

The **NEW RULES**

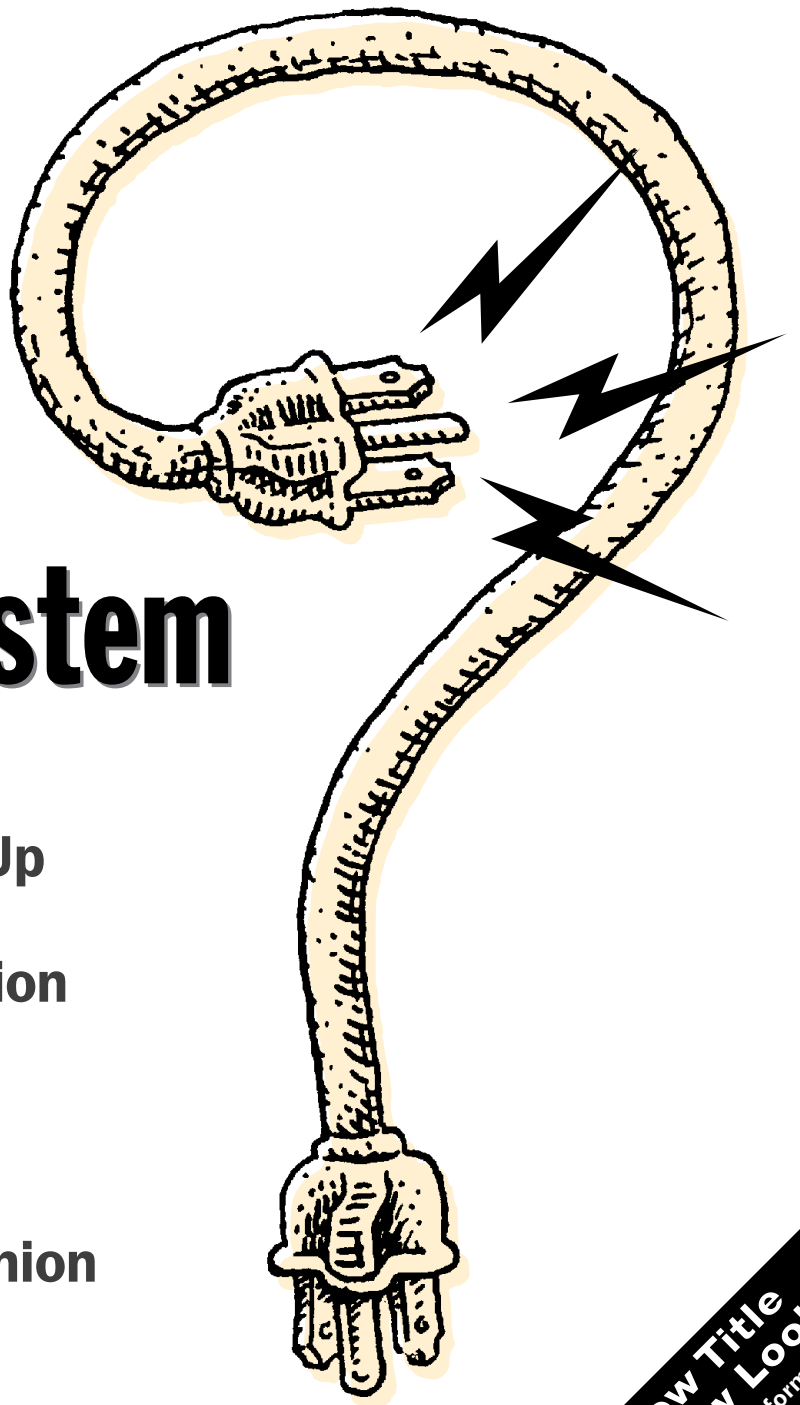
EXPLORING COMMUNITY, MOBILITY, SCALE AND TRADE • WINTER 1999

Who Will Control Our Electricity System

How ATMs Stick Us Up

Fighting Noise Pollution

**Franchises Marry
Local to Large-scale,
But It's a Troubled Union**



**New Title
& New Look**
The journal formerly
known as
GUNDWORT

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COVER ILLUSTRATION

Ken Avidor



Designing rules as if community matters



Welcome to *The New Rules*, journal of The New Rules Project

A NEW NAME. A NEW LOOK. WHY? Because we're talking about rules here and people have told us we might as well 'fess up to it up front.

This is a tough historical moment to talk about rules. For most Americans, rules are the problem. We agree—and disagree. Human societies always have and always will establish rules to govern their inhabitants' conduct. The question is not whether we will have rules—we will—but how they should be designed, and to what end, and by whom.

As to ends, let's be perfectly clear. The New Rules Project seeks to identify rules that enable strong communities. Place matters. Wherever possible, politics and economics should be coterminous.

Currently, public policy and public law move us in the opposite direction. I was reminded of this again by an exchange at a recent Minnesota conference on the farm crisis. One panelist argued that policy makers should nurture a diversified rural economy with many small- and medium-sized producers. The attorney from the antitrust division of the U.S. Justice Department responded, "Those concerns are not relevant" to the application of existing federal law.

For the federal government, size per se doesn't matter. Nor does place. Indeed, back in the 1980s Ronald Reagan's antitrust chief reportedly insisted that, in theory, nothing in antitrust law would prevent one company from producing everything. We prefer former Supreme Court Justice Louis D. Brandeis's dictum, "The statement that size is not a crime is entirely correct...from the point of motive. But size may become such a danger in its results to the community that the community may have to set limits."

If place mattered, the burden of proof would be on those who would preempt local authority and foster concentrated economic power. Why, for example, as Les Blomberg argues in this issue, shouldn't communities be allowed to get a good night's sleep by banning nonemergency nighttime plane flights? Why, as I asked in an article in the first issue of this journal, shouldn't communities have the right to impose the same sales taxes on distant businesses that they do on local businesses?

For some, the idea of place is an antiquated and romantic conceit relegated to the dustbins of history by new

community pharmacies, and more than 30,000 second-generation family-owned businesses. These are impressive statistics by any measure. They reveal that in the battle for the hearts and minds of America community-based enterprises retain considerable clout.

There are economies of scale to production and distribution, to be sure. But the traditional axiom that larger production systems make cheaper products than smaller ones has been undermined by technological advances. And where economies of scale do exist, they may well be captured by cooperation rather than consolidation. Independent hardware stores, for example, appear to be weathering the onslaught of the Home Depots better than most of their locally owned retail brethren because of the buying, marketing, and service cooperatives they have created.

The New Rules is similar to its predecessor, *Groundwork*. We are still feeling our way in the search for the best vehicle for creating a national conversation about designing rules as if community matters. As part of that search, we have created a companion vehicle to this journal: The New Rules website at www.newrules.org. Philosophy becomes concrete when you see it translated into law. The New Rules website contains a repository of actual rules—laws, regulations, codes, statutes, court decisions—that policy makers and others can download at their convenience. Any rules mentioned in this journal can be found on the website.

For those of you who subscribed to the first issue of *Groundwork*, thank you for your patience. For those of you who are new to this journal, welcome aboard. You'll find a subscription form on the back cover of this issue. We invite your comments, observations and ideas.

—David Morris

The New Rules Project seeks to
identify rules that enable strong
communities. Place matters.
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economics should be coterminous.

information technologies and the rise of the global economy. Yet while down, the independent and rooted sector is by no means out. In preparation for a conference ILSR held last November in which the CEOs of place-based enterprises from two dozen sectors discussed how they could work together to insure their future, we discovered that almost 40 percent of all electricity customers in Minnesota own their own electric company. More than 400 community banks or credit unions hold more than 25 percent of all bank assets in the state. Minnesota is home to more than 20,000 independent farmers, more than 500 independent

Protecting the Family Farm: South Dakota Ends Corporate Agriculture

Until recently, Nebraska had the only tough anti-corporate farming law on the books. Now the voters of South Dakota have added their voice, passing, by 59 percent, Amendment E. The new law states that corporations cannot own or control farm land or engage in agriculture, including the practice of companies paying farmers to raise crops or livestock on their behalf.

The only major exceptions to the law allow family farm corporations (formed by people who are related to each other) and some types of cooperatives. Nebraska's law—enacted in 1982—exempts family farm corporations, but the family members must live on the farm or be involved in its day-to-day activities.

South Dakota voters were motivated by a number of factors, including environmental liability: they didn't like the governor putting \$750,000 in taxpayer dollars into an environmental clean-up fund rather than taxing companies directly. Many voters also thought their long-cherished independent nature was being challenged when Murphy Family Farms, the country's largest hog producer based in North Carolina, began paying some South Dakota farmers to contract feed hogs owned by the company.

Those opposed to the amendment argued that the measure would harm farmers by restricting their business arrangements and drying up valuable sources of capital. But that has not happened in Nebraska. Since 1982, according to the Center for Rural Affairs, that state has gained market share in cattle and hogs, as well as in processing and slaughter capacity.

Although South Dakota's Amendment E passed with the backing of two-thirds of farmers and significant support from urban centers, a legal challenge is all but certain. Supporters can be heartened by the unanimous decision in March 1998 by Nebraska's highest court that not only upheld

that state's prohibition against corporate farming but also ruled that citizens could sue to enforce prohibition if the state does not.

Food Fight: When in Rome—or Anywhere—Take Time to Savor Tradition

Thirteen years ago to protest the opening of a McDonald's in Rome, food writer Carlo Petrini formed Slow Food, an organization whose mission, according to the *Washington Post*, is to celebrate "products that rely on time to ferment and develop, that grow from tradition, and are firmly anchored in a particular locale."

Today, Slow Food, whose logo-mark is a snail, is busy fending off the homogenizing effects of European Union regulations on regional foods. Petrini rails against hyperhygienic legislation such as the insistence of pasteurizing milk for aged cheese, even calling for a movement to defend microbes. "Without them," he says, "we can get no great goat cheese or salami."

Slow Food has a membership of about 40,000 in 405 local chapters called Convivia, mostly in Europe. There are also chapters in New York; Durham, North Carolina; St. Louis, Missouri; Seattle, Washington; and San Francisco and Sonoma, California. For more information, check Slow Food's website at www.slow-food.com.

Homegrown Economies: Canada's Labor Funds Go Local

In 1983 Quebec established the Solidarity Fund of Workers (Le Fonds de Solidarité des Travailleurs), a unique type of venture capital firm controlled by organized labor. The success of that fund led the Canadian government to offer handsome tax incentives to Canadians who invested in other labor funds (see "Owning Your Own Economy" by Sherman Kreiner in our journal *Groundwork*

—published last year—for a fuller discussion of Canadian labor funds). Today there are labor funds in every province. They account for more than half of that nation's venture capital market and well over half of all new venture investment and investment in companies of \$1 million or less.

In the mid-1990s the Solidarity Fund, in association with the Quebec Union of Regional County Municipalities and individual municipalities, established decentralized and autonomous local and regional pools, known as SOLIDEs. By the end of 1997, Quebec, with a population of 7.3 million, had more than 70 SOLIDEs in 16 Quebec regions.

Le Fonds de Solidarité des Travailleurs, 8717 rue Berri, Montréal, QC H2M 2T9; telephone 514-383-3663.

We May Not Like 'Em, But They're Ours: How the Census Counts Criminals

Some 1.8 million Americans are behind bars, the highest incarceration rate in human history for nonpolitical offenses. This rising tide of inmates has forced states to make prison construction and operation an ever larger proportion of their budgets, and to save money some states have begun housing their lawbreakers in other states. The U.S. Census Bureau has ruled that prisoners housed in other states will be counted as residents of those states in the same way that military personnel are counted as residents of the state in which their bases are located.

Wisconsin Governor Tommy G. Thompson is seeking to overturn that rule. According to the *Milwaukee Journal Sentinel*, Wisconsin has nearly 2,600 inmates in out-of-state prisons, more than any other state in the nation. And corrections officials will seek budget authority next year to increase the number to 8,000. If these out-of-state prisoners are treated as nonresidents, Wisconsin may well lose a congressional seat after the 2000 census. [!]

The National Bank Robbery

Within five years, industry analysts predict, just five networks will control 90 percent of ATM transactions. Fees to use these machines will go up, while community-based financial institutions will decline. Some states are fighting back—but can they win?

By Stacy Mitchell

MANY CONSUMERS NOW DEAL WITH THEIR bank or credit union almost exclusively through automated teller machines (ATMs). The old adage “location, location, location” may still hold true, but the relevant question for consumers is not only where, but how many. A financial institution’s ability to provide its customers extensive ATM access at little or no cost has become essential to attracting deposits and remaining viable.

Electronic banking poses significant challenges for small banks and credit unions. Unable to operate more than a few ATMs on their own, these community-based institutions depend on affiliation with one or more regional or national ATM networks, which allow their customers account access at every machine in the system.

When these networks first formed in the 1970s and 1980s, most were established as not-for-profit enterprises with governance shared among a large number of participating financial institutions. This structure is rapidly eroding. Most ATM networks have converted to for-profit status, and network ownership and control is no longer shared but increasingly concentrated among a limited number of large banks.

Stacy Mitchell is a researcher with The New Rules Project of the Institute for Local Self-Reliance.



Along with the rest of the banking industry, ATM networks have undergone massive consolidation, declining in number over the last twelve years from more than 150 to just 40. Nationally, the top ten networks now account for 79 percent of switched transactions. Consolidation is expected to continue with many industry observers predicting that just five networks will control 90 percent of switched transaction volume within five years. ➔

Many regions are now dominated by a monopoly network. The giant MAC network, for instance, which is owned by five of the nation's largest banks, processes about 90 percent of Pennsylvania's transactions and has a commanding share in surrounding states.

Moreover, the majority of the ATMs themselves now belong to just a few corporations. Ten companies own more than one-third of the ATMs in the U.S. and Canada. Regional and local concentration is even more extreme. Sixty-five percent of the ATMs in Massachusetts and more than 80 percent within Boston are owned by just two banks.

What does this mean for small, locally owned banks and credit unions? Large banks' increasingly tight grip on the channels of electronic commerce bodes ill for small banks and credit unions. In order to avoid antitrust scrutiny, ATM networks usually allow any financial institution to join. But, while a small bank may join an ATM network, because most networks are no longer cooperative in structure, this membership does not include any decision-making authority within the network. The big banks that own both the networks and the bulk of the ATMs have the power to determine how much access to this infrastructure will cost and are using this power to place their smaller rivals at a competitive disadvantage.

There are several fees involved in an ATM transaction. Two of these—the "interchange" and "switch" fees—cover the cost of the machines and the network. The owner of an ATM collects an interchange fee every time the machine is used by a customer of another bank in the network. This fee is paid by the customer's bank. Interchange fees are set by the networks and generally range from 30 cents to 60 cents for withdrawals. The customer's bank will also pay the network itself a switch fee of about 2 cents to 10 cents to cover the cost of routing and switching the transaction.

Many small financial institutions absorb these costs. Others pass them on to their customers—usually with a little profit thrown in—by charging a fee each time a customer uses an ATM owned by another bank. This fee appears on the customer's bank statement and averages \$1.18.

On top of interchange fees, many ATM owners now require noncustomers to pay a fee, or surcharge, for each ATM use. Surcharging began about two years ago, and 83 percent of all big banks now surcharge other banks' customers an average of \$1.35 per transaction.

Banks that own a sizable share of the nation's ATMs usually generate more interchange revenue than they pay out, meaning that they handle transactions for other banks' customers more frequently than their own customers use other banks' ATMs. Additionally, 29 percent of ATMs are owned by nonbanks. Because they have no depositors and issue no cards, these ATM owners only generate revenue from interchange. Both

groups have an incentive to use their control of ATM networks to raise interchange fees, thereby increasing costs for small banks and credit unions, which typically pay interchange fees more often than they receive them. In fact, while the cost of ATM technology has steadily declined over the last 20 years, interchange fees have only risen.

Local financial institutions are also at a disadvantage when it comes to routing ATM transactions. Most banks belong to more than one network. For instance, a bank's ATMs might be linked to both the regional MAC network and Visa's national Plus network. These networks in turn are linked to other networks, meaning that there are multiple channels through which any given transaction might

travel en route to the cardholder's bank. The transaction might even be handled, or switched, by more than one network. Most networks allow ATM owners to control how transactions are routed. They have an incentive to opt for the network with the highest interchange fee. The cardholder's bank, which pays the interchange fee as well as the switch fees charged by the networks, has no control and cannot choose the least-cost option.

Surcharges further distort the free market and have become a serious threat to small banks and credit unions. As David Balto of the Federal Trade Commission has noted, surcharges "present a perverse form of price competition where firms can actually

Resources

Iowa's electronic funds transfer law—Iowa Code Chapter 527—can be found beginning at
www.state.ia.us/government/com/bank/Docs/rulereg.htm.

Connecticut's electronic funds transfer law can be found at
www.cslnet.ctstateu.edu/statutes/title36a/t36a-p5.htm. *The law is part of a larger bank law. The relevant part is*
Part IV: Automated Teller Machines, Satellite Devices and Point of Sale Terminals, which includes
Sec. 36a-155 through
Sec. 36a-159.

By imposing surcharges on customers of other financial institutions, banks that dominate ATM markets are either able to generate income—consumers paid an estimated \$2.5 billion to \$3 billion in surcharges last year—or, better yet, induce customers of smaller competitors to move their accounts to the dominant bank in order to avoid the fees.

gain customers by raising prices (and the costs of their rivals)." By imposing surcharges on customers of other financial institutions, banks that dominate ATM markets are either able to generate income—consumers paid an estimated \$2.5 billion to \$3 billion in surcharges last year—or, better yet, induce customers of smaller competitors to move their accounts to the dominant bank in order to avoid the fees.

ATM owners insist that surcharges are needed to pay their operating expenses, but interchange fees easily cover these costs. According to the Office of Thrift Supervision, the federal regulatory agency that oversees the nation's thrift institutions, the average ATM transaction costs 27 cents (compared to \$2.93 for transactions processed by human tellers).

Not only are consumers being gouged by surcharges, but the market for banking services is becoming increasingly less competitive and more expensive. Several studies by the Federal Reserve Board and consumer groups have found that large banks charge substantially higher account fees and offer lower interest rates on deposits than small banks. Rather than compete on rates and fees, big banks are using their control of electronic commerce to eliminate their smaller, lower-cost rivals.

In the last two years, legislation to ban surcharges has been introduced in Congress, 26 states and at least two cities, but large banks have succeeded in stifling these efforts. Only two states currently prohibit surcharges. Both are facing lawsuits.

In Connecticut, Banking Commissioner John Burke issued an order barring surcharges in 1995, arguing that the state's electronic funds transfer (EFT) law implicitly prohibited these fees. Fleet Bank and First Union, which collectively own 30 percent of the state's ATMs, have challenged the surcharge ban in both state and federal court, arguing that the banking commissioner's interpretation of state law is incorrect and that the ban violates their civil rights. Connecticut Attorney General Richard Blumenthal has vowed to "fight this till the last dog dies or the last banker barks."

The other state with no surcharges—Iowa—has been sued in federal court by Bank One, the nation's second largest ATM deployer with more than 8,200 machines. While the suit touches on Iowa's surcharge ban, much more is at stake.

When ATMs first appeared in the 1970s, Iowa had the forethought to establish a set of rules to ensure that the infrastructure of electronic banking would be equitably shared among the state's financial institutions.

Iowa followed the precedent set by policies governing other essential commercial networks, such as telephone wires or railroads. Defined as common carriers, these networks are required to be made available to all users at equal rates. For instance, a

company that owns telephone wires must allow its competitors access to those wires and may not charge more for that access than it charges other users, including its own subsidiaries and affiliates.

To this end, Iowa's EFT law defines ATMs as "essential facilities in the channels of commerce" and requires that they be "available for use on a nondiscriminatory basis by any other financial institution which engages in electronic transactions"

in the state. This nondiscriminatory language is the basis of the banking superintendent's 1992 opinion declaring surcharges illegal. It also means that customers of Iowa banks and credit unions can access their account at any of the state's ATMs.

Other states have mandated universal access, but what makes Iowa's system unique are the state's provisions concerning the routing of electronic transactions. All ATMs are required to be connected to a central routing unit approved by the state. Transactions originating in the state drawn on an Iowa financial institution must be routed directly through this central switch.

The state's certified central router is Shazam, Inc., an Iowa-based ATM network that spans eight states and has more than 1,000 members. Unlike most networks, Shazam is a nonprofit corporation and each member has one vote, regardless of size. Selling or ➔

Resources

Letters from the Connecticut and Iowa banking commissioners that declare surcharges illegal based on interpretation of existing state laws can be found at www.newrules.org/rules/finance/state/atmsurbans.html.

In April 1998, the U.S. Public Interest Research Group published Big Banks, Bigger ATM Fees: A Third PIRG National Survey of ATM Surcharging Rates. It can be found at www.pirg.org/consumer/banks/atm98/index.htm.

The organization can also be contacted at 218 D Street SE, Washington, DC 20003; telephone 202-546-9707.

F.Y.I. San Francisco may become the first city to ban ATM surcharges. Supervisor Tom Ammiano introduced an ordinance to prohibit the fees in early February. As of this writing, the measure seems likely to pass the Finance and Labor Committee and move on to the Board of Supervisors for a full vote. 95 percent of ATMs in the city assess surcharges and more than 60 percent of the ATMs statewide are owned by just two banks. If the ordinance fails to pass, the California Public Interest Research Group has vowed to secure a citywide ballot initiative in November. Several other California cities have expressed an interest in enacting a similar law.

merging the network requires the approval of 75 percent of the members. As a state certified central router, Shazam's board of directors must include several voting members appointed by the state to represent the public interest.

Iowa's law requires that the interchange fees set by the network must reflect actual ATM operating costs plus a reasonable rate of return. These fees are determined by a committee of Shazam members representing both ATM owners and card issuers and both small and large institutions.

Furthermore, Iowa requires that banks that offer ATM service must be fully engaged in the business of banking in Iowa. Out-of-state banks may operate ATMs, but only if they have a branch office in the state.

The dispute with Bank One began in late 1997 when the bank installed ATMs at several Sears stores in Iowa. The state's banking superintendent ordered Sears to cease operation of the machines, citing violation of several provisions contained in the EFT law including the state's routing rules, universal access provision, surcharge ban, and geographic restriction barring banks without in-state branches from operating ATMs.

Bank One insists that, as a nationally chartered bank, it doesn't have to play by state rules. It filed suit in federal court in May 1998 arguing that the federal National Bank Act (NBA) preempted Iowa's ATM regulations and that the state's EFT law violated the commerce clause of the U.S. Constitution.

In July the federal court ruled in favor of Iowa, finding no conflict with federal law and concluding that a disruption of the state's ATM system "would adversely affect the public interest." The court stated that the relevant federal statute was not the NBA, under which national banks are chartered, but the federal EFT Act, which expressly allows states to enact measures that provide greater consumer protection than afforded by federal law. Moreover, the court found Iowa's EFT law not in violation of the commerce clause because its geographic restrictions and routing rules equally burdened in-state and out-of-state institutions.

While decidedly good news for Iowa's consumers and community-based financial institutions,

Bank One has appealed, and several other recent developments point to the continued erosion of state authority over ATMs.

Connecticut had a run-in with Bank One this year as well. Like Iowa, Connecticut prohibits banks without branches in the state from operating ATMs. Bank One has no offices in Connecticut and installed eight ATMs in the state, which the banking commissioner declared illegal. Bank One filed a lawsuit against the state in February 1998. The federal Office of the Comptroller of Currency (OCC), the regulatory agency that oversees the country's 2,600 national banks, issued an opinion

on behalf of Bank One (as it did in the Iowa case), arguing that amendments to the NBA in 1996 changed the legal status of ATMs. No longer considered bank branches, ATMs are not subject to state authority or geographic restrictions. Connecticut backed down, and Bank One turned its machines back on.

The Office of Thrift Supervision has concurred with the OCC, ruling that state laws that restrict ATM placements by out-of-state financial institutions cannot be applied to the 1,181 federally chartered thrifts. In Colorado the OCC assisted Wells Fargo Bank in nullifying the state's ban on advertising on ATMs, which is also a feature of Iowa's EFT law. Again, the OCC determined that ATMs owned by national banks were not subject to state authority.

Should the courts and federal agencies continue to chip away at states' ability to regulate ATMs, community-based financial institutions will be left to depend on the federal government to ensure that these essential facilities are equitably shared. Past federal action provides little comfort. The Department of Justice has done nothing to stem the tide of ATM network consolidation, allowing every proposed network merger to go forward. Nor in evaluating this decade's deluge of bank mergers has the Department of Justice given much consideration to the effects of these mergers on ATM networks. In the U.S. Senate last year a bill to ban surcharges failed by a three-to-one margin. [!]

Resources

The Office of the Comptroller of Currency's Interpretive Letter No. 821, concluding that state law is preempted by federal law that gives national banks the authority to establish ATMs without geographic restriction, can be found at www.occ.treas.gov/interp/mar98/intmar98.htm.

The OCC's Interpretive Letter No. 789, published June 27, 1997, concludes that state law prohibiting national banks from displaying their names or advertising on ATMs is preempted by federal law. It can be found at www.occ.treas.gov/interp/jul97/intjul97.htm.

Iowa's EFT law defines ATMs as "essential facilities in the channels of commerce" and requires that they be "available for use on a nondiscriminatory basis by any other financial institution which engages in electronic transactions" in the state. This is the basis of the state banking superintendent's 1992 opinion declaring surcharges illegal.

Franchising: The Worst of Both Worlds?



Franchising has experienced an explosion of growth in the last two decades and now accounts for 40 percent of all U.S. retail sales and more than 60 percent of all restaurant sales. *By Stacy Mitchell*

IDEALLY, FRANCHISING COMBINES THE SOCIAL AND economic benefits of local ownership with the advantages of large-scale enterprises such as a widely recognized trade name and superior purchasing power.

Unfortunately, the relationship between the local entrepreneur—the franchisee—and the corporation marketing the product or service—the franchisor—is often marked by a great disparity in power. Over the last 15 years, franchise contracts have grown increasingly one-sided, transferring obligations and risks to the franchisee and rights and rewards to the franchisor.

As a result, franchisors exert unilateral control over many aspects of the enterprise. They are often able to terminate the contract at will or restrict the sale of the business, making it difficult for franchisees to receive fair market value for their investment. Exclusive territories, once a core element of the franchise agreement, have become rare, allowing franchisors to build new outlets that cannibalize the sales of existing franchises. Contracts frequently contain sourcing restrictions that force franchisees to purchase supplies—often at inflated cost—from the franchisor or its affiliates. Franchisees may also be required to waive their legal rights under certain federal or state statutes.

Much of this loss of autonomy has been made possible by the high demand for franchise businesses and the common belief that franchising is a virtually risk-free venture. Franchisors have consistently claimed in promotional material that 90 percent of franchisees survive their first decade while 80 percent of independents fail. Recent research commissioned by the Small Business Administration, however, has shown that in the first five years of operation franchises actually fail at a higher rate than independent businesses—38 percent compared to 32 percent—and have substantially lower profit margins.

By the late 1980s abusive practices and misuse of power had become so rampant in the industry that fran-

chisees organized trade associations and demanded new rules at the state and federal level to restore their rights as business owners and to return an equitable balance of power to the franchise relationship. Their efforts met with success in Iowa in 1992 when the legislature passed a comprehensive franchise law with bipartisan support. “It’s my opinion the business in Iowa should not be dictated to by these large international conglomerates,” declared state Republican Rep. Joseph M. Kremer.

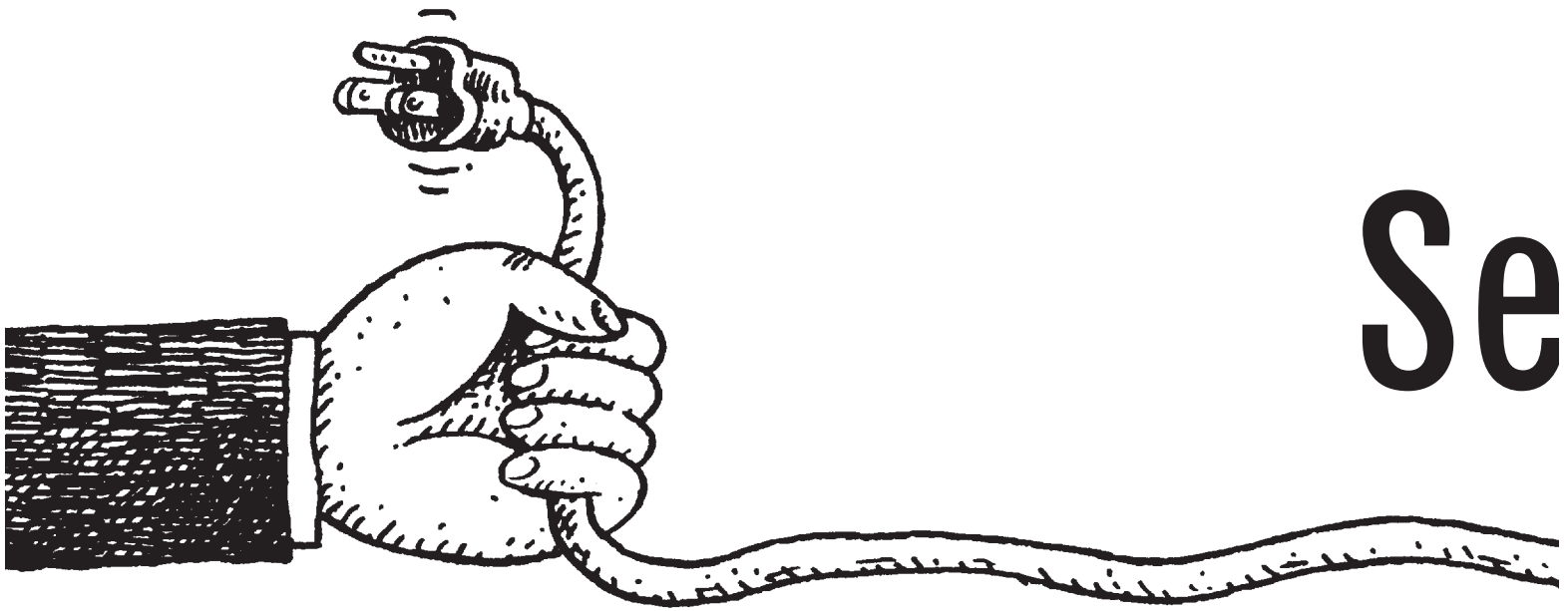
Iowa’s law sets minimum standards of fair conduct, prohibiting such things as contract termination without good cause, unreasonable restrictions on the sale of the business, and contract provisions that require franchisees to waive legal rights. The law also limits a franchisor’s ability to locate new outlets in close proximity to existing franchises.

A few of the provisions in Iowa’s law can be found in the 15 states that have rules governing some aspect of the franchise relationship. None of these laws, however, is as comprehensive as Iowa’s, and in the majority of states, franchisees lack even basic protections. Since 1992 franchisors have successfully blocked efforts to enact franchise laws in more than 20 states and at the federal level.

Given that many franchisees derive little benefit from their affiliation with large corporations, perhaps a better option for local merchants seeking the advantages of scale would be to join a purchasing or wholesale cooperative. These cooperatives, such as Ace Hardware or Independent Stationers, enable their members to reduce costs through volume buying, and, like large national retail companies, are often able to negotiate directly with manufacturers. Many cooperatives provide small retailers with other advantages like national advertising, brand identity, and expert marketing advice that would be unaffordable to an independent business. Unlike franchise corporations, cooperatives are owned by the merchants who participate in them. Decision making is shared and profits are funneled back to members. [!]

Resource

To view Iowa Code Chapter 523H on the Web, see www.newrules.org/rules/biz/state/franchise.html.



The current rush to deregulate our electricity system is being driven by the self-interest of large utilities. But the public interest can be better served if we change the rules to create a more environmentally benign, humanly scaled, and democratic system. *By David Morris*

TODAY, VIRTUALLY EVERY STATE LEGISLATURE, HUNDREDS of cities, and the U.S. Congress are writing rules that will determine the future shape, scale, and ownership structure of the nation's third largest industry after medical care and automobiles.

In the last 36 months, the Federal Energy Regulatory Commission (FERC) has changed the way electricity is sold on the wholesale level. Seventeen states with more than half the nation's population are changing the way electricity is sold on the retail level. And this year Congress will debate a law that would preempt state and local authority and impose uniform rules on all parts of the nation.

What makes this rush to judgment remarkable is that it is responding neither to popular demand nor to clear evidence that the present system is broken. The vast majority of the population appears satisfied with the current electricity system, for good reason: it is among the lowest priced and most reliable of any in the world.

Customer choice is the rallying cry for restructuring advocates. Yet the lack of a demand by customers for choice has been evident even to them. "Citing surveys finding most consumers content with their electric service providers, [FERC Commissioner James]

Hoecker called the public's general silence in terms of demanding customer choice 'positively deafening,'" noted an article in *Electric Utility Weekly*. After the Texas-New Mexico Power utility withdrew its restructuring plan—titled "Customer Choice"—when it encountered substantial public opposition, a utility spokesperson lamented: "We're trying to give our customers something that would be good for them, but this is apparently something they don't know they need."

Evidence from other formerly monopoly sectors shows that even when choice is offered only a minority of customers participate. Fifteen years after long distance telephone was opened to competition, 54 percent of people still have not exercised choice. Two-thirds of all customers continue with AT&T.

A 1997 survey of all 50 state regulatory commissions by Martin Kushler found that only two—Maine and Vermont—had conducted a scientific survey of utility customers to determine their opinions regarding utility restructuring. Deregulation in and of itself was not a high priority. When residents of Maine were asked to choose between having utilities "deregulated to allow greater competition and possibly lower rates" or to "continue to be closely regulated in an effort to protect consumers and the environment," 54 percent preferred the latter.

People preferred a more localized electricity system. Maine participants were asked "Would you like to be able to choose your electric power provider if it meant the possibility of losing Maine-based utility

David Morris, vice president of the Institute for Local Self-Reliance, is the author of two books: Be Your Own Power Company and Self-Reliant Cities. This article will appear as part of the upcoming policy paper, Seeing the Light: The New Power Rules (ILSR, 1999).

Bringing the Light



companies to New England-based and nationally-based companies?” Support for choice dropped by half—to 38 percent—with 56 percent saying no.

To date, the debate about electricity deregulation has largely been driven by and for major players. As *The National Journal* notes, “At both the state and federal levels, homeowners and small-business owners have been relegated to the sidelines in the electricity deregulation debate. The playing field has been dominated by business leaders who crave cheaper power and by new energy companies eager to serve the most lucrative customers.” The majority of electricity customers have become aware of the decisions made on their behalf only after the fact.

This lack of broad public debate has resulted in a narrowly framed deliberation. Albert Einstein’s observation, “Perfection of means and confusion of ends seems to characterize our age,” serves as an apt characterization of the debate about the future of electricity.

For proponents of deregulation, the only end is to allow customers to choose their electricity supplier. The principal means is to create a virtually automated national marketplace for electricity.

This definition of “choice” defines us solely as consumers. It ignores our right and desire to choose systems that enhance our roles as producers and citizens. And the sole emphasis on the marketplace as a means ignores the inability of the market to take into account important social values such as universal service, or long term outcomes such as environmental degradation.

Any future electrical system must be at least as safe, reliable, inexpensive, and universal as the present one. That is a given. But those standards can be met

using many kinds of structures, technologies, and fuel sources. The rules we make will channel entrepreneurial energy, scientific genius, and investment capital in certain directions. What should they be? I offer three for your consideration.

Decentralize capacity. We should remember Alvin Toffler’s 25-year-old term and become prosumers. For Thomas Jefferson, the widest distribution of

property, which he defined as productive capacity, is the safeguard of a healthy democracy. Technological advances offer us the opportunity to make this a key feature of our future electricity system.

Devolve authority. Shorten the distance between those who make the decisions and those who feel the impact of those decisions. Encourage customer-owned electricity systems and local control.

Accept responsibility. Local control must be accompanied by local and personal responsibility.

That includes responsibility for those in the community who lack the resources to access electricity and the next generation that will feel the consequences of the technologies and the fuels we rely on.

Decentralizing capacity. Devolving authority. Accepting responsibility. These should be the three objectives of the new power rules.

Moving in this direction would, to a significant degree, mean reversing the dynamic of the first 100 years of electricity development, a period in which generating capacity, regulatory authority, and ownership moved further and further away from the customer, and little attention was paid to the long-term consequences of the fuels we used to generate the electricity. ➔

.....
What makes the rush to judgment
in the electrical sector so remarkable
is that it is responding
neither to popular demand nor to
clear evidence that the present
system is broken.
.....

Resources

The Institute for Local Self-Reliance's New Rules website offers proposed and existing rules that enable the goals outlined in this article: www.newrules.org.



Decentralizing Capacity

FOR THE FIRST 100 YEARS THE ELECTRICITY SYSTEM WAS characterized by increasing returns to scale. Bigger was better. By 1980 a new power plant generated sufficient electricity for a city of 500,000 at a cost of almost \$1 billion. Electricity traveled more than 200 miles from power plant to ultimate customer.

Recent technological advances could reverse this trend. "Technology is moving toward the end user," says California Public Utilities Commissioner Renz D. Jennings. Consider a few recent news items.

- Allied Signal has recently introduced a 75 kW, \$45,000, washing machine-sized power plant capable of supplying the electrical needs of a small store or restaurant. Before the first micro-turbine came off the assembly line, Allied had sold the first two years of production.

- Plug Power, a 50-50 joint venture between DTE Energy, the parent company of Detroit Edison, and Mechanical Technology of Latham, New York, has begun demonstrating its 7 kW Plug Power 7000 fuel cell. The power plant is expected to cost about \$3,000. The system will come with its own battery storage system. Says its CEO and president, Gary Mittleman, "You won't need to be connected to a power grid."

- The Sacramento Municipal Utility District has installed solar electric devices on the roofs of more than 500 homes and businesses. The 3 kW systems offset 75 percent of a home's annual energy needs. In 1998 Sacramento issued a new multi-year contract that contains price reductions that could make solar electric roof shingles competitive with central power plants in three years. At the same time, President Clinton launched his Million Solar Roof initiative. The goal is to have one million buildings with solar cells or solar collectors by the year 2010. To date, individual utilities and local and

state governments had already committed themselves to achieving more than half that goal.

In 1997 there were about 10,000 power plants in the United States. By 2000 there could be five times as many. By 2010 our homes, factories, and stores could host several million power plants.

Thomas Edison would be delighted. The structure of the electricity system may be coming full circle, back to a time when the electricity industry was dominated by those who built and installed power

plants in or near the customer. In high-priced regions, decentralized power may already be cost-competitive. As Paul Colgan, director of public affairs for the Building Owners and Managers Association of Chicago, says, "It's something we feel that every commercial property owner should look at." Those who worry about brownouts and blackouts also are seriously considering on-site power generation. One utility, Alliant Energy, owner of Wisconsin Power and Light, has gone so far as to advise some of its customers to buy their own generators to avoid

shutdowns related to the Y2K computer bug problem in the beginning of the year 2000. "For some people, an outage for a half-hour in the dead of winter could be very serious," says spokesman David Giroux, "so buying a generator might be a good idea."

In lower-priced regions, decentralized power may be prized for guaranteeing the quality of electricity. First National Bank of Omaha is installing a 800 kw fuel cell system in its 200,000-square-foot computer data center. The site provides 24-hour ATM, credit card, and check processing operations for many midwestern banks. The system costs \$3,000 per kw, making it too expensive for typical commercial and industrial applications. But the additional reliability the system gives the bank and the higher quality of on-site generated electricity convinced First National that the price was right.

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"Homeowners and small-business
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sidelines....The playing field has
been dominated by business lead-
ers who crave cheaper power and
energy companies eager to serve
the most lucrative customers."
.....

Resource

*The Cape and Islands
Self-Reliance
organization's service
—American Local
Power Project—offers
information and
reports on the
community default
opt-out option
mentioned in
this article:
www.local.org.*



Decentralized power plants will come on-line. But whether they become an integral part of a more decentralized and miniaturized electricity system or simply become awkward add-ons to the existing system depends on the rules we create. Here are three that can help bring power to the people.

1. Full Cost Accounting. In many cases the cost of self-generated electricity is higher than the utility's price. But the cost to the customer of decentralized power does not take into account its benefits to the electrical system. For example, as homes install more computers, bigger TVs, and more central air conditioning, the load on neighborhood distribution lines increases. At some point the utility will have to upgrade those lines, a costly and disruptive proposition. Installing power plants at the customer's site can forestall that expense.

Southern California Edison found that a 150 kW solar cell system can deter replacement of a 4 kV distribution line into a residential neighborhood, avoiding the disruption that comes from tearing up residential streets, the loss of customer good will, and nearly \$1 million in costs.

The Distribution Power Coalition of America has put a number on the many system benefits of decentralized power, such as enhanced reliability, reduced transmission system losses, increased distribution capacity, and reduced risk: 1.7 cents to 2.8 cents per kilowatt hour. It also put a number on the associated environmental benefits, such as reduced sulfur dioxide and nitrogen oxide emissions: 1.6 cents to 2.25 cents per kWh. If a significant portion of these benefits were available for on-site power producers, most decentralized power plants would immediately become competitive with central power plants.

In the 1980s and 1990s many states developed regulatory procedures that moved them toward full cost accounting. Two dozen states required utilities to issue

bids for new capacity, and bidders could offer to improve efficiency at the customer site rather than build a new power plant. Half a dozen state regulatory commissions also quantified the environmental costs of various types of generating plants and took these costs into account when they selected the winning bidders. In the future this process, called Integrated Resource Planning or Performance-Based Ratemaking, can be refined and applied to utility distribution systems. The result would be to encourage decentralized power as well as renewable energy and energy efficiency.

2. Net Metering. A household that generates electricity will only consume that electricity when its lights or appliances are on. At such times it displaces electricity the customer would otherwise have to purchase at high retail rates. But when there is no internal demand, self-generated electricity goes out to the grid. Typically, the customer is paid nothing for it. If customers want to be paid, utilities may charge them hundreds of dollars to install two meters.

Net metering laws, enacted in 24 states, allow a customer's meter to run backwards. This enables the customer to receive the retail rate for that electricity regardless of whether the electricity is consumed on-site or not. At the end of the month (or the year in some states), the customer pays the utility the net difference between the amount exported and the amount imported. If the net difference works in the customer's favor, the utility pays the wholesale rate (between 2 cents to 4.5 cents).

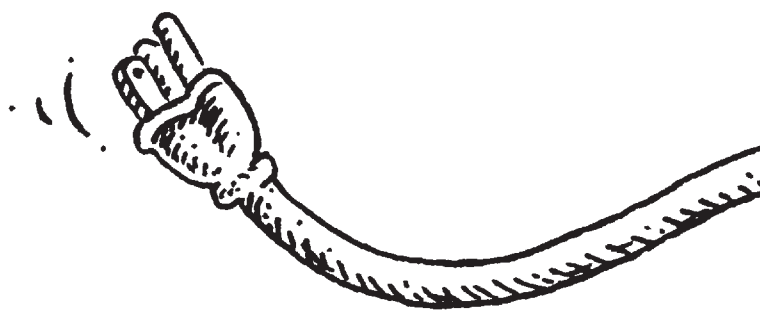
Net metering can be worth several hundred dollars a year to a household and several thousand dollars a year to a business.

3. Congestion Pricing. The 1992 Energy Policy Act required FERC establish rules that would open high-voltage transmission lines to all electricity suppliers on the same terms. So far FERC hasn't cared what type of ➔

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Resources

The Union for Concerned Scientists offers several excellent policy reports focusing on measures that would expand our use of renewable energy:
www.ucs.org.



pricing system regional transmission authorities use so long as they do not favor the incumbent utility. But different pricing systems will have a different effect on how fast decentralized power expands.

Some authorities have adopted so-called postage stamp rates. Electricity suppliers are charged the same no matter how far the electricity travels. This encourages long-distance transport and more centralized power plants.

Some have adopted mileage-based prices that encourage dispersed power plants.

The regional power pool that serves New Jersey, New York, and Pennsylvania has adopted a novel system called locational marginal pricing. Prices vary constantly along 1,600 sections of the line depending on the amount of congestion in those sections. If congestion rises, the value of electricity generated nearer the customer rises, encouraging on-site power plants.

Missouri the proportion of customers that own their electric systems approaches 40 percent, and in Alabama, Tennessee, and Mississippi two-thirds of the electric utilities are customer-owned.

The debate about the relative efficiencies of customer-owned and investor-owned utilities (IOUs) has raged for more than 100 years. Data can be marshaled to support both sides. Our conclusion is that both ownership structures are efficient, reliable, and innovative.

In the past public policy has favored customer-owned utilities. They have been given preference for the inexpensive power generated by federal dams. And they have been allowed to use tax-exempt bonds to finance their facilities. Today IOUs are insisting that both privileges be eliminated, and several members of Congress have introduced bills to that effect. Customer-owned utilities argue that the tax code offers quite handsome subsidies to investor-owned utilities as well. (For example, utilities are able to collect federal taxes from

their customers while deferring paying them.)

Customer-owned utilities argue that their ownership structure is more responsive, more place-based, and more democratic (one "shareholder" one vote) and that those values should be "preferred" by policy makers. When IOUs insisted that Congress prohibit customer-owned utilities from using tax-exempt bonds to finance facilities that would, in a deregulated market, compete with IOUs, the American Public Power Association turned the tables on the IOUs. It suggested that, in return for being able to participate in the wholesale power market and to sell to public power customers, Congress require that private power companies conduct open meetings, comply with public records laws, hold public hearings on budgets, hold public board elections, allow the public recall of the CEO, and include ratepayer representatives on their boards.

Resource

Ratepayers for Affordable and Green Electricity (RAGE) is a coalition of more than 130 grassroots organizations working at the state and local level on electricity deregulation. Contact: Wenona Hauter, Public Citizen, 215 Pennsylvania Avenue SE, Washington, DC 20003; telephone 202-546-4996.

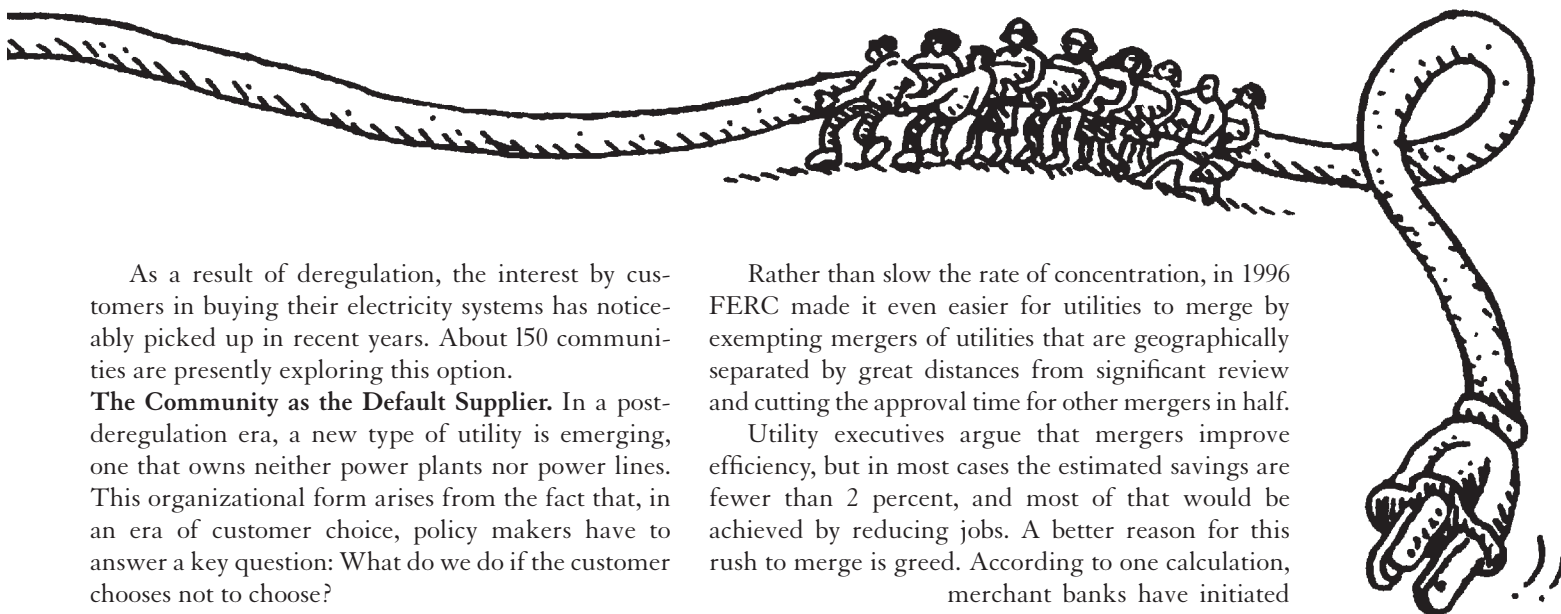
In Massachusetts, if customers do not choose an electricity supplier, then their community represents them. Local control is favored over absentee control, and the rules favor linking authority and responsibility.

Devolving Authority

TO SATISFY OUR CRITERION OF SHORTENING THE distance between those who make the decisions and those who feel the impact of those decisions, policy makers should encourage customer ownership.

About one-third of the nation's electricity customers own their own electric companies, either directly through 900 cooperatives or indirectly through 2,100 municipal utilities. Only 244 of some 3,200 utilities are owned by investors, although these serve two-thirds of all customers and generate three-quarters of all electricity.

The extent of customer ownership varies dramatically. Nebraska's electricity system is 100 percent publicly owned, while Hawaii's is 100 percent investor-owned. In New York, New Jersey, and Pennsylvania only about 3 percent of population is served by customer-owned electric utilities. In New England the ratio rises to about 10 percent. In midwestern states from North Dakota to



As a result of deregulation, the interest by customers in buying their electricity systems has noticeably picked up in recent years. About 150 communities are presently exploring this option.

The Community as the Default Supplier. In a post-deregulation era, a new type of utility is emerging, one that owns neither power plants nor power lines. This organizational form arises from the fact that, in an era of customer choice, policy makers have to answer a key question: What do we do if the customer chooses not to choose?

So far the vast majority of customers have decided not to switch to a new supplier. Who then should be their default supplier? Once upon a time the answer would have been obvious: the local utility. But that was obvious only when the utility owned both transmission lines and power plants. Many states have required their utilities, as a condition of deregulation, to divest themselves of their power plants. In the future these IOUs will make their money solely by distributing electricity. Thus there is no longer a compelling reason for the local utility to be the default supplier. Who then should play this role?

As a result of the remarkable work of Matt Patrick, a selectman from Barnstable, Massachusetts, and head of the nonprofit Cape and Islands Self-Reliance, one state—and one state only—has made the default supplier a town or city. Individual customers can opt out and choose their own supplier, but if they choose to do nothing their community represents them. In Massachusetts local control is favored over absentee control, and their rules favor linking authority and responsibility. Other states are now considering this opt-out option.

A Moratorium on Mergers. Since 1993, when the Energy Policy Act was passed, 86 utility mergers and acquisitions have taken place. About one-third of the entire asset base of private utilities has been the subject of merger activity in the last three years.

Rather than slow the rate of concentration, in 1996 FERC made it even easier for utilities to merge by exempting mergers of utilities that are geographically separated by great distances from significant review and cutting the approval time for other mergers in half.

Utility executives argue that mergers improve efficiency, but in most cases the estimated savings are fewer than 2 percent, and most of that would be achieved by reducing jobs. A better reason for this rush to merge is greed. According to one calculation,

merchant banks have initiated upwards of two-thirds of all merger and acquisition activity. Banks advising PacificCorp in its bid for the Energy Group, for example, accrued fees in excess of \$100 million.

Currently there are more than 240 investor-owned utilities in the U.S. Some observers expect that within a decade only a handful will remain. FERC Commissioner William Massey predicts, "I think you'll eventually have a half dozen or so big generating companies and a dozen or so big transmission companies."

The national associations that represent customer-owned utilities—the National Rural Electric Cooperative Association and the American Public Power Association—have called for a moratorium on further large utility mergers. Joel Klein, antitrust chief of the Department of Justice, has supported such a moratorium.

At a minimum, we need to change the rules so that the burden of proof is on those who would concentrate power, not on those who would disperse it.

Accepting Responsibility

OUR PERSONAL CONSUMPTION HABITS CAN AFFECT THE quality of life of our children and their children. This is clearly the case with electricity.

Electric generation is the nation's single largest source of air pollution. According to the U.S. Environmental Protection Agency, electricity generation is responsible ➔

for 66 percent of sulfur dioxide, 29 percent of nitrogen oxide, 36 percent of carbon dioxide, and 21 percent of mercury emissions. And the vast majority of our high-level radioactive waste comes from nuclear generators.

The marketplace rarely takes environmental factors into consideration. Therefore, if a clean environment is important to us, we will need to design policies that move us in that direction. We offer three such rules.

1. Require Coal-fired Power Plants to Meet the Highest Emission Standards. The Clean Air Act of 1970 grandfathered existing power plants from new emission requirements. This exemption was continued in the 1977 and 1990 versions of the act. Policy makers expected these plants would be retired by the late 1990s. This has not occurred.

On average, coal plants built before 1976 emitted more than twice as much sulfur dioxide and almost twice as much nitrogen oxides as newer plants in 1996. In a deregulated era, these low-cost but highly polluting plants will be revved up to generate even more electricity. Says Ralph Cavanaugh of the Natural Resources Defense Council, "For at least the next decade, the most important environmental variable for North American electricity is the fate of more than 300,000 MW of underutilized coal-fired generation." Coal-fired generation could increase by as much as one-third in response to continental demand growth and access to new markets.

Policy makers should require that coal-fired power plants that sell into deregulated markets must meet current emission standards. Several states, such as Connecticut and Massachusetts, have developed regulations that would have a similar effect. They have established rigorous emission performance standards that all retail suppliers must meet in their generation portfolios.

2. Require a Renewable Portfolio Standard. Poll after poll shows that Americans want to rely on renewable energy sources, and are willing to pay modestly higher prices to do so. For example, when Texas Utilities in Dallas surveyed its customers in October 1998 about whether the utility should invest in renewables, 96 percent said yes, and 90 percent said they would be willing to pay at least one dollar more per month for energy from renewable sources.

Today electricity suppliers are peddling "green" electricity. This is an interesting marketing initiative, but the evidence is that only 1 percent or so of customers will pay the stiff premiums these green marketers are charging. Rather than adopt green consumerism as our strategy for expanding renewable energy, we should adopt green citizenship. When a majority of customers of a utility want to aggressively expand renewables, the utility should do so and

spread the cost over all its customers. This would result in far more renewables coming on-line at a much lower price. Indeed, the same Texas Utilities survey found that 79 percent of their customers preferred that the costs of renewable energy were spread over all of them.

One strategy for translating green citizenship into public policy is the renewable portfolio standard. In the 1970s federal and state governments forced manufacturers and builders to improve the efficiencies of their appliances, cars, and buildings, with great success. We need to do for the supply side what we did on the demand side. The renewable portfolio standard does this. It requires that electricity suppliers generate an increasing proportion of their power using renewable energy (some states allow fuel cells, even when using natural gas, to count as renewables because of their zero emissions.) For example, Connecticut requires that by 2009, 6 percent of the electricity sold in the state be generated by renewable fuels. Massachusetts requires 6 percent by 2011.

3. Transform Electricity Taxes into Green Taxes. More than \$15 billion a year is generated from electricity-related fees and taxes imposed by cities, counties, and states. When customers are able to buy electricity from out-of-state suppliers, these place-based taxes will raise the price of homegrown electricity, making in-state suppliers less competitive.

To remedy that problem, several states that are restructuring their electricity systems are embracing a tax shift. They are reducing or eliminating utility property taxes or franchise fees and instead imposing a "wire charge," or a per-kilowatt-hour fee paid by the final customer, on all electricity purchased. This puts in-state and out-of-state suppliers on an even footing.

Why not tax electricity on the basis of its pollution impact? Based on national carbon emission figures, \$15 billion translates into a carbon tax of \$75 per ton. This would raise the price of coal-fired electricity by almost 2 cents a kilowatt hour, enough to make certain kinds of solar electricity, such as wind power, competitive with coal. Indeed, the Department of Energy national labs estimate that 40,000 MW to 80,000 MW of electricity would be brought on-line by 2010 if a \$50 per ton carbon tax were imposed.

Today in city halls, state capitols, and Washington we are changing the power rules. We have the unprecedented opportunity to participate in that process and design rules that create an electricity system that not only offers us low-cost and high-quality electricity, but that also reflects our values. We have the opportunity to recreate the electricity system as a place-based system where capacity, authority, and responsibility are coterminous. [!]

Resources

Minnesotans for an Energy Efficient Economy (ME3) has a web page, managed by the Institute for Local Self-Reliance, that is the single best starting point for information about electricity. It contains a section that tracks reports and news on deregulation: www.me3.org.

Paying for Past Mistakes

As the electricity industry becomes more competitive, liabilities become more apparent. But who will be saddled with these stranded costs?

BY THE MID 1990S IT HAD BECOME CHEAPER TO build new high-efficiency natural gas-fueled power plants than to operate some existing utility-owned power plants. Under competition, tens of billions of dollars of utility assets would become liabilities. Who should bear these costs—shareholders or customers? In the debates about deregulation this issue may be the most controversial.

Eleven of the 16 states that have gone through the restructuring process at this writing have forced customers to pick up 100 percent of the tab for these so-called “stranded costs.” Two states have taken a different course. In late 1998 the elected Public Service Commission of New Mexico refused to require customers to pay any of Public Service of New Mexico’s (PSNM) liabilities because “under New Mexico law, the utility duty to render efficient service precludes the recovery of stranded costs, which are, by definition, a measurement of inefficiency.” PSNM sued and the case is in the courts. New Hampshire’s regulatory commission allowed full recovery of stranded costs if the utility’s rates were at or below the regional electric average. If rates were higher than those of neighboring utilities, the commission assumed that management had demonstrated poor judgment and the shareholders, not the customers, should pay the price. Public Service of New Hampshire sued. The case is in the courts.

The answer to a simple question could guide state policy makers in deciding who should pay the stranded costs: Who was the prime mover behind the original investment? In the case of nuclear power—by far the largest single stranded cost—utilities were clearly the responsible party. There was widespread and active resistance to the construction of these plants, especially after the near-meltdown at Three Mile Island in 1979. Opponents argued that nuclear power

was expensive, that huge new power plants were not needed in the light of slackening demand and excess capacity, and that there was no long-term solution to the problem of radioactive wastes. Utilities spent hundreds of millions of dollars to lobby state and federal legislatures and convince state regulatory commissions that nuclear reactors should be built.

History has proven the opponents right. While coal- and gas-fired power plants are sold at a premium, the going price for nuclear plants is far below book value. Recently, GPU sold Unit 2 at Three Mile Island—one of the best operating nuclear reactors in the world, the antithesis of its closed and radioactive sister unit—and received virtually nothing. And a long-term solution to the nuclear waste problem remains unsolved.

Thus the stranded costs of nuclear power, estimated to be about \$85 billion, should be paid by the stockholders of nuclear utilities. Where the commissions impose this liability on customers, they should give them the ability—through a referendum—to decide whether to continue to operate these plants.

Another significant liability for utilities in a competitive market is high-cost, long-term contracts with independent power producers. In 1978 the Public Utilities Regulatory Policy Act required utilities to purchase independently produced power. The goal was to encourage renewable-energy technologies and high-efficiency power plants. In the early 1980s state commissions substantially raised the price that utilities had to pay independent producers and kept the price high even when the average wholesale price of electricity was declining. In court and in state regulatory proceedings, utilities fought long and hard against these contracts, but they were rebuffed at every level. In this case, legislatures, regulatory commissions, and most customers were the driving force behind these investments. Thus the customers should shoulder the liability.

It is important to point out that while stranded costs have been a key and contentious issue for the first states to embrace retail competition, many other states find themselves in the happy situation of having stranded benefits, not costs. Their utilities’ low-cost gas- and coal-fired power plants have become even more valuable in a competitive environment. For these states, the question will be how to distribute the wind-fall rather than how to distribute the liability. States with stranded benefits also have low electricity costs and therefore are adopting a much more cautious approach than their high-cost neighbors.

—David Morris

Sound Decisions

Noise is one of the most debilitating aspects of modern life. Yet more and more municipalities have taken action to preserve their communities' peace—the first steps toward setting a sound public policy. *By Les Blomberg and David Morris*

THE TALLY SHEET ON NOISE IN OUR LIVES DOES NOT look promising. Those noises that we are all too familiar with have increased dramatically since 1960: Car traffic is up 162 percent, airliner traffic up 438 percent, truck traffic up 483 percent, and air cargo traffic up 2,156 percent.

Added to this are the new noises that only a technological society can boast: jet skis, leaf blowers, weed whackers, boom boxes, and car alarms, not to mention the increasing decibel level of movie trailers that announce coming attractions in theaters.

And the good news? Hotel doormen's whistles have been almost eliminated.

Noise comes from the Latin word *nausea*, originally meaning seasickness. Which is not surprising because noise makes us sick. Noise inflames the lining of the stomach, raises blood pressure, changes blood chemistry, and makes us anxious, tired, and distracted. Much of the hearing loss that people associate with aging may actually be caused by noise exposure, since people in cultures with low levels of noise suffer little hearing loss with age.

Noise reduces productivity. Psychologist Arline Bronzaft tracked the progress of children at an elementary school in Manhattan located next to an elevated train. The children exposed to the noise were one year behind in reading levels compared to those who went to classes on the quiet side of the building. The European Union recently estimated

that noise's effects on productivity could cost as much as 2 percent of its members' economies.

Noise diminishes our sense of civility. In one experiment a man with a cast on his arm dropped parcels on a sidewalk in a noisy neighborhood. No one stopped to help him. When the same man dropped his packages on the same sidewalk when it was quiet, he was inundated with offers to help. Noise numbs compassion and breeds aggression and hostility.

Noise disturbs our sense of place. It is one of the reasons people continue to flock to suburbs where they are convinced they can find a respite from noise. There they huddle among the setbacks, cul-de-sacs, sound walls, and berms erected to deaden sound. These designs are not always successful. What they are successful at, however, is further isolating neighbor from neighbor. Noise ranks higher than crime, traffic, and public services as a cause of popular dissatisfaction in neighborhoods, according to the federal government. "Calling noise a nuisance is like calling smog an inconvenience," said former U.S. Surgeon General Dr. William H. Steward.

Noise ranks higher than crime, traffic, and public services as a cause of popular dissatisfaction in neighborhoods. "Calling noise a nuisance is like calling smog an inconvenience," said former U.S. Surgeon General Dr. William H. Steward.

Noise is rapidly becoming our most pervasive pollutant. In Europe noise reduction was officially added to its environmental agenda in 1993. In a report, Green Paper on Future Noise Policy, the European Union estimated that 20 percent of its population—or close to 80 million people—suffer from unacceptable noise levels. An additional 170 million people live in "grey areas" where noise levels are high enough to cause annoyance during the daytime.

The situation, already bad, is getting worse. Canadian noise expert Winston Sydenborgh estimates that world noise levels are doubling every ten years. The

Les Blomberg is executive director of the Noise Pollution Clearinghouse (NPC), in Montpelier, Vermont, and David Morris is vice president of the Institute for Local Self-Reliance and advisor to NPC.

number of people in the U.S. living in areas where noise is excessive is now 40 percent greater than in the 1970s.

The number of places where we can find peace is diminishing. "Out of the silence perhaps one gathers the feeling of repose," wrote John Van Dyke in his 1920 book about the Grand Canyon. Today, because of airplane and helicopter overflights, natural quiet is preserved in only 7 percent of the Grand Canyon National Park—and nowhere in Hawaii's Volcano National Park. In Yellowstone National Park the most distinctive wintertime sound is not the exploding of geysers or the bugling of elk, but the drone of 2,000 snowmobiles. "For snowmobilers, Yellowstone has become an experience they don't want to miss," Bill Butts, general manager of the Flagg Ranch, a hotel at Yellowstone's southern entrance, told the *New York Times*. When asked what it was about the experience that made it so attractive he answered, without irony, "The solitude."

To some, noise is simply the price we pay for living in a modern, industrialized economy. But it doesn't have to be. Electric vehicles virtually eliminate engine noise. New European roads are designed to reduce tire noise by more than 70 percent. When Los Angeles banned gas-powered leaf blowers within 500 feet of a residence, a Van Nuys auto mechanic showed up at City Hall with a homemade invention: a pollution-free, whisper-quiet leaf blower built from common car parts.

In the 1970s Congress charged the Environmental Protection Agency (EPA) with monitoring and regulating noise. The EPA created the Office of Noise Abatement and Control (NAC), which carried out its mandate with mixed results. By 1982 the program's funding had allowed 1,100 states and cities to institute active noise-control efforts. That same year, however, Ronald Reagan shut down NAC, ending nearly all research, education, and assistance to states and local communities. Almost all local programs were scaled back, neglected, or abandoned.

Today, as noise becomes increasingly pervasive, communities are fighting back.

Advocates of quiet must answer two questions. Do we have the right to compel quiet? And if we do, what level of government should exercise this authority?

Owners of jet skis, snowmobiles, and leaf blowers argue that theirs are legal products and thus they have as much right as anyone to use them in the woods or lakes or backyards. Friends of quiet, however, respond that the outdoors represents a public commons and that although everyone is entitled to its use, we should strive to design rules to allow for as many possible uses simultaneously. Sailboats, swimmers, canoeists, and even boats with small electric motors can coexist easily. Add jet skis or heavy-engined boats to the mix, however, and other activities are precluded.

We can exercise our property rights only to the extent that we do not diminish the rights of others. Your right to

swing your fist ends at my nose. Your right to make noise ends at my ear. Friends of quiet liken their battle to the 25-year-old one against secondhand smoke. Over almost three decades it has become routine for states and cities to decide that your right to smoke ends at the air I breathe.

Today a number of organizations exist to aid communities in their noise-abatement efforts. The Right to Peace and Quiet Campaign began in 1991 in England. In 1994 the Citizens Coalition Against Noise (now Noise Watch) was founded in Toronto. That same year Project Quiet Yards began in the U.S. The Noise Pollution Clearinghouse was established in 1996 to act as an information clearinghouse for noise-reduction activities.

Communities are regulating noise in several ways. Dozens of communities have introduced traffic calming into their cities. Some, like Huntington, New York, are banning products such as leaf blowers that generate noise above a certain level. Some communities allow the use of leaf blowers or jet skis but only at certain times. Still others ban them entirely. The courts have consistently upheld the right of communities to ban noisy products. In 1998, for example, the State of Washington's Supreme Court upheld a ban on personal watercraft in the San Juan Islands (see "Making Waves" on page 20).

For more common noises, communities are recognizing that the right to use property as the owner wishes can infringe on others' right to peaceful and quiet enjoyment of their property. As a result, communities are lowering noise limits and establishing time-of-use restrictions. Communities must also balance different interests. For example, when a large grocery store in one town placed air conditioning, refrigeration compressors, and cooling towers on its roof, the noise entered nearby residences 24 hours a day. When neighbors sought relief, the store owner →

Resources

For additional information on noise pollution and what is being done about it, contact the Noise Pollution Clearinghouse, P.O. Box 1137, Montpelier, VT 05601; telephone 800-200-8332; website www.nonoise.org.

Or in Canada, Noise Watch, 65 Front Street W, Suite 0116, Box 35, Toronto, ON M5J 1E6; telephone 416-410-2236; website www.noisewatch.org.

Or in England, Right to Peace & Quiet Campaign, P.O. Box 968, London SE2 9RL, England; telephone 081-312-9997.



explained that it would be prohibitively expensive to deaden the noise. The town council is still trying to balance the “rights” of the business with those of its neighbors.

While communities have the right to regulate late-night parties or mufflerless motorcycles, they still do not have the right to regulate low-flying or late-night aircraft or early-morning trains, even if these generate noise many times louder than a neighbor’s stereo. When it

comes to transportation, mobility takes precedence over quiet. The 1990 Airport Noise and Capacity Act gave the Federal Aviation Administration (FAA) sole responsibility for controlling aircraft noise. Similarly, the Federal Rail Administration has sole authority over train noise.

The question of who could regulate airplane noise was unsettled for many years. In Santa Monica in 1981 anger at the increasing noise of planes at its municipal

14 Ways to Quiet the Skies



Resources

For additional information on airport noise, contact U.S. Citizens Aviation Watch, P.O. Box 1702, Arlington Heights, IL 60006; telephone 847-506-0670.

- 1** Increase local control of airports with regard to expansion, number and time of takeoffs, landings, ground operations, etc.
- 2** Demand that two-thirds of airport commission members live within areas where average day/night levels exceed 65 dBA (what the FAA calls moderate noise exposure).
- 3** Abandon the day/night sound pressure level of 65 dBA that the FAA uses to separate low noise exposure from moderate noise exposure. The 65 dBA value is still too noisy and unhealthy. Use 55 dBA as an interim value until a descriptor that includes low frequency noise is developed.
- 4** Remove the FAA from oversight of environmental quality and public health since the agency sees its main role as promoting air transportation, which is a conflict of interest. Noise and other environmental pollutants need to be regulated by some combination of the EPA and local oversight.
- 5** Demand objective health studies of noise and other pollutants near airports.
- 6** Demand that airports and airlines pay the full cost of airline travel. Remove all FAA and local subsidies. Increase landing fees to cover decreases

in property values, insulation programs, health effects, and annoyance, and increase fuel taxes to account for environmental and public health damage.

7 Expand soundproofing programs to all homes, churches, schools, hospitals, and commercial businesses experiencing a day/night average of greater than 55 dBA from airports. Eventually, all sensitive properties—such as homes, churches, schools, day care centers, and hospitals—should be protected against indoor single event readings exceeding 45 dBA even with the windows open.

8 Increase the minimum altitude for general aviation aircraft and helicopters to 2,000 feet above ground level and implement an effective policing mechanism. Impose a minimum flight altitude of 2,500 feet for all tour operations and commercial transport services such as air taxis.

9 Ban flights over and within two miles of non-urban national parks, wilderness areas, national monuments, national seashores, and other sensitive and pristine public lands. Excepted would be flights for emergencies, research, and construction and maintenance activities.

10 Support a Global Nighttime Curfew. Around the world, hundreds of airports already have curfews. Local nighttime curfews, while a positive step, only shift the problem elsewhere.

11 Develop a high-speed rail alternative to air craft flights of less than 500 miles. Redirect government investment from airport expansion to high-speed rail and support efforts to quiet rail transit.

12 Ban commercial SST flights from U.S. airports and block proposed corporate SST flights from U.S. airspace.

13 Support quieter and cleaner aircraft technology, called Stage IV.

14 Avoid solutions that shift noise to others. A fairer distribution of noise might make sense for many airports, but moving the noise around doesn’t solve the problem and divides people who should be united against airport noise.

—Les Blomberg

airport finally led the City Council to vote to close the airport. The Justice Department threatened to sue, arguing that since the city had received federal funds for the airport, it was obligated to keep it open. In 1984 a compromise was reached. The federal government gave Santa Monica some authority to regulate flights in return for the city's commitment to keep the airport open until 2015.

Using the Santa Monica precedent, several California communities in the 1980s established mandatory nighttime curfews for planes. Then in 1990, Congress preempted any further bans, curfews, or fines without prior approval by the FAA. No such approval has been granted. In return, Congress has phased out noisier so-called Stage II aircraft by 1999. But many communities found that the increase in flights was overcoming the reduced noise per plane. Moreover, the FAA's phase-out of Stage II aircraft does not affect general aviation aircraft under 75,000 pounds, which includes virtually all corporate jets, a fast-growing part of air traffic. The noise exposure contour for a Lear 25 or Gulfstream III is vastly larger than that of a Boeing 757-200, 737-300, MD-82, or A300.

Since communities are usually stopped from preventing transportation-related noises, they tend to focus on mitigation. Airport trust funds are used to buy out surrounding homes or to insulate them to reduce noise impacts. In some cases entire neighborhoods are being bought out to reduce complaints about airplane noise. Highway trust funds are used to erect noise barriers along highways. These unsightly barriers are typically 12 feet high, but they can be much higher. Philip Langdon, writing in *The Atlantic Monthly*, reports that among the tallest is the 39-foot-high, 2,000-foot-long concrete wall in Vienna, Virginia, erected so performers can give concerts in the open-air amphitheater of Wolf Trap

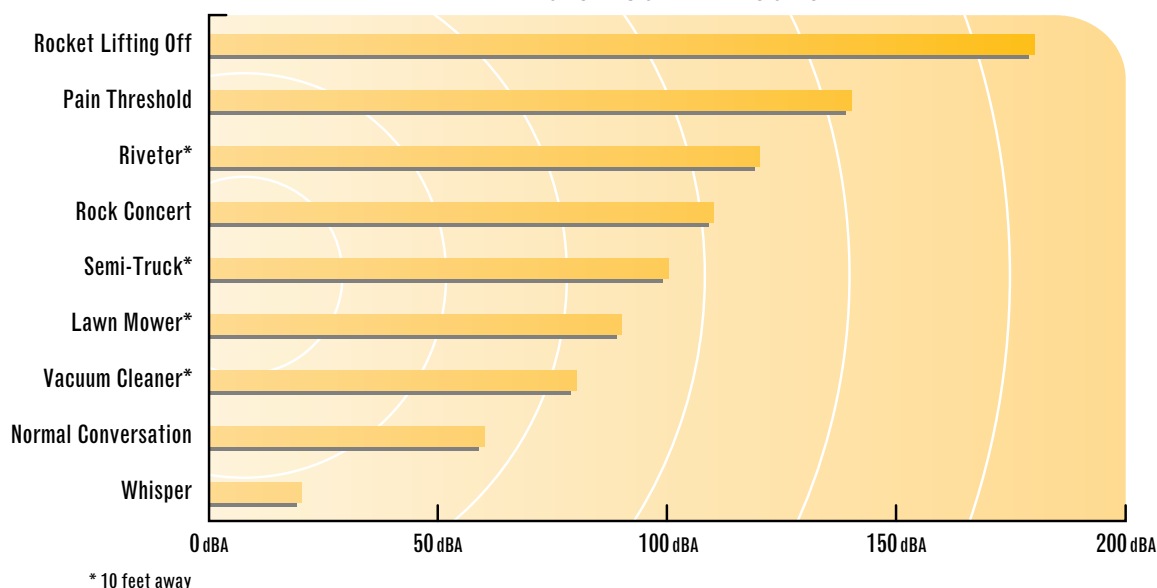
Farm Park while traffic whizzes by on the Dulles Toll Road, 380 feet away.

Noise regulation is made more difficult by the complexities of measuring and describing noise. Sound pressure is measured in decibels or dB. Humans do not hear all frequencies equally, however, so different frequencies are usually weighed differently to correspond more closely to human hearing. The decibel scale—either dB or dBA—is logarithmic, which can be confusing. One hundred dBA is not twice as noisy as 50 dBA, and two noise sources, both of which are 60 dBA, together are 63 dBA, not 120. It is easier, then, to understand noise measurements in terms of how humans perceive loudness. For every 10 dBA increase, the loudness doubles. Similarly, a 10 dBA decrease in noise levels—for example, from 60 dBA to 55 dBA—cuts noise in half. So 100 dBA is approximately 32 times louder than 50 dBA. The noise of a rocket lifting off is 180 dBA; 140 dBA is the threshold for feeling pain. A rock concert can generate 110 dBA to 120 dBA, a semi truck ten feet away 100, a lawn mower 90, a vacuum cleaner 80, normal conversation 60, and a whisper 20.

Where the noise is measured also matters. Noise generally drops off by 6 dBA for every doubling of the distance from the source. Most regulations strive to reduce daytime noise levels to 55 dBA to 65 dBA, although the EPA has found that 17 percent of the population is “highly annoyed” if the average sound level measures 55 decibels.

Fortunately, citizens and communities do not need noise experts to tell them when a noise is annoying or disruptive. The Noise Pollution Clearinghouse has a CD available that contains noises that can be played at different levels, a useful item to play at city council meetings where they're debating an 80 dBA limit. ➔

NOISE COMPARISONS



The federal noise standards have two glaring weaknesses. First, the limits are too loud. Local communities generally set noise standards significantly lower than federal noise limits. Communities routinely ticket persons for noise disturbances that are less noisy than what the federal government allows for airplane, rail, and highway noise.

The second problem is that when the federal government measures noise, it does so on a daily or hourly weighted-average basis. Instead of prohibiting noise over a certain level, as communities do, the FAA, for example, uses the equivalent sound level, or the level of the noise if

it were averaged over the 86,400 seconds in a 24-hour day. An explosion powerful enough to burst eardrums becomes, using the FAA's procedure, a quiet hum.

From leaf blowers and jet skis to 747s, the issue of noise illuminates and cuts across some of today's key political questions. What is the relationship between private property rights and public space? Who should make the rules? What should take precedence—mobility or community? As more and more communities address these issues, their residents are coming to the realization that the answers ultimately rest with them. [!]

Making Waves

While jet skis churn up trouble on the nation's waterways, a billion-dollar industry tries to churn up trouble among levels of government.

A MAJOR SQUALL IS BREWING ON AMERICA'S WATERWAYS: more than one million personal watercraft (PWCs)—commonly called jet skis—have invaded the nation's lakes, rivers, and coastal areas. As their numbers grow, so does opposition to the noise, pollution, and safety risks they create.

Even the organization that represents this billion-dollar industry—the Personal Watercraft Industry Association (PWIA)—has agreed that some regulation is required. “Watercraft...do little circles, they do big circles, they jump waves...there goes tranquillity. This is what leads to complaints,” said an editorial for the online PWC magazine *The Personal Watercraft Zone*. “We must all work together.... Follow the rules.... Ride responsible.” But while the industry is offering an olive branch with one hand, it is dialing attorneys with the other as soon as someone tries to put new rules in place.

The PWIA's strategy is simple: pit one level of government against another. When Monroe County, in Florida, enacted an ordinance that allows PWCs only to use a zone 1,200 feet out from shore and prohibits them from using certain zones that motorboats can use, the industry went to court. The challenge to the ordinance from the PWIA, made in October 1998 in the U.S. District Court for the District of Southern Florida, states that the ordinance “violates the plaintiffs' navigational rights

under the U.S. Constitution and conflicts with both federal and state boating laws.” The establishment of special zones for jet skis, the suit continues, “conflicts with the Florida Keys National Marine Sanctuary regulations, which apply to all motorized vessels....” In other words, the PWIA thinks it should be up to the federal government.

In New Jersey, North Carolina, and Rhode Island, the PWC industry has opposed legislation that would have granted municipalities the authority to control personal watercraft, arguing that this would lead to “balkanized regulation” and confuse PWC operators. The industry demanded that regulations instead be made at the state level.

In early 1998, however, when a bill was introduced into the California Assembly to prohibit the operation of PWCs and two-stroke motors on the state's drinking water reservoirs, the industry wasn't any happier. This time they argued that local officials were better suited to handle the problem. Mark Denny, government affairs manager for the International Jet Sports Boating Association, said the proposed legislation was yet “another attempt by the state to remove local control from the communities and their elected officials.”

The PWIA has sued at all levels of government, sometimes claiming discrimination when PWCs were singled out for regulation over other motorized watercraft. Just as often, though, the industry's arguments have attempted to play off one level of government against another. Their reliance on many people's conventional acceptance of government—any government—as something not to be trusted has, for the most part, not worked. Instead, people's common sense has prevailed as they have recognized that the only effective avenue of protest against jet skis and what they can wreak on the environment are the same officials whom the people have duly elected.

—Sean Smith

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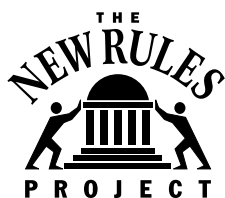
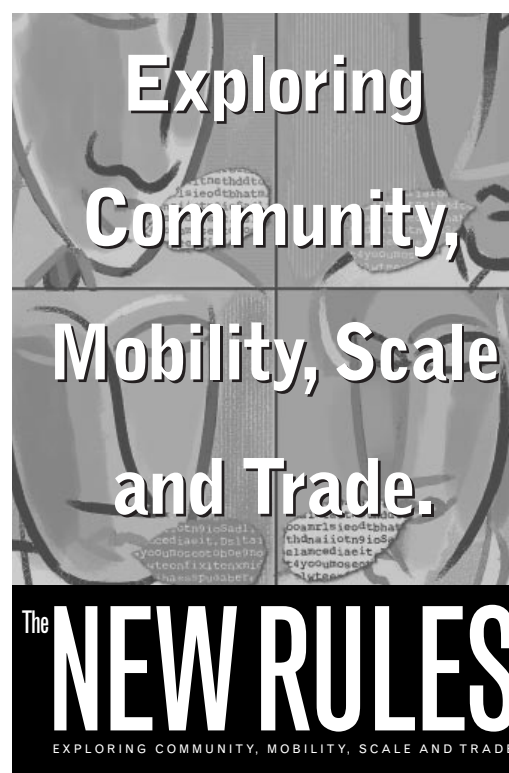
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