. § 196.58(4) and (5).

3. Combined water and wastewater utilities are, however, fully regulated by the PSC.

4. See Wisconsin's Public Water Systems 2018 Annual Drinking Water Report, PUB-DG-045 2019 (July 2019).

5. See Final Decisions in PSC dockets 2740-WR-110 and 3420-WR-106.

6. For example, the City of Kenosha implemented the first PSC-approved lead service line replacement program under Wis. Stat. § 196.372. See PSC docket 2820-LS-100.

7. Wis. Stat. §§ 61.34(1) and 62.11(5).

8. *Hack v. City of Mineral Point*, 203 Wis. 215, 219, 233 N.W. 82 (1930) ("[A] city operating under the general chapter finding no limitations in express language has under the provisions of this chapter all the powers that the Legislature could by any possibility confer upon it:").

9. It is worth noting that funds generated through utility operations are considered enterprise funds. Governing body access to such funds is therefore restricted by state law (Wis. Stat. § 66.0811), PSC rules and in some instances, by revenue bond covenants.

10. See *Schroeder v. City of Clintonville*, 90 Wis. 2d 457, 280 N.W.2d 166 (1979).

11. In villages, the village board functions as the board of public works for purposes of letting contracts under Wis. Stat. § 61.54.

12. The City of Madison provides one example of non-66.0805 utility board governance. City of Madison Code of Ordinances Section 13.01.

13. When designating members of the governing body to a committee or utility board or commission, municipalities must consider the provisions of Wis. Stat. § 66.0501, which restricts the ability of elected officials to serve on boards over which they have the authority of selecting members.

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