AGRICULTURE AND NATURAL RESOURCES COMMITTEE

The Agriculture and Natural Resources Committee was assigned three studies. House Concurrent Resolution No. 3028 (2005) directed a study of the utilization of the state's abundant energy resources to attract energy-intensive economic development projects to the state. Section 1 of 2005 House Bill No. 1370 directed a study of railroad fuel surcharges. Section 1 of 2005 Senate Bill No. 2115 directed a study of the process to negotiate and quantify reserved water rights. The Legislative Council also assigned responsibility for overview of the Garrison Diversion Project and related matters and any necessary discussions with adjacent states on water-related topics, responsibility to receive a report from the Game and Fish Department regarding the department's findings on its assessment of the status of mountain lions in North Dakota, and responsibility to receive reports from the Agriculture Commissioner regarding all notifications and requests for assistance by individuals who believe local weed boards have not eradicated or controlled noxious weeds satisfactorily. In addition to these activities, the committee reviewed grain quality issues and agricultural research activities, the future of North Dakota's endangered species protection program, the Public Service Commission's case against rail carriers for high grain shipment rates, and renewable energy initiatives under consideration in Fargo and Grand Forks.

Committee members were Representatives Chet Pollert (Chairman), LeRoy G. Bernstein, Michael D. Brandenburg, Tom Brusegaard, Chuck Damschen, Rod Froelich, Lyle Hanson, Craig Headland, Scot Kelsh, Keith Kempenich, Joyce Kingsbury, Matthew M. Klein, Jon O. Nelson, Eugene Nicholas, Mike Norland, Dorvan Solberg, and Gerald Uglem and Senators Bill L. Bowman, Joel C. Heitkamp, Stanley W. Lyson, David O'Connell, and Herb Urlacher.

The committee submitted this report to the Legislative Council at the biennial meeting of the Council in November 2006. The Council accepted the report for submission to the 60th Legislative Assembly.

ENERGY-INTENSIVE ECONOMIC DEVELOPMENT STUDY

Background

House Concurrent Resolution No. 3028 directed the Legislative Council to study utilization of the state's abundant energy resources to attract energy-intensive economic development projects to the state.

Proponents of the resolution testified that North Dakota has an abundance of energy resources in this state but that the state has encountered problems transmitting energy produced from these resources outside the state. One solution to this problem identified by the sponsors of the resolution would be to encourage businesses to relocate to North Dakota and utilize this energy in state.

Oil and Gas Production

North Dakota crude oil production totaled 97,168 barrels per day for July 2005, ranking North Dakota 10th out of the 31 oil and gas-producing states and federal offshore areas. The state had 3,172 producing oil wells in July 2005, averaging 31 barrels of oil per day. The state produced 5,660,754 million cubic feet (mcf) of gas in March 2004 and sold 4,528,795 mcf of gas in that month. The state has a single refinery--Tesoro West Coast Refinery--located at Mandan, with a distillation capacity of 58,000 barrels per day.

The federal Department of Energy estimates that North Dakota has 353 million barrels of crude oil proved reserves, ranking the state eighth in the nation. The state has seven major crude oil pipelines, three major product pipelines, and two major liquefied petroleum gas pipelines.

Coal Production

North Dakota's coal resources are in the form of lignite--a low-grade, low-sulfur coal. North Dakota mines produced 30.1 million tons of lignite coal in 2004, marking the sixth year in a row that over 30 million tons have been produced. Since 1988 the state's lignite production has consistently been near the 30-million-ton range, making it 1 of 16 major coal-producing states, as measured by the Energy Information Administration. North Dakota ranked 11th among the 26 coal-producing states in 2003.

There are six active coal mines in North Dakota. There are four large mines and two small mines that produce leonardite. The large mines are BNI Coal, Ltd.'s Center Mine, Dakota Westmoreland Corporation's Beulah Mine, Coteau Properties Company's Freedom Mine, and Falkirk Mining Company's Falkirk Mine. The Coteau Properties Company and Falkirk Mining Company are subsidiaries of the North American Coal Corporation. In addition to these mines, there are five other mines that have closed and remain permitted and bonded for reclamation purposes. These are the Gascoyne, Glenharold, Indian Head, Larson, and Royal Oak Mines. In 2004 the Freedom Mine, the state's largest lignite producer, sold over 15 million tons of lignite, which was used by four customers. These were Dakota Gasification Company's Great Plains Synfuels Plant, Basin Electric Cooperative's Antelope Valley and Leland Olds Stations, and Great River Energy's Stanton Station. The Falkirk Mine, the state's second largest lignite producer, sold 7.6 million tons of lignite in 1984. The primary customer of this mine is Great River Energy's Coal Creek Station, the largest of the state's power plants. The Center Mine, owned by BNI Coal, a subsidiary of Minnesota Power, produced 4.1 million tons of lignite, which was primarily sold to Minnkota Power Cooperative's Milton R. Young Station. The Beulah Mine produced three million tons of lignite. Otter Tail Power Company's Coyote Station and Montana-Dakota Utilities Company's Heskett Station purchase coal from the Beulah Mine.

The Department of Mineral Resources estimates that western North Dakota contains an estimated 351 billion tons of lignite, the single largest deposit of lignite known in the world. The survey estimates that North Dakota also contains an estimated 25 billion tons of economically minable coal. The lignite and coal reserves are sufficient to last for over 800 years at the present extraction rate of 32 million tons per year.

Wind Energy

The National Wind Coordinating Committee estimates the United States could meet 10 to 40 percent of its electricity demand with wind power. Areas of the United States identified as having significant wind energy potential include areas near the coasts, along ridges of mountain ranges, and in a wide belt that stretches across the Great Plains, including North Dakota. The Great Plains is an especially attractive area for wind energy development because many coastal areas and mountain ridges are unsuitable for wind energy development due to rocky terrain, inaccessibility, environmental protection, or population density. Wind energy can be converted to electricity by using wind turbines. The amount of electricity created depends on the amount of energy contained in wind that passes through a turbine in a unit of time. This energy flow is referred to as wind power density. Wind power density depends on wind speed and air density, with air density being dependent on air temperature, barometric pressure, and altitude. Wind speed, wind shear, and turbine costs determine a site's wind energy potential.

According to the American Wind Energy Association, installed wind energy generating capacity totals 4,685 megawatts, and generates approximately 11.2 billion kilowatts of electricity, less than 1 percent of electricity generated in the United States. By contrast, the American Wind Energy Association estimates the total amount of electricity that could potentially be generated from wind in the United States at 10,777 billion kilowatts annually, three times the electricity generated in the United States today. North Dakota ranks first among the top 20 states for wind energy potential, as measured by annual energy potential in billions of kilowatt-hours, factoring in environmental and land use exclusions for wind classes of three and higher. The top 20 states are listed in the following table:

1	North Dakota	1,210
2	Texas	1,190
3	Kansas	1,070
4	South Dakota	1,030
5	Montana	1,020
6	Nebraska	868
7	Wyoming	747
8	Oklahoma	725
9	Minnesota	657
10	Iowa	551
11	Colorado	481
12	New Mexico	435
13	Idaho	73
14	Michigan	65
15	New York	62
16	Illinois	61
17	California	59
18	Wisconsin	58
19	Maine	56
20	Missouri	52

Source: An Assessment of the Available Windy Land Area and Wind Energy Potential in the Contiguous United States, Pacific Northwest Laboratory, 1991.

Similarly, the Department of Energy National Renewable Energy Laboratory has identified North Dakota as having the greatest wind resource of any of the lower 48 states. North Dakota also has few environmental restraints regarding land availability. However, the Division of Community Services within the Department of Commerce has identified a number of issues that must be addressed before significant wind energy development can occur in North Dakota. The single biggest obstacle identified by the Division of Community Services is constraints on the state's existing transmission grid. North Dakota currently exports nearly 60 percent of the power generated within the state, and it is likely that most wind-generated electricity also will be exported. Thus, utility experts agree that additions to the current transmission grid will be necessary for significant generation expansion in the state, regardless of fuel source. Other issues include identification of the market for wind energy and possible avian issues related to raptors and nesting waterfowl.

A continued interest in wind energy development in the United States and worldwide has produced steady improvements in technology and performance of wind power plants. In addition to being cost-competitive, wind power projects may offer additional benefits to the economy and the environment. The National Wind Coordinating Committee has indicated that wind energy development carries the economic benefits of job and business creation while supporting local economies and reducing reliance on imported energy. Wind energy may also protect utilities and energy consumers from the economic risks associated with changing fuel prices, new environmental regulations, uncertain load growth, and other cost uncertainties. In addition, the National Wind Coordinating Committee has found the environmental benefits of wind energy development to be substantial by reducing a utility's pollutant emissions, thus easing regulatory pressure and meeting the public's desire for clean power sources. The National Wind Coordinating Committee summarizes the benefits of wind energy as being cost-competitive; creating no air pollution; and benefiting the public health, the environment, and the economy. In addition, wind power does not require fuel, create pollution, or consume scarce resources.

Concerning the effect of wind energy development on state and local economies, the National Wind Coordinating Committee has identified several direct economic effects on the economy. Direct effects include increased revenues to local governments and landowners, creation of jobs and demand for local goods and services during construction and operation, and additional property tax revenues to local governments. Secondary or indirect effects identified by the National Wind Coordinating Committee include increased

consumer spending power, economic diversification, and use of indigenous resources.

Rural landowners can reap substantial economic rewards from wind energy development. Rent to landowners is paid because land rights for a wind energy project must be secured in advance by purchase or lease. The National Wind Coordinating Committee estimates that rural landowners can receive $50 to $100 per acre from wind energy development projects. In addition, in most cases, farming operations may continue undisturbed. Thus, a landowner is recognizing significant increased income while retaining use of that landowner's land.

Wind power plants generally can be constructed in less than a year. The National Wind Coordinating Committee estimates that for a 50-megawatt wind project, 40 full-time jobs may be created. Operation and maintenance of wind power plants generally require between two and five skilled employees for each 100 turbines. In addition, construction and operation of a wind project creates demand for local goods and services, such as construction materials and equipment; maintenance tools; supplies and equipment; and accounting, banking, and legal assistance. These economic benefits are not weakened by heavy demands on state and local infrastructure, and wind projects require little support from public services, such as water and sewer systems, transportation networks, and emergency services. Wind energy projects also contribute to economic diversification in a local economy, thus ensuring greater stability by minimizing high and low points of business cycles. The National Wind Coordinating Committee indicates this effect may be particularly important in rural areas that generally have one-dimensional economies.

Primary Sector Economic Incentives

The Department of Commerce has compiled a schedule of incentive programs available to businesses in the state. These incentive programs are primarily finance tools and tax advantages that benefit primary sector businesses and corporations. The Department of Commerce has responsibility for certifying primary sector businesses, defined as individuals, corporations, partnerships, or associations that, through the employment of knowledge or labor, add value to products, processes, or services which result in the creation of new wealth. These incentive programs are divided into income tax incentives, renaissance zones, property tax exemptions, sales tax exemptions, finance programs, training funds, and additional programs.

A new or expansion project in a primary sector business or tourism qualifies for an income tax exemption for up to five years. The exemption is limited to income earned from the qualifying project. The project operator must file a state income tax return even though the exemption is granted. However, this exemption is not allowed to an individual, estate, or trust that calculates an income tax under North Dakota Century Code (NDCC) Section 57-38-30.3, the simplified method of computing income tax. A project is not eligible for an exemption if it received a tax exemption under tax increment financing; there is a recorded lien for delinquent property, income, or sales and use taxes against the project operator or principal officers; or the exemption fosters unfair competition or endangers existing businesses.

A corporation doing business in North Dakota for the first time may take an income tax credit equal to 1 percent of wages and salaries paid during the tax year for each of the first three years of operation and one-half percent of wages and salaries paid during the tax year for the fourth and fifth years. A corporation qualifies for the credit if it did not receive a new business income tax exemption; was not created from a reorganization or acquisition of an existing North Dakota business; and is engaged in assembling, fabricating, manufacturing, mixing, or processing of an agricultural, mineral, or manufactured product.

An individual, estate, trust, or partnership is allowed an income tax credit for investing in a business certified by the Department of Commerce Division of Economic Development and Finance. For a partnership, the credit is passed through to its partners, but only its individual, estate, or trust partners may claim their share of the credit. The credit is equal to 45 percent of an investment of at least $4,000 but not more than $250,000. Not more than one-third of the credit is allowed in any taxable year. The unused credit may be carried forward up to four years. The total amount of tax credits allowed for all investments made in all years is limited to $2.5 million.

An income tax credit is allowed to an individual, estate, trust, or corporation for buying membership in, paying dues to, or contributing to a certified nonprofit development corporation. The credit is equal to 25 percent of qualifying payments or $2,000, whichever is less. Unused credit may be carried forward seven years. This credit is not allowed to an individual, estate, or trust that calculates an income tax under NDCC Section 57-38-30.3.

An income tax credit is allowed to an individual, estate, trust, or corporation for investing in a qualified North Dakota venture capital corporation. The credit is equal to the lesser of 25 percent of the amount invested or $250,000. The unused credit may be carried forward seven years. This credit is not allowed to an individual, estate, or trust that calculates an income tax under NDCC Section 57-38-30.3.

An income tax credit is allowed to an individual, estate, trust, corporation, financial institution, or insurance company for investing in the North Dakota Small Business Investment Company. The credit is equal to 25 percent of the amount invested or 50 percent in the case of a financial institution or insurance company. The unused credit may be carried forward seven years. The credit is not allowed to an individual, estate, or trust that calculates an income tax under NDCC Section 57-38-30.3.

An individual, estate, or trust is allowed a deduction of up to $5,000, or $10,000 on a joint return, for investing in a qualified North Dakota venture capital corporation. The deduction may only be taken in the tax year in which the investment qualifies for the North Dakota venture capital corporation investment credit. This deduction is

not allowed to an individual, estate, or trust that calculates an income tax under NDCC Section 57-38-30.3.

A corporation is allowed an income tax credit for the expenses of conducting research in North Dakota. The credit is 8 percent of the first $1.5 million of expenses in excess of base period research expenses and 4 percent of expenses over that amount. The unused credit may be carried back three years and forward 15 years.

A taxpayer is allowed an income tax credit for installing a geothermal, solar, or wind energy device in a building or on a property owned or leased in North Dakota. The credit for a device installed before January 1, 2001, is equal to 5 percent of the cost of acquisition and installation and is allowed in each of the first three taxable years. For a device installed after December 31, 2000, the credit is equal to 3 percent of the cost of acquisition and installation and is allowed in each of the first five taxable years. In all cases, the credit is first allowed in the year the installation is completed. For a passthrough entity, the amount of credit is determined at the entity level and passed through to the partners, shareholders, or members in proportion to their respective interests in the passthrough entity. The credit is not allowed to an individual, estate, or trust that calculates an income tax under NDCC Section 57-38-30.3.

An individual, estate, trust, or partnership is allowed an income tax credit for investing in a cooperative or limited liability company that operates an agricultural commodity processing facility in North Dakota. The cooperative or limited liability company must be certified by the Department of Commerce Division of Economic Development and Finance. For a partnership, the credit is passed through to its partners, but only its individual, estate, or trust partners may claim the credit. The credit is equal to 30 percent of the first $20,000 invested. Not more than 50 percent of the credit is allowed in any taxable year. The credit in any taxable year may not exceed 50 percent of the tax liability. The unused credit may be carried forward up to 15 years.

Businesses and individuals may qualify for one or more tax incentives for purchasing, leasing, or making improvements to real property located in a North Dakota renaissance zone. A renaissance zone is a designated area within a city which is approved by the Department of Commerce Division of Community Services. The tax incentives consist of a variety of state income and financial institution tax exemptions and credits as well as local property tax exemptions.

Any new or expanding business project may be granted a property tax exemption for up to five years. Two extensions are available, agricultural processors may be granted a partial or full exemption of up to five additional years and a project located on property leased from a governmental entity qualifies for exemption for up to five additional years upon annual application by the project operator. In addition to, or instead of, an exemption, local governments and any project operator may negotiate payments in lieu of property taxes for a period of up to 20 years from the date the project operations commence. To qualify, a project must be a new or expanded revenue-producing enterprise. All buildings, structures, or improvements used in, or necessary to, the operation of the project qualify. Land does not qualify for an exemption. A project is not eligible for exemption if a tax exemption was received under tax increment financing or the governing body determines the exemption fosters unfair competition or endangers existing businesses. North Dakota exempts all personal property from property taxation, except for certain oil and gas refineries and utilities.

A new or expanding plant may exempt machinery or equipment from sales and use taxes if the machinery or equipment is used primarily for manufacturing or agricultural processing or is used solely for recycling. The expansion must increase production volume, employment, or the types of products which may be manufactured or processed.

A sales and use tax exemption is allowed for the purchase of computers and telecommunications equipment that are an integral part of a primary sector business or a physical or economic expansion of a primary sector business provided the primary sector business has been certified by the Department of Commerce. The exemption does not extend to the purchase of replacement equipment.

Construction materials used to construct an agricultural processing facility are exempt from sales and use taxes. The processor must apply to the Tax Commissioner for a refund of the tax paid by a contractor.

A sales and use tax exemption is allowed for purchasing building materials, production equipment, and other tangible personal property used in the construction of wind-powered electrical generating facilities between July 2001 and January 2011. To be eligible, a facility must have at least one single electrical energy generation unit with a nameplate capacity of 100 kilowatts or more. The manufacturer, recycler, wind-powered electrical generating facility, or qualifying primary sector business must receive prior approval from the Tax Commissioner to qualify for the exemption at the time of purchase. If prior approval is not received, the manufacturer, recycler, wind-powered electrical generating facility, or qualifying primary sector business must pay the tax and then apply to the Tax Commissioner for a refund. The exemption is not available to contractors. Manufacturers, recyclers, wind-powered electrical generating facilities, or qualifying primary sector businesses may apply for a refund of the appropriate portion of the tax actually paid by the contractors on eligible machinery, equipment, computers, and telecommunications equipment.

The Bank of North Dakota operates two loan programs that may be used for incentives. Both programs require local bank participation. These are the partnership in assisting community expansion (PACE) program and a match program. The PACE program is designed to assist manufacturing, processing, data processing, communications, and telecommunications projects and the match program is designed to assist manufacturing, processing, and value-added industries with a long-term credit rating of "A" or better.

The North Dakota Development Fund, Inc., provides flexible gap financing through debt and equity investments for new or expanding primary sector businesses. The Development Fund also operates the regional rural development revolving loan fund. The Development Fund makes investments of up to $300,000 through direct loans, participation loans, and subordinated debt and equity investments. All loans must be secured with a first or second mortgage in fixed assets, equipment, inventory, or other reasonable sources of available collateral. The established criteria for the Development Fund includes the requirement that the entrepreneur must have a realistic financial commitment at stake, which means that generally, principals must have a minimum of 15 percent equity in the project; refinancing of the debt is not eligible; principal shareholders with 20 percent or greater ownership are generally required to guarantee the debt and other shareholders may also be required to guarantee the debt; the fund will not participate in more than 50 percent of a project's capitalization needs; and financing is available to a primary sector business project, except production agriculture. The regional rural development revolving loan fund is allocated equally among the state's economic regions for projects located in communities with a population less than 8,000 or more than five miles outside the city limits of a larger city.

The North Dakota new jobs training program provides a mechanism for primary sector businesses to secure funding to help offset the cost of training new employees for business expansion or startup. Under the new jobs training program, a business obtains funds in the form of grants, which may be obtained from the state, city, or local economic development corporation; loans, which may be obtained from a commercial lender, a local development corporation, the Bank of North Dakota, or other qualified lender; or through self-financing. Funds are made available through the capture of the state income tax withholding generated from permanent, full-time new positions that are created. Reimbursements to repay the loan, plus interest, are made directly to the lender. Reimbursements for a grant are made directly to the granting community or local economic development corporation. Under the self-financing option, 60 percent of the allowable state income tax withholding may be reimbursed directly to the participating business. The state income tax withholding may be captured for up to a 10-year period or until the loan is repaid, or the self-financing or grant obligations have been met, whichever occurs first. To be eligible, a business must be a primary sector business, a new employer locating in North Dakota creating a minimum of five new jobs, or an expanding business increasing its base employment level by a minimum of one new job. A business may not be closing or reducing its operation in one area of the state and relocating substantially the same operation to another area of the state. Also, employees in eligible new positions must be paid a minimum of $7.50 per hour plus benefits by the end of the first year of employment in the new job position created. The amount of tax withheld is based on the number of permanent, full-time new positions created, the wage rate for these new positions, and a withholding formula provided by the Tax Commissioner applied to the actual annual salary of the new jobs being created. The formula considers the individuals' average tax liability using a varying number of exemptions. The formula is applied to the annual gross wages of the new jobs created, and then is multiplied by the number of new positions in each pay category. The figure is then multiplied by 10, the maximum number of years of the program, to establish the maximum state income tax withholding available under the new jobs training program. To determine the loan amount or self-financing amount, the business provides the lender with the amount of state income withholding available. Based on the interest rate charged and draw-down schedule established by the business, the lender amortizes the total amount of state income tax withholding to determine the loan amount. Sixty percent of the allowable quarterly withholding will be reimbursed directly to the business up to the maximum available withholding identified in a program agreement. A grant is based upon the amount of the state income tax withholding available.

Work Force 2000 is a state-funded program that assists employers in providing retraining and upgrade training to support the introduction of new technologies and work methods into the workplace. The funding is provided for current workers and new employees. Training funded under Work Force 2000 is limited to North Dakota residents who are or will be employed in the state. The program is a funding source to assist in reducing the cost of training for the employer. Businesses and industries that bring new revenue to the state by selling a majority of products and services outside North Dakota are given priority for funding. Businesses that sell products or services in the local area are eligible but must demonstrate compelling economic benefit to the community or state. Projects must emphasize job skill training or basic skill training. Only training for permanent jobs that have significant career opportunities and require substantive instructions may be considered for funding. For projects that train new employees for expansion and startups, employees who successfully complete training must be given priority in hiring by the business. If the occupation for which training is being conducted is covered by a collective bargaining agreement, union concurrence is required. If new job openings are created through upgrade training, the sponsoring company should give priority consideration to individuals eligible for other state and federal job training programs. Costs for training needs assessments and the preparation of applications are the responsibility of the company. Only direct training costs can be reimbursed.

Work Force 2000 funds may not be used to reimburse salaries; fund in-house trainers; purchase equipment, software, or nonexpendable supplies; or for in-house training space. Grants are based on cost reimbursement of those actual costs identified in the contract. A company is required to submit a report identifying individuals participating in the training program. Followup reports on individuals who

participate in Work Force 2000-funded training must be submitted by the employer 90 days, 180 days, and 365 days after training.

The roots program is an incentive to assist companies in moving new employees to North Dakota. This program is offered through the Housing Finance Agency and provides incentives to purchase homes in North Dakota. The incentive is either an interest rate reduction on a first mortgage or a downpayment and closing cost assistance. To qualify for the roots program, a prospective homeowner must be a new or returning North Dakotan who is employed by a new primary sector business or who has moved to North Dakota for an employment opportunity with an existing primary sector business. The borrower must have lived and worked outside North Dakota for at least one year. The borrower must purchase a primary residence within six months of employment in North Dakota. Borrowers must meet standard credit underwriting criteria. Under one option, the first mortgage interest rate is reduced by one-half of 1 percent off the current market rate, as determined by the Housing Finance Agency. The loan is a 30-year fixed rate loan and is not assumable. The loan must be standard credit quality and requires a $500 minimum home buyer contribution. The second option is in the form of a five-year second mortgage fixed rate loan at the first mortgage rate. The amount of assistance available is equal to the present value of a one-half of 1 percent interest rate reduction with a minimum $500 home buyer contribution. The first mortgage loan is at current market interest rates.

Testimony and Committee Activities

The committee reviewed efforts by Montana-Dakota Utilities Company, Basin Electric Power Cooperative, and Xcel Energy, Inc., in assisting the state and the communities they serve in the retention and attraction of energy-intensive development projects to the state. Representatives of Montana-Dakota Utilities Company testified that the main method employed by the company in attracting projects is through competitive energy rates. Montana-Dakota Utilities Company's filed electric tariff rates are in the lower half of electric rates nationwide. One tool that allows the company to be more competitive in attracting companies is an existing economic development rate tariff, which allows the company to flex on the demand portion of the energy charge for the initial five years of a new business's operation. In addition, a special contract rate may be negotiated with the new business. Montana-Dakota Utilities Company also has the potential to offer a customer a flex rate on natural gas service. Although this rate does not allow the adjustment of the cost of the natural gas commodity, it allows some room to flex on the distribution rate charged by the company. Montana-Dakota Utilities Company also participates financially in specific projects and uses in-kind efforts to assist in the attraction of new companies to locate in North Dakota or to ensure that existing companies remain competitive.

Representatives of Basin Electric Power Cooperative testified that North Dakota's lower than average electric rates are extremely important in promoting energy and economic development in the state. The cooperative's abundant supplies of lignite, combined with renewable hydroelectric power, provide a reliable, low-cost supply of power to the consumers of North Dakota.

Representatives of Xcel Energy, Inc., testified that the primary incentive it uses to attract new economic development to the state is its low electric rates. In addition, Xcel Energy, Inc., provides financial support for economic development in the state and increases the value of its investments through the leadership role its employees take in economic development activities at the state and local levels.

The committee received testimony from representatives of Headwaters, Inc., concerning the coal-to-liquids facility being constructed by Headwaters, Inc., Great River Energy, Falkirk Mining Company, and the North American Coal Corporation at Underwood. The coal-to-liquids project will produce 50,000 barrels of fuel per day, export up to 500 megawatts of electricity, consume 15 million tons of lignite per year, employ 1,000 people, and costs $5 billion. Benefits of the project for North Dakota include a multibillion dollar investment, thousands of direct and indirect jobs, millions of dollars of additional tax revenue, efficient use of natural resources, production of clean fuel, generation of clean power, downstream industrial growth, and making the state the leader in the United States in clean coal and energy security.

The committee received testimony from representatives of Westmoreland Coal Company concerning the FutureGen proposal and the Lignite Vision 21 Gascoyne project. Westmoreland Coal Company is pursuing a 500-megawatt project at the Gascoyne site. The Gascoyne site can accommodate air permits for a 500-megawatt project and a 275-megawatt FutureGen project. Westmoreland Coal Company is pursuing potential customers, continuing the permitting process, exploring opportunities to bargain with wind energy producers, and exploring transmission issues.

The committee received testimony from representatives of Great River Energy concerning Great River Energy's resource plans, including the Spiritwood Industrial Park, Blue Flint ethanol project, coal-to-liquids project, and baseload issues. The Spiritwood Industrial Park will be composed of the Cargill malting plant, the Spiritwood ethanol plant, and the Spiritwood energy generation facility. Following the upgrade at the Cargill malting plant, it will be the world's largest malting plant. The Spiritwood ethanol plant will produce 100 million gallons of ethanol per year and the energy facility will provide electricity for the malting plant and ethanol plant. The Blue Flint ethanol plant is being constructed by a partnership comprised of Headwaters, Inc., and Great River Energy. The Blue Flint ethanol plant will be located adjacent to Great River Energy's Coal Creek Station at Underwood and will produce 50 million gallons of ethanol per year. The plant is being built to allow expansion to 100 million gallons per year. The plant will utilize 18 million bushels of No. 2 yellow corn, will be McLean Electric Cooperative's largest customer, and in addition to the 50 million gallons of ethanol will produce

160,000 tons of dry or 420,000 tons of wet distillers grain. The distillers grain will be sufficient to feed 225,000 head of feeder cattle. The Blue Flint ethanol plant will employ 37 full-time employees.

The committee received testimony from representatives of Great Northern Power Development concerning the Lignite Vision 21 South Heart project. The South Heart power project is on schedule for commencing commercial operations for the period 2013 to 2015. The committee also received resource updates from Basin Electric Power Cooperative and Minnkota Power Cooperative, including the latter's plans to develop the Milton R. Young III Station.

Conclusion

The committee makes no recommendation concerning its study of energy-intensive economic development.

RENEWABLE ENERGY INITIATIVES

The committee reviewed petitions to amend the city of Fargo and the city of Grand Forks home rule charters to provide that 20 percent of each of the city's electricity must come from renewable sources by 2020 and 30 percent of each city's electricity must come from renewable sources by 2030. The initiatives require that at least half of the renewable electricity must be generated in North Dakota. Qualified renewable electricity generating sources include electricity generated by solar, wind power, biomass, liquid biofuels, geothermal, hydrogen derived from water using electricity from fuels that otherwise qualify, and hydrogen derived from biomass or biofuels

The president of the Utility Shareholders of North Dakota urged the committee to oppose the petition drives or any mandates for wind energy. Representatives of Cass County Electric Cooperative, Inc., testified that the home rule charter amendments raise several questions that should be answered in order for the voters of Fargo and Grand Forks to cast informed votes on the measures. These questions include the costs of complying with the measures and if the measures would impact Fargo's and Grand Forks' ability to be competitive with other locations as places where operating costs are reasonable, the effect on grid stability when 20 percent or 30 percent of the generating capacity is supplied by an intermittent source, such as wind energy, the impact if some other technology is developed between now and 2020 that proves to be even better than those on the list of qualified sources contained in the measures, the omission of hydroelectric power as a renewable energy source, uncertainty if it is not technologically feasible to meet the percentages by the deadlines stated in the initiatives, uncertainty if the measures' requirements are not met, and uncertainty concerning the term "delivered into the city."

Representatives of Xcel Energy, Inc., testified that Xcel Energy, Inc., is the largest producer of wind energy in the country, currently producing 1,048 megawatts. By 2007 the utility plans to have 2,300 megawatts of wind capacity in its energy supply portfolio. In its five-state electric delivery system in the Upper Midwest, Xcel Energy, Inc., will have nearly 20 percent of its electricity supplied by wind resources. Representatives of Xcel Energy, Inc., noted that the utility purchases 500 megawatts of hydroelectricity from Manitoba but under the proposed initiatives the purchases would not fulfill the requirements of the proposal as hydropower is not listed as a qualifying source. The representatives testified that cost is a key concern for many who have reviewed the proposal and that the Xcel Energy, Inc., North Dakota residential rates have been the lowest among investor-owned utilities in North Dakota, South Dakota, Montana, Wyoming, Minnesota, Wisconsin, and Iowa three of the last four years and the utility has done this by having a diverse mix of generation sources available and planning on an integrated system basis. The representatives noted that if Xcel Energy, Inc., is required to adjust this portfolio for a particular resource within an arbitrary timeframe, its customers' energy costs would increase.

Representatives of Otter Tail Power Company testified that Otter Tail Power Company actively supports the development of renewable resources for the provision of electricity and while supporting increased use of renewables for generating electricity, the utility does not support the use of mandates, either by states or municipalities, to accomplish this goal.

RAILROAD FUEL SURCHARGES STUDY

Background

House Bill No. 1370 (2005) directed the Legislative Council to study railroad fuel surcharges. House Bill No. 1370, as introduced, would have provided that the Public Service Commission, to the extent not inconsistent with federal law, prohibit fuel surcharges in North Dakota by a railroad which are higher than the average of fuel surcharges imposed by that railroad in other states in which that railroad operates. House Bill No. 1370, as engrossed, would have provided that the Public Service Commission, to the extent not inconsistent with federal law, prohibit the assessment of a railroad fuel surcharge on a shipment of commodities in this state if the surcharge is not assessed in a region, zone, or area on a per car basis or if the surcharge exceeds on a per car basis the surcharge on a carload shipment of the commodities originating in the same or similar region, zone, or area. As enacted, the bill is limited to the section calling for a study.

State Jurisdiction Over Railroads

Barring a constitutional limitation, states have the power to regulate railroads within their states. The major limitation on this power comes from the commerce clause of the Constitution of the United States. Under the commerce clause, a state may not discriminate against an out-of-state entity without an important noneconomic state interest and there can be no reasonable nondiscriminatory alternative. Even if a state does not discriminate, a state cannot burden interstate commerce if the burden outweighs the state's interest. Even if a state passes one of the preceding tests, under the supremacy clause, the "Constitution, and Laws of the United States which shall be made in pursuance

thereof . . . shall be the supreme law of the land" and Congress can supersede conflicting state laws or preempt all the state laws in the same field under a specifically listed power in the Constitution.

Under the commerce clause, Congress has the power to "regulate commerce with foreign nations, and among the several states, and with Indian tribes." Under the necessary and proper clause, Congress can "make all laws which shall be necessary and proper for carrying into execution" the commerce clause. The commerce clause is broad in scope and regulation under the clause may address any activity, even if entirely intrastate, that taken with other similar acts affects commerce in other states. The necessary and proper clause is broad in scope and extends the commerce clause to anything appropriately related to railroads. In short, Congress has the power to regulate anything relating to railroads.

Generally, the intent of Congress is that railroads should be regulated primarily on the national level through an integrated network of federal law. In particular, Congress has passed laws relating to railroad employees, economic regulation, safety regulation, and taxation.

Economic Regulation

Under the Interstate Commerce Act of 1887, freight railroads became the first industry in the United States to become subject to comprehensive federal economic regulation. Railroads were regulated by the federal government through the Interstate Commerce Commission for the next 93 years. In 1980 Congress passed the Staggers Rail Act. The Staggers Rail Act deregulated the railroad industry, but not completely. The Interstate Commerce Commission retained authority to set maximum rates or to take certain other actions if railroads were found to have abused market power or engaged in anticompetitive behavior. In addition, the Interstate Commerce Commission had jurisdiction over railroad line abandonments. With the passage of the Interstate Commerce Commission Termination Act of 1995, the Surface Transportation Board succeeded the Interstate Commerce Commission as the federal agency with jurisdiction over railroads. Under 49 U.S.C. § 10501(b), the Surface Transportation Board has **exclusive jurisdiction** over:

> (1) **transportation by rail carriers**, and remedies . . . with respect to rates, classifications, rules . . ., practices, routes, services, and facilities of such carriers; and
>
> (2) the construction, acquisition, operation, abandonment, discontinuance of a spur, industrial, team, switching, or side tracks, or facilities, even if the tracks are located, or intended to be located, entirely in one State, . . .
>
> [T]he remedies . . . with respect to regulation of rail transportation are **exclusive and preempt** the remedies as provided under Federal or State law. (emphasis supplied)

Transportation is defined as including property, facility, instrumentality, or equipment of any kind related to the movement of passengers or property, or both, by rail and services related to that movement, including receipt, delivery, storage, handling, and interchange of passengers and property. Rail carrier is defined as a person providing common carrier railroad transportation for compensation. Railroad is defined to include a switch, spur, track, terminal, terminal facility and freight depot, yard, and ground, used or necessary for transportation.

In exercise of its commerce power, Congress has preempted most economic regulation by states of railroads. There are three forms of preemption--express, field, and conflict. Express preemption is when Congress explicitly preempts state law. Field preemption is when congressional regulation of a field is so pervasive or the federal interest so dominant that the intent to preempt can be inferred. Conflict preemption is when a state law stands as an obstacle to the purpose of a federal statute. When the preemption is explicit, the first step is to look at the plain meaning of the statute. However, there is a presumption against the federal government supplanting the historic state police powers unless preemption is the clear and manifest purpose of Congress.

In a 2002 article in *Widener Journal of Public Law*, "Wheeling and Lake Erie Railway Co. v. Pennsylvania Public Utility Commission: Pennsylvania Maintains Police Powers Over Railroad Bridge Construction Despite the Interstate Commerce Commission Termination Act of 1995," the author states:

> Few courts in the country have addressed whether the ICC Termination Act preempts the states' police powers, and the courts that have addressed this issue have held that Congress intended to preclude the states from regulating any aspect of the railway industry based on the broad jurisdiction clause of the statute.

In addition to having exclusive jurisdiction over "transportation by rail carriers," the broadly inclusive phrase "regulation of rail transportation" evidences congressional intent to preclude state remedies for violation of any state laws or rules regulating rail transportation. As stated in *CSX Transportation, Inc. v. Georgia Public Service Commission*, 944 F. Supp. 1573 (N.D. Ga. 1996), "[i]t is difficult to imagine a broader statement of Congress's intent to preempt state regulatory authority over railroad operations." In *Burlington Northern Santa Fe Corporation v. Anderson*, 959 F. Supp. 1288 (D. Mont. 1997), the court stated the "federal scheme of economic regulation and deregulation is intended to address and encompass all such regulation and to be completely exclusive."

In *City of Auburn v. U.S. Government*, 154 F.3d 1025 (1998), cert. denied, 119 S. Ct. 2367 (1999), the Ninth Circuit Court of Appeals addressed federal preemption of local environmental regulation. In that case, the city of Auburn asserted that congressional preemption over railroads only related to economic regulation of rail transportation, not the traditional state police power of environmental review. The court found that the plain

language of the Interstate Commerce Commission Termination Act explicitly granted the Surface Transportation Board exclusive authority over railway projects. The court found that any distinction between economic and noneconomic regulation begins to blur. Noneconomic regulation can turn into economic regulation if the carrier is prevented from constructing, acquiring, operating, abandoning, or discontinuing a line.

Safety Regulation

The federal regulation of railway safety is accomplished through the Federal Railway Safety Act. In the Act, Congress has expressly provided for state regulation of railroad safety. Under 49 U.S.C. § 20106, national uniformity is provided as follows:

> Laws, regulations, and orders related to railroad safety and laws, regulations, and orders related to railroad security shall be nationally uniform to the extent practicable. A State may adopt or continue in force a law, regulation, or order related to railroad safety or security until the Secretary of Transportation (with respect to railroad safety matters), or the Secretary of Homeland Security (with respect to railroad security matters), prescribes a regulation or issues an order covering the subject matter of the State requirement. A State may adopt or continue in force an additional or more stringent law, regulation, or order related to railroad safety or security when the law, regulation, or order--
>
> (1) is necessary to eliminate or reduce an essentially local safety or security hazard;
>
> (2) is not incompatible with a law, regulation, or order of the United States Government; and
>
> (3) does not unreasonably burden interstate commerce.

Under this scheme, state regulations can fill gaps that the Secretary of Transportation has not regulated and a state can respond to safety concerns of a local, rather than national, character. In addition, under 49 U.S.C. § 20113, a state may enforce federal safety regulations in certain circumstances if the state is certified to investigate railroads for violations under 49 U.S.C. § 20105.

In *CSX Transportation, Inc. v. Easterwood*, 113 S. Ct. 1732 (1993), the United States Supreme Court found that language under the Federal Railroad Safety Act preempted the state common-law duty to operate a train at a safe speed. The Court said federal regulation of speed limits should be understood as "covering the subject matter" of the state law. Federal railroad safety regulations cover the same subject matter if the regulation substantially subsumes the same subject matter as a federal regulation and does more than merely touch upon or relate to a federal regulation. Under *Burlington Northern and Santa Fe Railway Company v. Doyle*, 186 F.3d 790 (1999), the Seventh Circuit Court of Appeals opined that even nonregulation can be regulation preempting state regulation. This happens when the Federal Railroad Administration has examined and determined that there is no need for regulation.

Congress has provided for specific regulation applicable to different aspects of railway safety under 49 U.S.C. §§ 20131 through 20153 and the Federal Railroad Administration has made many rules relating to these areas of railroad safety. There are statutes or rules relating to noise omissions, whistles, locomotive boiler inspections, and safety as to cars and the coupling of cars, among other things. Whether a certain state action is preempted depends upon the type of regulation. For example, locomotive boiler inspection and car safety are preempted through field preemption. In other areas, there may be no rule or rules that allow cooperation between state and federal authorities. Any state regulation of safety requires a review of federal law and Federal Railroad Administration rules to determine if the regulation is preempted or allowed and, if allowed, in what measure. The courts give great weight to an agency delegated with authority over an area to determine whether a state law should be preempted.

Under North Dakota Century Code Section 49-11-19:

1. A person may not operate any train in a manner as to prevent vehicular use of any roadway for a period of time in excess of ten consecutive minutes except:
   a. When necessary to comply with safety signals affecting the safety of the movement of trains;
   b. When necessary to avoid striking any object or person on the track;
   c. When the train is disabled, by accident or otherwise;
   d. When the train is in motion except when engaged in switching operations or loading or unloading operations;
   e. When vehicular traffic is not waiting to use the crossing;
   f. When necessary to comply with a government statute or regulation; or
   g. When allowed by written agreement between the governmental entity that controls the roadway and the interested commercial entities. The agreement must indicate which party is responsible for the timely notification of local emergency service providers regarding the crossing that will be blocked and the period of time the crossing will be blocked.
2. A person that violates this section is guilty of a class B misdemeanor. This section does not apply to a city that has an ordinance covering the same subject matter.

In *CSX Transportation, Inc. v. City of Plymouth*, 283 F.3d 812 (2002), a similar statute was reviewed to determine if the state regulation was preempted by federal regulation. A Michigan statute prohibited trains from continuously blocking grade crossings for more than five minutes. There were two exceptions to the

prohibition--if the train is continuously moving in one direction, then the train can block a grade crossing for up to seven minutes, and if the train stopped because of an accident, mechanical failure, or unsafe condition. CSX had been repeatedly fined for violating the statute. Federal regulation provides for the regulation of speed, length, and brake testing. The Sixth Circuit Court of Appeals found that these regulations preempted Michigan's law because the amount of time a moving train spends at a grade crossing is mathematically a function of the length of the train and the speed the train is traveling. As such, the federal regulations substantially subsume the subject matter of the state statute.

State Taxation

The Railroad Revitalization and Regulatory Reform Act of 1976, often referred to as the 4-R Act, prohibits states from discriminatorily taxing railroads. Under 49 U.S.C. § 11501, a state is prohibited from unreasonably burdening or discriminating against interstate commerce. In particular, a state may not:

(1) Assess rail transportation property at a value that has a higher ratio to the true market value of the rail transportation property than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction has to the true market value of the other commercial and industrial property.

(2) Levy or collect a tax on an assessment that may not be made under paragraph (1) of this subsection.

(3) Levy or collect an ad valorem property tax on rail transportation property at a tax rate that exceeds the tax rate applicable to commercial and industrial property in the same assessment jurisdiction.

(4) Impose another tax that discriminates against a rail carrier providing transportation subject to the jurisdiction of the Board under this part.

In *Ogilvie v. State Board of Equalization of the State of North Dakota*, 893 F. Supp. 882 (D. N.D. 1995), the United States District Court found that the North Dakota tax system continued to violate the 4-R Act and previous court orders by exempting all personal property from taxation, except that of railroad companies, airlines, and public utilities and by granting a 5 percent discount for early payment of real property taxes while classifying a property used for railroad purposes as personal property.

In addition, under *Trailer Train Company v. State Board of Equalization of the State of North Dakota*, 710 F.2d 468 (1983), the Eighth Circuit Court of Appeals extended the rationale for the violation of the 4-R Act to a railcar corporation. The railcar corporation engaged in the business of providing standardized railroad flatcars to railroad companies. The court found that since tax discrimination against the train car corporation adversely affected railroad companies as directly and immediately as tax discrimination against the railroad cars of the railroad companies, North Dakota's practice of taxing personal property of the railcar corporation while exempting personal property of other commercial and industrial taxpayers was a violation of the Act.

Railroad Fuel Surcharges

On August 8, 2005, the Burlington Northern Santa Fe (BNSF) Railway issued a mileage-based fuel surcharge announcement. The announcement included a letter that stated in part that for a number of years, the BNSF Railway has assessed a fuel surcharge based on a percentage of a customer's freight bill. The fuel surcharge allows the BNSF Railway to recover a portion of its increased expense when the price of diesel fuel increases significantly. The fuel surcharge percentage changes as diesel fuel prices change. In response to feedback from its customers, the railway announced in March 2005 the railroad industry's first mileage-based fuel surcharge program was to take effect January 1, 2006. The effective date was set to allow customers and the railroad adequate time to design and implement system changes. The letter continued that in this era of tight transportation capacity, rapidly rising fuel prices, and fuel price volatility, the railroad believes a mileage-based fuel surcharge program is the most direct and accurate method of reflecting the impact of fuel price changes on the railroad and its valued customers.

Testimony and Committee Activities

The committee received testimony from representatives of the North Dakota Grain Dealers Association that railroad fuel surcharges are considerably higher than what is needed to compensate railroads for their increased fuel costs. The North Dakota Grain Dealers Association also objected to the way the surcharge was calculated before January 1, 2006, and that although the mileage-based system is an improvement, it should be based on rail miles rather than highway miles. The committee received testimony from representatives of the North Dakota Grain Dealers Association that the fuel surcharge charged by the BNSF Railway was 9 percent in January 2005, 11.5 percent in September 2005, and 13 percent in October 2005. The representatives testified that the fuel surcharge charged by the Canadian Pacific Railway has consistently been 3.5 percentage points below that charged by the BNSF Railway. The committee received testimony that until January 1, 2006, these percentages are applied to the rate, which does not necessarily correspond to the cost of fuel. For example, wheat rates are higher than corn and soybean rates and thus the fuel surcharge for wheat is more than for soybeans moved from the same elevator to the same destination. The representatives testified that wheat and soybeans weigh the same and thus the weight of a carload or a trainload is the same.

The committee received testimony from representatives of the BNSF Railway that the rail industry began assessing fuel surcharges some time ago when the price of diesel fuel began to escalate. The

BSNF Railway alone consumes approximately 1.4 billion gallons of diesel fuel each year. The reason the fuel surcharge was applied as a percentage of the basic freight rate until January 1, 2006, is because it was the easiest and simplest way to calculate the surcharge for both the railroads and their customers.

The committee received testimony from representatives of BNSF Railway that although the railroad planned to switch from a surcharge based on a percentage of the freight rate to one based on mileage and the formula was to use highway miles, rather than rail miles, in calculating the surcharge, the railroad elected to use actual rail miles in calculating the surcharge for grain and coal customers.

Representatives of the Public Service Commission testified that the commission has everything it needs under state law to allow it to regulate railroads in this state to the extent allowed under federal law and regulation and the commission does not require any change in state law to address rail regulation issues.

Conclusion

The committee makes no recommendation concerning its study of railroad fuel surcharges.

RAIL RATE COMPLAINT CASE

Throughout the interim, representatives of the Public Service Commission provided periodic updates concerning the rail rate complaint case. House Bill No. 1008 (2005) appropriated $945,000 to the Public Service Commission for the rail rate complaint case. Representatives of the Public Service Commission reported that in midwinter 2005-06 the railroad industry began implementing a series of rate cuts on wheat. The commission believes these changes were in response to the state's impending rate case. According to calculations prepared by the Upper Great Plains Transportation Institute, rate reductions directly attributable to rate case activities total nearly $10 million annually or approximately 4 cents per bushel on shipping costs on wheat for North Dakota producers. In addition, representatives of the Public Service Commission noted that the BNSF Railway has restructured its fuel surcharges to a mileage-based rate that has resulted in further cost reductions for North Dakota shippers. The Upper Great Plains Transportation Institute calculates this change resulted in a 1.5-cent to 2-cent transportation cost reduction per bushel.

Representatives of the Public Service Commission reported that the federal Surface Transportation Board has released proposed rules for the filing and processing of small shipper rate complaint cases which may adversely affect the North Dakota rail rate case. Representatives of the Public Service Commission testified that due to this development it may be unwise for the commission and stakeholders to spend the funds appropriated for the rail rate case this biennium. Representatives of the Public Service Commission recommended that if, by the end of the biennium, it has not yet filed a rail rate complaint case, the Legislative Assembly consider creating a continuing appropriation for rail litigation. This fund would serve as a reserve to guard against abusive rail practices. Also, the Public Service Commission representatives testified that if the commission recommends such a fund be established that the purposes of the fund be expanded to address a wide range of rail concerns that extend to both rate and service issues.

Late in the interim, the committee learned that the Surface Transportation Board proposes to limit small shipper complaint filing rules to those cases the maximum values of which are under $200,000. Representatives of the Public Service Commission testified that this standard would be damaging to North Dakota's efforts because while North Dakota shippers are small by any standard, the value of these cases is almost always above $200,000 due to the excessive freight rates North Dakota shippers pay. The proposed Surface Transportation Board rules are procedurally and legally untested which would mean increased cost, time, and litigation. The Public Service Commission has filed a "notice of intent to participate" in the Surface Transportation Board rulemaking.

GRAIN QUALITY ISSUES AND AGRICULTURAL RESEARCH ACTIVITIES

Throughout the interim, representatives of North Dakota State University, the North Dakota Agricultural Experiment Station, the North Dakota State University Extension Service, and the State Board for Agricultural Research and Education briefed the committee on grain quality issues and agricultural research activities.

Fusarium head blight or scab is caused by a fungus, the spores of which are dependent on high rainfall for development. The fungus spores are then dependent upon high rainfall and humidity to be carried to the grain head. Infection of wheat and barley only occurs after the head is fully emerged and only under conditions very favorable for the fusarium head blight fungus. The high rainfall that North Dakota received in June 2005 was conducive to fusarium head blight infestation.

Fusarium head blight causes lower test weight in pounds per bushel, causes the presence of vomitoxin and deoxynivalenol, and results in damaged kernels. Fusarium head blight management techniques include reduction of infected stubble, crop rotation with nonhost crop varieties, development of fusarium head blight resistant crop varieties, and the use of fungicides. The prevalence of no-till and minimum-till practices in North Dakota reduce the viability of reducing infected stubble. The use of fungicides has proven beneficial and studies have shown the use of scab fungicides may result in a 20 percent yield increase.

Fusarium head blight first became a significant problem in North Dakota in 1993. Since that time, North Dakota State University has undertaken significant research activities and has developed and released three varieties of wheat that have some degree of scab resistance.

Cultural control methods for fusarium head blight include the North Dakota Agricultural Weather Network which is widely used by wheat and barley growers in an effort to control fusarium head blight. The system has a

disease forecasting model that can be accessed either by computer or by toll-free telephone. Information obtained from this site allows the grower to determine whether conditions are conducive to fusarium head blight infection and if it would be appropriate to spray the grower's crop with fungicides. Other cultural control methods include chemical control, crop rotation, the development of resistant cultivars, hard red spring wheat breeding and genetics, durum wheat breeding and genetics, barley breeding and genetics, and the efforts of the United States wheat and barley scab initiative. The United States wheat and barley scab initiative funds approximately 130 scientists in 22 states and Mexico who are collaborating to control the fusarium head blight epidemic. Funding for the program is obtained from earmarked funds through the United States Department of Agriculture and administered by Michigan State University. The current annual funding for the scab initiative is approximately $6 million and is distributed through a competitive grants process. Of the 22 states, North Dakota receives the greatest level of funding, approximately $1 million per year, distributed among 10 to 15 scientists. These funds are used for winter nurseries, germplasm screening, disease nurseries, equipment, operations, and funding of graduate students.

Economists at North Dakota State University have examined losses to North Dakota's farm economy resulting from reduced grain yields per acre and reduced acres harvested due to field abandonment. Because the Northern Plains is a major producer of hard red spring wheat, durum, and barley, reduced yields and fewer acres harvested impact grain supplies. Reductions in supply can have a positive impact on grain prices, but the reduced supplies may be offset by substitution of grains grown elsewhere. Prices received by farmers may be impacted further by discounts when scab affects wheat or barley quality. Although there was a predicted positive overall impact on hard red spring wheat prices due to reduced supplies, production losses and negative price effects in durum and barley combined to produce an overall loss to growers of these crops of approximately $157 million in 2005. These losses represent 8 percent, 31 percent, and 21 percent, respectively, of the value of production of these crops in 2004. Research conducted by North Dakota State University revealed that for each $1 in crop losses there is a corresponding $2.08 in total economic loss as a result of fusarium head blight. Thus, the total state impact of the $157 million loss to producers in 2005 was close to $500 million. Fusarium head blight has caused a total of $1.5 billion in direct economic losses to North Dakota producers since 1993.

The committee also received information from the North Dakota State University Extension Service showing the estimated crop and livestock production losses in North Dakota due to 2006 drought conditions. North Dakota had 26 counties meeting the criteria for the livestock assistance grant program. The North Dakota State University Department of Agribusiness and Applied Economics estimated $58,435,000 of net direct losses due to drought conditions in 2006 in North Dakota. The impact to livestock was $31,135,000 and the impact to crops was $320,138,000, with $292,873,000 of crop insurance and indemnity payments, leaving a net estimated direct loss of $58,435,000.

The committee also reviewed budget issues concerning the Agricultural Experiment Station and College of Agriculture, Food Systems, and Natural Resources for the 2007 legislative session. The Agricultural Experiment Station has identified and prioritized general fund major projects for the 2007-09 biennium. Priority No. 1 is the research greenhouse complex Phase 2 at a cost of $9 million. Priority No. 2 is headquarter office buildings additions and renovations at a cost of $1,107,750. These include additions and renovations at the Carrington Research Extension Center, the Hettinger Research Extension Center, and the North Central Research Extension Center. Priority No. 3 is a beef research facility costing $950,000. The committee also reviewed initiatives to develop and expand existing enterprises and to give rise to entirely new ones.

Representatives of North Dakota State University reviewed the Grow 21: Enhancing North Dakota's Economy Through Agriculture initiative. The initiative identifies three essential attributes to a healthy community--a diverse resilient economy, effective efficient infrastructure, and leadership. The components of a diverse and resilient economy are agricultural business development, food industry enhancement, bioproducts and bioenergy development, livestock industry enhancement, cropping systems enhancement and control of scab and other pests, and multiple land uses. The report estimates the cost of this component at $6,925,000. The estimated cost of the effective and efficient infrastructure component is $2,302,000 and the growing agriculture and community leadership component is estimated to cost $200,000.

RESERVED WATER RIGHTS STUDY

Background

Senate Bill No. 2115 (2005) directed the Legislative Council to study the process to negotiate and quantify reserved water rights. Senate Bill No. 2115, as introduced, would have authorized the State Engineer to negotiate reserved water rights of the United States and federally recognized Indian tribes.

Proponents of Senate Bill No. 2115 noted that state law does not contain a procedure allowing the state to negotiate with tribes or the federal government to quantify reserved water rights and Senate Bill No. 2115 would have established such a procedure. In addition to the State Engineer, the Turtle Mountain Band of Chippewa Indians supported the bill. The bill was opposed by the Three Affiliated Tribes - Mandan, Hidatsa, and Arikara Nation and the Standing Rock Sioux Tribe. The chairman of the Three Affiliated Tribes - Mandan, Hidatsa, and Arikara Nation testified that in addition to the State Engineer, other individuals and parties should be involved in the negotiation process and that it may be better for the tribes to negotiate with a body or perhaps a commission that would be a fair representative of the state rather than with just one

individual. The chairman testified that any agreement negotiated by the State Engineer should be subject to ratification by the Legislative Assembly and signed by the Governor. Finally, the chairman testified that the Three Affiliated Tribes - Mandan, Hidatsa, and Arikara Nation objected to the provisions of Senate Bill No. 2115 providing that exceptions to an agreement would be resolved through an administrative process. The chairman of the Standing Rock Sioux Tribe testified that the tribe was in fundamental opposition to Senate Bill No. 2115. The chairman testified that the bill posed grave risks for all North Dakota tribes and did not believe it was necessary at this time to quantify the tribes' reserved water rights under the "Winters doctrine" relating to reserved water rights for Indian tribes.

As enacted, Senate Bill No. 2115 is limited to the section calling for a study.

Surface Water Appropriation

There are generally two systems that govern the appropriation of water in the United States. The humid Eastern states where water resources are more plentiful follow the common-law doctrine of riparian rights. The arid Western states where water resources are more scarce follow the doctrine of prior appropriation.

A riparian right is a right to use a portion of the flow of a watercourse that arises by virtue of ownership of land bordering a stream. The basic principle of prior appropriation is that a person may acquire an exclusive right to use a specific quantity of water by applying it to a beneficial use without reference of the focus of the use. An appropriate right is also defined by the time period of use as well as by the quantity claimed. Thus, the prior appropriation doctrine is often known as the first in time first in right water appropriation system.

North Dakota is a prior appropriation doctrine state. North Dakota Century Code Section 61-04-06.3 provides, in part:

> Priority in time shall give the superior water right. Priority of a water right acquired under this chapter dates from the filing of an application with the state engineer, except for water applied to domestic, livestock, or fish, wildlife, and other recreational uses in which case the priority date shall relate back to the date when the quantity of water in question was first appropriated, unless otherwise provided by law.

Ground Water Appropriation

Generally, there are four water allocation doctrines applicable to ground water--absolute ownership, reasonable use, correlative rights, and prior appropriation. The first three are based upon ownership of the land overlying the water resource, and the fourth doctrine has been applied to ground water by a number of states that use the prior appropriation doctrine to allocate surface water resources.

The absolute ownership doctrine was imported to the Eastern United States from England. Under its provisions, a landowner owns, and has an unlimited right to withdraw, any water found beneath the landowner's land. This doctrine is followed in Connecticut, Georgia, Illinois, Indiana, Maryland, Massachusetts, Mississippi, Rhode Island, Texas, and the District of Columbia.

Under the reasonable use doctrine, ground water may be used without waste on overlying land and landowners are only liable for injuries arising from their ground water withdrawals if their use is unreasonable. A use is unreasonable if it is wasteful or if the water is used on nonoverlying lands. This doctrine is followed in Arizona, Nebraska, and Oklahoma. However, Nebraska has enacted legislation authorizing industrial and municipal nonoverlying ground water uses if a permit has been obtained.

The correlative rights doctrine was designed to accommodate all overlying owners when water supply is insufficient to meet the reasonable needs of all overlying landowners. Under this doctrine, owners of land are each limited to a reasonable share of the total supply of ground water. The share is usually based on the amount of acreage owned by each landowner. California is the only state that follows this doctrine.

The prior appropriation doctrine, when applied to ground water, has been modified in most jurisdictions to allow more widespread ground water use than strict application of the doctrine would allow. Alaska, Colorado, Idaho, Kansas, Montana, Nevada, New Mexico, Oregon, South Dakota, Utah, Washington, and Wyoming, as well as North Dakota, apply this doctrine.

Priority

Although North Dakota is a prior appropriation state, this common-law doctrine has been statutorily modified by the requirement that the first in time first in right be measured by the acquisition of a water permit from the State Engineer. North Dakota Century Code Section 61-04-02 requires that an appropriator secure a permit for the beneficial use of water. If there are competing applications for water from the same source and the source is insufficient to satisfy all applicants, then the State Engineer must follow the priority established by Section 61-04-06.1 in granting water permits. The priority established by Section 61-04-06.1 is:

1. Domestic use.
2. Municipal use.
3. Livestock use.
4. Irrigation use.
5. Industrial use.
6. Fish, wildlife, and other outdoor recreational uses.

The water appropriated must still be put to a beneficial use in order to secure a valid water right under the prior appropriation doctrine. Also, NDCC Section 61-04-06.3 provides, in part:

> Priority of appropriation does not include the right to prevent changes in the condition of water occurrence, such as the increase or decrease of streamflow, or the lowering of a water table, artesian pressure, or water level, by later appropriators, if the prior appropriator can reasonably acquire the prior appropriator's water under the changed conditions.

Reserved Water Rights Doctrine

In *Cappaert v. United States*, 426 U.S. 128 (1976), the United States Supreme Court stated:

> This Court has long held that when the Federal Government withdraws its land from the public domain and reserves it for a federal purpose, the Government, by implication, reserves appurtenant water then unappropriated to the extent needed to accomplish the purpose of the reservation. In so doing the United States acquires a reserved right in unappropriated water which vests on the date of the reservation and is superior to the rights of future appropriators. Reservation of water rights is empowered by the Commerce Clause, Article I, Section 8, which permits federal regulation of navigable streams, and the Property Clause, Article IV, Section 3, which permits federal regulation of federal lands. The doctrine applies to Indian reservations and other federal enclaves, encompassing water rights in navigable and nonnavigable streams.

The United States Supreme Court first recognized Indian reserved water rights in *Winters v. United States*, 207 U.S. 564 (1908). In *Winters* the United States Supreme Court held that the 1888 agreement and statutes, which created the Fort Belknap Reservation in north central Montana, implicitly reserved to the tribe water from the Milk River for irrigation purposes. In finding that the policy of the United States to promote the transformation of tribal members to a "pastoral and civilized people" would be defeated and the land would become "practically valueless" unless the tribe's supply of irrigation water was protected from non-Indians claiming water under state law, the Court stated that "[t]he lands were arid, and, without irrigation, were practically valueless. And yet, it is contended, the means of irrigation were deliberately given up by the Indians and deliberately accepted by the government. The lands ceded were, it is true, also arid; and some argument may be urged, and is urged, that with their cession there was the cession of the waters, without which they would be valueless, and 'civilized communities could not be established thereon.' And this, it is further contended, the Indians knew, and yet made no reservation of the waters. We realize that there is a conflict of implications, but that which makes for the retention of the waters is of greater force than that which makes for their cession." It should also be noted that courts have held that the priority of Indian reserved water rights dates from the creation of the Indian reservation and Indian reserved water rights are not subject to forfeiture or abandonment for nonuse.

Quantity of Reserved Water Rights - The Practicably Irrigable Acreage Standard

In *Arizona v. California*, 373 U.S. 546 (1963), the United States Supreme Court adopted the practicably irrigable acreage standard as the presumptive quantification standard for Indian reserved water rights. In *Arizona* the Court agreed with the special master's conclusion that the quantity of water intended to be reserved was intended to satisfy the future as well as the present needs of the Indian reservations and ruled that enough water was reserved to irrigate all of the practicably irrigable acreage on the reservations. *Arizona* contended that the quantity of water reserved should be measured by the Indians' "reasonably foreseeable needs," which the Court rejected. The Court concluded, as did the special master, that the only feasible and fair way by which reserved water for the reservations can be measured is irrigable acreage.

Adjudication and Quantification of Reserved Water Rights

In *Indian Reserved Water Rights* by John Shurts, the author outlines the rationale for the adjudication and quantification of Indian reserved water rights. He states that the "prospect of expensive litigation and uncertain outcomes has led Indian groups, the federal government, state and local governments, private water users, and others to focus heavily on negotiating agreements to confirm and quantify reserved rights; agreements that Congress is asked or will be asked to ratify. In the usual situation, a particular Indian nation is asked by the other parties to relinquish its indefinite and potentially expandable reserved rights in return for a clearly described right to a definite, quantified amount of water, plus an amount of money or an agreement for assistance in bringing water to reservation lands, or both." However, until passage of the McCarran Amendment in 1952, the ability of states to quantify reserved water rights and to incorporate them into decrees and administrative systems was thwarted by the sovereign immunity of the United States and tribes. The McCarran Amendment waives the sovereign immunity of the United States and allows the United States to be named as a defendant in state general adjudication and administration proceedings. The McCarran Amendment provides:

> Consent is hereby given to join the United States as a defendant in any suit (1) for the adjudication of rights to the use of water of a river system or other source, or (2) for the administration of such rights, where it appears that the United States is the owner of or is in the process of acquiring water rights by appropriation under State law, by purchase, by exchange, or otherwise, and the United States is a necessary party to such suit. The United States, when a party to such a suit shall (1) be deemed to have waived any right to plead that the State laws are inapplicable or that the United States is not amenable thereto by reason by its sovereignty, and (2) shall be subject to the judgments, orders, and decrees of the court having jurisdiction, and may obtain review thereof, in the same manner and to the same extent as a private individual in like circumstances.

The *American Indian Law Deskbook* notes that "[i]n part due to the passage of the McCarran Amendment and in part due to the increasing competition for scarce water, most western states have commenced general

adjudication of varying scope in order to quantify reserved water rights and incorporate them into comprehensive state water management systems."

As affirmed by the United States Supreme Court in *Colorado River Water Conservation District v. United States*, 427 U.S. 800 (1976), the McCarran Amendment allows Indian reserved water rights to be adjudicated in state courts by suing the United States in its role as trustee for the tribes. The *American Indian Law Deskbook* notes that tribes themselves cannot be named as defendants in state adjudication proceedings since the McCarran Amendment did not waive the sovereign immunity enjoyed by Indian tribes.

State adjudication proceedings generally take one of three forms. One form is the traditional civil judicial action wherein a court determines the water rights of the interested parties. The second form is to authorize an administrative agency to conduct the adjudication process. The third form is to create a commission to negotiate the adjudication of reserved water rights with Indian tribes.

An example of a state that provides for civil judicial adjudication of reserved water rights is South Dakota. South Dakota Codified Laws Section 46-10-01 provides that "[i]t shall be the duty of the attorney general to bring an action for the general adjudication of the nature, extent, content, scope, and relative priority of the water rights and the rights to use water of all persons, or entities, public or private, on any river system and on all other sources, when in his judgment, or in the judgment of the Water Management Board, the public interest requires such action." Section 46-10-1.1 provides that the procedure in any case of general adjudication is as in other civil cases, insofar as that procedure is not inconsistent with South Dakota law. Some commentators have criticized this method of adjudicating reserved water rights because the judicial proceedings are adversarial in nature and thus the final adjudication is sometimes viewed as one in which there are winners and losers.

An example of a state that has delegated negotiated authority to an administrative agency is Oregon. It appears that Senate Bill No. 2115 is based on the Oregon statute.

An example of a state that has adopted the commission form of adjudicating reserved water rights is Montana. Montana Code Annotated Section 85-2-701 provides that "because the water and water rights in each water division are interrelated, it is the intent of the legislature to conduct unified proceedings for the general adjudication of existing water rights under the Montana Water Use Act. It is the intent of the legislature that the unified proceedings include all claimants of reserved Indian water rights as necessary and indispensable parties under authority granted the state by 43 U.S.C. 666 (the McCarran Act). However, it is further intended that the state of Montana proceed under the provisions of this part in an effort to conclude compacts for the equitable division and apportionment of waters between the state and its people and the several Indian tribes claiming reserved water rights within the state. To the maximum extent possible, the reserved water rights compact commission should make the negotiation of water rights claimed by the federal government or Indian tribes in or affecting the basins identified by law its highest priority. In negotiations, the commission is acting on behalf of the Governor."

Montana has approved, ratified, and codified the Yellowstone River Compact, the Fort Peck-Montana Compact between Montana and the Assiniboine and Sioux Tribes of the Fort Peck Indian Reservation, the North Cheyenne-Montana Compact between Montana and the Northern Cheyenne Tribe of the Northern Cheyenne Indian Reservation, the United States Park Service-Montana Compact between Montana and the United States National Park Service, the United States Bureau of Land Management-Montana Compact between Montana and the United States Bureau of Land Management, the Chippewa Cree Tribe-Montana Compact between Montana and the Chippewa Cree Tribe of the Rocky Boy's Indian Reservation, the United States Fish and Wildlife Service, Black Coulee and Benton Lake-Montana Compact between Montana and the Fish and Wildlife Service, the Red Rock Lakes-Montana Compact between Montana and the Fish and Wildlife Service, the Crow Tribe-Montana Compact between Montana and the Crow Tribe, and the Fort Belknap-Montana Compact between Montana and the Fort Belknap Indian community of the Fort Belknap Reservation.

Testimony and Committee Activities

The chief assistant attorney general for the Idaho Attorney General's office reviewed the negotiation and quantification of federal and Indian reserved water rights in Idaho and other western states. The chief assistant attorney general reviewed the Snake River Basin adjudication, alternatives for quantification of Indian reserved water rights, state processes for negotiation of tribal claims, the Idaho reserved water rights adjudication process, the Shoshone-Bannock negotiations, the Nez-Perce negotiations, the Northwestern Band of Shoshoni negotiations, the Shoshone-Paiute negotiations, and general principles concerning the adjudication and quantification of federal and Indian reserved water rights.

The Snake River Basin adjudication was a general stream adjudication of all water rights in the Snake River Basin within Idaho. The purposes of the Snake River Basin adjudication were to obtain an accurate list of all state-based water rights, quantify all federal reserved water rights in the basin, and determine hydraulically connected water sources. The Snake River Basin adjudication was the second largest general stream adjudication in the United States. The Snake River Basin adjudication encompassed 150,000 water rights claims, 20,000 of which were federal and tribal water rights claims. To date, 120,000 claims have been decreed and it is expected the remaining claims will be decreed within the next five years.

The Shoshone-Bannock Tribe filed a claim for irrigation in the amount of 782,107 acre-feet per year of water. The final decreed amount was 581,031 acre-feet of water per year. The claim filed by the Nez-Perce

Tribe was recognized at 50,000 acre-feet of water per year with a settlement pending. The claim for the Shoshone-Paiute Tribe of 451 acre-feet per year is also pending. Other entities, such as the United States Department of Energy, United States Department of Defense, United States Department of Veterans Affairs, General Services Administration, United States Geological Survey, United States Fish and Wildlife Service, United States Army Corps of Engineers, and National Park Service, also filed federal reserved water rights claims in the Snake River Basin adjudication. There were federal claims for 5,970 acre-feet of water per year, of which 5,963 acre-feet of water per year were dismissed, thus recognizing federal claims for 7 acre-feet of water per year.

The process of adjudication and quantification of federal reserved water rights usually begins when the situation ripens by the presence of a strong desire to settle water rights in a basin, a sense of urgency is present, and the key players are involved. The next step is preparation for the adjudication process. It must be decided who will be present at the negotiation table, the spokespersons and resources must be identified, preparatory analysis must be completed, working relationships must be established, and information must be shared. The committee learned that there is no one right or correct water adjudication method, but what is important are the intangible factors, such as the relationships of the parties, information, and the motivation of each of the parties to reach an agreement. The next step is to reach a local agreement. Local agreements are reached by establishing and negotiating protocols, identifying the major goals and issues of the adjudication, developing strategies and proposals, finding alternative means to meet these objectives, and reaching agreement through compromise. The next step is authorization by the state and local parties followed by federal review and approval. Next, the agreement must be approved in a tribal referendum, court approval may be required, and congressional appropriations may need to be secured to fund the settlement. Finally, the agreement must be implemented.

The committee learned that there are at least three alternatives for quantification of Indian reserved water rights. These include litigation, negotiation, and a combination of litigation and negotiation. The Wind River adjudication in Wyoming is an example of quantification of Indian reserved water rights through litigation, the Warm Springs settlement in Oregon is an example of quantification of Indian reserved water rights through negotiation, and the states of Montana, Colorado, Arizona, and New Mexico have utilized litigation and negotiation to quantify Indian reserved water rights. There are at least four processes for negotiation of tribal reserved water rights claims. Oregon specifies the State Engineer conduct negotiations on behalf of the state. Montana has established a compact commission that conducts negotiations on behalf of the state. In Colorado, Washington, and Idaho negotiations are conducted by the executive branch. In Arizona, water users have initiated negotiation of tribal reserved water rights claims. Water users in Arizona have led the effort to settle tribal claims in order to quantify the amount of water reserved for tribes and to add finality to tribal claims. Regardless of the approach to negotiate tribal reserved water rights claims, most states form a multimember negotiating team consisting of a political official for policy direction, a senior management official for continuity of negotiations, a technical representative, a legal representative, and a lead negotiator. Concerning the process followed in Idaho, the Governor was the lead negotiator, supported by the Attorney General. These executive officials worked closely with the Idaho Legislature while the state director of water resources provided technical support to all parties involved with the negotiations. Idaho's process began with historical research of all federal claims followed by a technical review of those claims. Next, the legal representative evaluated the risks of litigation and chance for settlement. Next, Idaho developed a process for the development for key constituents, provided periodic updates to the Governor and the legislature, and provided a public process for approval of reserved water rights settlements.

The committee learned that whether a settlement needs to be approved by a state legislative body or Congress depends on the nature of the settlement. If the settlement only quantifies and adjudicates water rights, conceivably the water rights can be settled in a judicial decree without legislative approval. However, if the settlement includes something in addition to water rights, such as an economic development package or other services requiring state or federal funds, then the settlement would require legislative approval. The Idaho chief assistant attorney general recommended the legislative body be involved from the beginning because it is not known at the beginning of the process what form the settlement will take. For example, if the settlement includes state recognition of a tribal water right, the settlement may require legislative approval.

The committee learned that the technical review step is important because it determines what the historical diversions have been and what cropping patterns are on the reservation to determine the duty of water. Also, the technical review will reveal what the potential is to develop water on the reservation. This is important because a federal reserved water right is not limited to actual beneficial use but includes both present and future water needs.

Ten factors are necessary for successful reserved water right negotiations. There must be an uncertain outcome, realistic expectations, stakeholder involvement and continuity of stakeholders, a sense of urgency, mutual respect and trust, equal access to technical data and facts, avoidance of sovereignty issues, funding, a forum for conducting sensitive discussions, and clear boundaries on negotiations.

The Idaho chief assistant attorney general also reviewed the Shoshone-Bannock negotiations, the Nez-Perce negotiations, the Northwestern Band of Shoshoni negotiations, and the Shoshone-Paiute negotiations. The committee learned the negotiation process should be tailored to the needs of the parties. The committee learned the state must understand what

the claims are, what it is willing to negotiate, and at what point the state is willing to walk away from negotiations if a good agreement is not achievable. The state should insist on a strong federal commitment to the negotiation process. The state must assure the tribe that the state is committed to negotiations and finally the state must know the limits of what it is willing to negotiate. Once a water rights settlement is quantified, negotiated, and finalized, the agreement is final and cannot be renegotiated. This is to achieve one of the objectives of quantification and adjudication of water rights which is finality, which provides a basis upon which the interested parties can make future decisions.

Concerning the issue of whether the reserved water rights doctrine applies to ground water as well as surface water, the committee learned Western states have taken the position that the reserved water rights doctrine only applies to surface water and does not apply to ground water. The only case in which a reserved water right to ground water has been found is *Cappaert v. United States*, 426 U.S. 128 (1976). However, that case rests upon several unique facts, one of which is that the ground water was being expressed as a surface supply. Thus, there is no clear legal precedent whether the reserved water rights doctrine applies to ground water.

Concerning off-reservation reserved water rights, the committee learned Idaho litigation and cases are premised on the basis that a reserved water right is associated expressly with reserved lands and that absent the reservation of lands, there can be no reserved water right and thus the right would not extend off reservation.

The committee learned that all reserved water rights negotiations and agreements in Idaho are premised on the prior appropriation doctrine. Thus, if there is a shortage, subordination agreements are used whereby a senior appropriator may agree to and be compensated for subordinating that person's right to take a certain quantity of water, making that water available to a junior appropriator.

Representatives of the Turtle Mountain Band of Chippewa Indians testified the tribe desires a cooperative agreement with the state that benefits both the state and the tribe. The tribe knows it can commence litigation to settle its reserved water rights claims but prefers to quantify its reserved water rights through negotiations with the state. The primary reason the Turtle Mountain Band of Chippewa Indians would like to quantify its reserved water rights is to ensure the availability of water for the reservation and to protect the resource.

Committee Considerations

The committee considered a bill draft that authorized the Governor to negotiate reserved water rights of the United States and federally recognized Indian tribes. Under the bill draft, the Governor or the Governor's designee could negotiate with any federally recognized Indian tribe claiming a reserved water right in North Dakota and representatives of the federal government as trustee for the federally recognized Indian tribe to define the scope and attributes of rights to water claimed by the Indian tribe or negotiate with the federal government to define the scope and attributes of non-Indian reserved water rights claimed by the federal government. Under the bill draft, when the Governor or the Governor's designee and representatives of any federally recognized Indian tribe or the federal government with regard to non-Indian reserved water rights have completed an agreement, the agreement, upon approval of the Legislative Assembly, must be signed by the Governor on behalf of the state and by authorized representatives of the Indian tribe and the federal government as trustee for the Indian tribe or by an authorized representative of the federal government with regard to non-Indian reserved water rights agreements.

Representatives of the Three Affiliated Tribes - Mandan, Hidatsa, and Arikara Nation testified that the issue of reserved water rights is very important to the tribe and one of the objections of the tribe to the bill considered by the Legislative Assembly during the 2005 legislative session was that the Legislative Assembly delegated authority to negotiate Indian and federal reserved water rights to the State Engineer. The tribe favors legislation whereby a commission would be established to negotiate Indian reserved water rights. It was suggested this legislation might be similar to legislation enacted in Montana and that the Governor appoint a number, such as four or five, to a commission to negotiate Indian reserved water rights. Another aspect of the Montana commission system favored by the tribe is that there is an interim process whereby water rights can be used until final negotiations are concluded.

The committee considered a bill draft that would have created a reserved water rights compact commission. In negotiations, the commission would have been acting on behalf of the Governor. The commission would have consisted of two members of the House of Representatives, two members of the Senate, four members designated by the Governor, and one member designated by the Attorney General. The State Water Commission would have provided administrative, staff, technical, and engineering services to the commission; the Attorney General would have provided legal services to the commission; and the Governor would have designated a chairman from among the members of the commission.

Representatives of the State Water Commission noted that the bill draft required Legislative Assembly approval of any agreement following negotiations and then if there are exceptions, an adjudicative proceeding would begin with the State Engineer to issue a final order and the reserved water right would then become effective. The State Engineer proposed that the adjudicative process occur before the agreement would be submitted to the Legislative Assembly for ratification. Following ratification, the State Engineer would then issue a final order and the reserved water right would become effective. The State Engineer testified the State Water Commission would have sufficient resources to negotiate a reserved water rights agreement with the Turtle Mountain Band of Chippewa Indians but if the

state were to be involved in additional negotiations, additional resources may be required. The bill draft was supported by the Turtle Mountain Band of Chippewa Indians and the Three Affiliated Tribes - Mandan, Hidatsa, and Arikara Nation.

Several members of the committee indicated the Legislative Assembly should authorize the Governor to appoint qualified individuals to negotiate water rights agreements on behalf of the state and this structure may be preferable to including members of the Legislative Assembly on a commission. Several members of the committee noted the Governor would undoubtedly appoint qualified individuals to undertake the negotiations; whereas, members of the Legislative Assembly may not have the requisite expertise to be qualified members of the commission.

The committee considered a bill draft that authorized the Governor to negotiate reserved water rights agreements rather than having a commission, with a revised procedural process to provide that the agreements would be ratified by the Legislative Assembly near the end of the negotiation process.

Representatives of the Governor's office testified the Governor has authority to negotiate reserved water rights based upon the executive powers granted to the Governor by the Constitution of North Dakota and in statutes enacted by the Legislative Assembly to coordinate state agency dealings with Indian tribes. Article V, Section 7, of the Constitution of North Dakota states that the Governor is the chief executive of the state and shall transact and supervise all necessary business of the state with the United States, the other states, and the officers and officials of this state. North Dakota Century Code Chapter 54-40.2 provides that state agencies may negotiate agreements with Indian tribes regarding subjects over which they have authority under state law. These agreements are effective only upon approval by the Governor. The representative of the Governor's office noted that Chapter 61-02 gives the State Water Commission full and complete power, authority, and general jurisdiction over the regulation and appropriation of water in this state, full control over all unappropriated public waters of the state, and specific authority to make all contracts or compacts necessary or requisite with the United States or any department, agency, or officer thereof. The representative of the Governor testified that these constitutional and statutory provisions indicate the authority to negotiate reserved water rights with the federal government and Indian tribes already exists. The representative of the Governor's office said requiring legislative approval over reserved water rights agreements may cause a delay because the Legislative Assembly only meets once every two years. Also, if the negotiators know that legislative approval is required, it may discourage serious negotiations. A representative of the Attorney General agreed there are mechanisms in North Dakota law which allow state officials to negotiate with tribes to determine and settle their water rights. The representative noted that if the Governor uses the authority under Chapter 51-40.2 or 61-02 to negotiate reserved water rights agreements, then the Legislative Assembly could amend the statutes to require legislative approval. However, if the Governor is relying on the authority contained in Article V, Section 7, of the Constitution of North Dakota, that the Governor as chief executive officer of the state has authority to transact and supervise all necessary business of the state with the United States, the other states, and the officers and officials of this state, then requiring legislative oversight may violate the separation of powers contained in the state constitution.

Representatives of the Turtle Mountain Band of Chippewa Indians testified that the tribe prefers the bill draft be tribe-specific, that the Governor may negotiate with the Turtle Mountain Band of Chippewa Indians to negotiate that tribe's reserved water rights. A member of the committee noted that the bill draft should not be limited to a single tribe but as drafted is discretionary and allows those tribes that wish to negotiate their reserved water rights an opportunity to do so but does not force any tribe to enter negotiations with the state to quantify its water rights. A member of the committee noted if the committee did not recommend the bill draft to the Legislative Council for submission to the Legislative Assembly, then the committee is saying that the Legislative Assembly should not be involved in approving reserved water rights agreements. However, if the committee forwards a bill draft to the Legislative Council, it is making a strong statement that the committee believes the Legislative Assembly should have final approval over any reserved water rights agreement negotiated between the state and a tribe. A member of the committee noted it is clear the Governor has authority to negotiate reserved water rights agreements under current law. However, if the Legislative Assembly is to have a voice in the process by requiring an agreement be submitted to the Legislative Assembly for approval, then the bill draft should be approved and recommended to the Legislative Council.

Recommendation

The committee recommends House Bill No. 1025 to authorize the Governor to negotiate reserved water rights of the United States and federally recognized Indian tribes. Upon signature by all required parties, an agreement must be submitted to the Legislative Assembly for approval. Upon approval by the Legislative Assembly, the State Engineer is required to incorporate the agreement in a final order. The agreement is effective upon issuance of the final order.

NOXIOUS WEED REPORTS

Section 37 of 2005 Senate Bill No. 2280 provides that the Agriculture Commissioner shall report to the Legislative Council all notifications and requests for assistance by individuals who believe local weed boards have not eradicated or controlled noxious weeds satisfactorily. A representative of the Agriculture Commissioner reported for 2005 that the department received approximately 10 calls complaining about weed control during the summer of 2005. Each time the individual was referred back to the county weed board for action. The department did not receive any written

appeals on weed control problems for the 2005 season. The department did not receive a request from county weed boards to enforce NDCC Chapter 63-01.1 because of a conflict of interest.

The Agriculture Commissioner reported that for 2006 the department received a complaint on April 3, 2006, which was investigated.

ENDANGERED SPECIES ACT

A representative of the Agriculture Commissioner reviewed the future of North Dakota's endangered species protection program. The committee learned the Environmental Protection Agency will start adding county bulletin reference language to pesticide labels in 2006. The state will be required to have county bulletins in place within the next year. Existing North Dakota bulletins will not be adequate. The Agriculture Commissioner is analyzing what role the state should play in developing the bulletins. The commissioner has identified three options. Option 1 is to have the Environmental Protection Agency develop bulletins for North Dakota just as it will do for most states. This is the default option if the state does nothing. Option 2 is to have the commissioner take complete ownership of the program under a state-initiated endangered species protection program. This option is estimated by the commissioner to require five additional full-time equivalent positions and $1.5 million in state funds. Option 3 is a hybrid approach under which the Environmental Protection Agency would retain ultimate responsibility for the preparation of the publication of bulletins but the commissioner could offer input to the agency and furnish agency staff with local pesticide use data, cropping data, species distribution maps, environmental monitoring data, and recommendations for bulletin language. The commissioner estimated this option would require an additional three full-time equivalent positions at approximately $500,000 in additional funds per biennium. The Agriculture Commissioner recommended the state pursue Option 3 as it would allow significant input in the process and allow the state some control over the pesticide use restrictions found in the bulletins. Representatives of the North Dakota Farm Bureau, the North Dakota Farmers Union, the North Dakota Grain Growers Association, and the North Dakota Agricultural Association testified that these organizations support Option 3--the hybrid approach--under which the Environmental Protection Agency would retain ultimate responsibility for the preparation of publication of bulletins but with state input. This option would provide substantial cost-savings and may provide the most workable solution.

MOUNTAIN LION ASSESSMENT REPORT

Section 2 of 2005 House Bill No. 1102 requires the Game and Fish Department in cooperation with tribal authorities to assess the status of mountain lions in North Dakota. Between 1958 and 1991, there were 11 confirmed sightings of mountain lions in North Dakota. In 1991 the Legislative Assembly classified mountain lions as fur-bearers and directed the Game and Fish Department to manage them with other rare fur-bearers in a closed season. However, there are statutory provisions allowing individuals to take mountain lions to protect livestock. North Dakota Century Code Section 20.1-07-04 allows a landowner or tenant or that person's agent to catch or kill any wild fur-bearing animal that is committing depredations upon that person's poultry or domestic animals. However, this section requires a person catching or killing a mountain lion to report the capture or killing to the department within 24 hours and the entire animal must be turned over to the department. Between 1991 and 2003, there were 26 confirmed reports of mountain lions in North Dakota. A new reporting system was developed by the department beginning in 2004 to obtain specific locational information on mountain lions; to attempt to verify sightings based on physical evidence; and to classify sightings as unfounded, improbable unverified, probable unverified, or verified. Approximately 2 percent of North Dakota can support a small population of mountain lions. The suitable habitat is located in the Badlands and Missouri River Breaks and, assuming there is no managed harvest, can support between 45 and 74 mountain lions.

The department held an experimental mountain lion season between September 2, 2005, and March 12, 2006. A quota of five mountain lions was allowed and when this quota was reached, the season was closed. The first mountain lion was harvested on November 16, 2005, and the final mountain lion taken on January 15, 2006.

Although most of North Dakota does not contain habitat suitable for mountain lions, mountain lions either have recolonized or are in the process of recolonizing a portion of their former range in the Badlands. Individual lions travel through the other portions of the state and are most likely young dispersing animals. The lion population in North Dakota likely will be limited due to geographic isolation from other lion populations in adjacent states.

Representatives of the department reported seven bighorn sheep have been killed by mountain lions with mountain lions suspected in another three sheep deaths. The department has invested substantial resources in expanding the bighorn sheep population in the state and if it is documented a mountain lion is taking sheep, the lion will be removed by the department.

The department representatives reported the department will again offer an experimental mountain lion hunting season in 2006-07. The season will run from September 2, 2006, through March 12, 2007, or when the quota of five mountain lions has been reached. The season will be very similar to the 2005-06 season; however, no hunting or pursuing with dogs will be allowed until after January 1, 2007. Also, individuals hunting with dogs may not pursue or take a female mountain lion accompanied by kittens. Any mountain lion other than kittens, lions with visible spots, or females accompanied by kittens will be a legal animal. Finally, in the event that none of the five lions are taken on the Fort Berthold Reservation, one additional mountain lion may be taken on the reservation when the quota has been reached and the statewide season closed.

GARRISON DIVERSION PROJECT AND RED RIVER VALLEY WATER SUPPLY PROJECT STUDIES

The Garrison Diversion Conservancy District is an instrumentality-political subdivision of the state created in 1955 to construct the Garrison Diversion unit of the Missouri River Basin project as authorized by Congress on December 22, 1944. Amendments enacted by Congress in 1986 and 2000 have changed the Garrison Diversion unit from a million-acre irrigation project into a multipurpose project with an emphasis on the development and delivery of municipal and rural water supplies. The mission of the Garrison Diversion Conservancy District is to provide a reliable, high-quality, and affordable water supply for the benefit of North Dakota. The manager of the Garrison Diversion Conservancy District updated the committee on the municipal, rural, and industrial water supply program, recreation programs, agricultural research, the Oakes Test Area, and the Red River Valley water supply project.

The Garrison Diversion Conservancy District and the State Water Commission jointly administer the municipal, rural, and industrial water supply program. To date in 2006, they have distributed $4,116,847 in federal funding. Approximately $245 million remains of federal authorization for this program. The conservancy district and State Water Commission have also distributed $715,837 from the water development and research fund in 2006.

The Garrison Diversion Conservancy District allocates two-tenths of its one-mill tax levy to a matching recreation grant program within the district. In 2005, $176,000 in matching grant funds were approved for 30 applicants. In fiscal year 2006, just over $190,000 in matching grant funds have been approved to project applicants in 20 of the 28 counties that comprise the conservancy district. The Dakota Water Resources Act of 2000, an amendment to the Garrison Diversion Unit Reformulation Act of 1986, authorized $6.5 million for a recreation program. The conservancy district is developing an agreement with the federal Bureau of Reclamation to implement this program.

The conservancy district supports agricultural research by providing funding to the North Dakota Irrigation Association, the Oakes Field Trials administered by North Dakota State University, and an irrigation specialist with North Dakota State University. The conservancy district is working with a local irrigation district to facilitate the smooth transition of the Oakes Test Area from federal ownership to local ownership in 2009. This title transfer, mandated by the Dakota Water Resources Act of 2000, must occur within two years of the formal record of decision on the Red River Valley Water Supply Project.

The Dakota Water Resources Act of 2000 authorized $200 million for construction of the Red River Valley Water Supply Project to meet the water supply needs of the Red River Valley. The Act authorized two studies. The first study was a needs and options study conducted by the Secretary of the Interior. The study was a comprehensive study of the water quality and quantity needs of the Red River Valley and possible options for meeting those needs. Second, the Secretary of the Interior and the state, represented by the conservancy district, are jointly preparing an environmental impact statement concerning all feasible options to meet the comprehensive water quality and quantity needs of the Red River Valley. The needs and options report was completed in 2005 and the environmental impact statement is scheduled for release in February 2007. North Dakota has selected a buried pipeline from the McClusky Canal to Lake Ashtabula as the preferred alternative to meet the long-term water supply needs of the Red River Valley. The Red River Valley Water Supply Project will be funded jointly by local water users, the state of North Dakota, and the federal government.