NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

# ELECTRIC UTILITIES COMMITTEE

Tuesday, February 17, 1998
Roughrider Room, State Capitol
Bismarck, North Dakota

Representative Al Carlson, Chairman, called the meeting to order at 9:00 a.m.

**Members present:** Representatives Al Carlson, Robert Huether, Matthew M. Klein; Senators Randel Christmann, Pete Naaden, Larry J. Robinson

**Others present:** See Appendix A

**It was moved by Senator Robinson, seconded by Senator Klein, and carried that the minutes of the December 16, 1997, meeting be approved as mailed.**

## ELECTRIC UTILITY TAXATION AND RATES

At the request of Chairman Carlson, Mr. James H. Kane, Senior Manager, Arthur Andersen LLP, Chicago, Illinois, addressed the committee. A copy of the overheads used by Mr. Kane in his presentation is attached as Appendix B. He encouraged the committee not to seek a quick solution to taxation issues raised by electric utility industry restructuring. He said current state taxes focus on an industrial age when the United States has moved into an information age and the nation's tax system has failed to keep abreast of these changes.

Mr. Kane said issues that must be addressed in any restructuring proposal include the potential revenue impacts of restructuring to state and local government, whether current tax laws make sense in a restructured industry, whether the tax laws provide a competitive playing field, whether policy considerations are affected by current tax laws, the legal and constitutional limitations relating to types of taxes and taxpayers, and whether utilities in a restructured industry should be treated differently from other businesses. He said any state restructuring initiative must keep the state's domestic electric industry competitive and the tax revenue produced by that industry coming into the state's treasury. He said dealing with the taxation issue after restructuring is only a prescription for failure. He said those states that have restructured their electric industries without addressing the taxation issue have created a number of problems that they are only now resolving.

Mr. Kane said two additional questions that must be answered are those developed by the National Conference of State Legislatures Utility Taxation Partnership, i.e., the impact of competition on tax revenues and the impact of tax policy on competition. He said issues identified by the National Conference of State Legislatures partnership include the different types of taxes, the role of state and local taxes in a competitive market, and how states can create a competitive playing field for all classes of electric generators.

Mr. Kane next reviewed the tax legislation of three states, Pennsylvania, New Jersey, and New Hampshire, that have considered tax issues along with restructuring issues.

In response to a question from Representative Carlson, Mr. Kane said Pennsylvania is a high cost of electricity state and, although it generates a large amount of electricity, it is a net importer of electricity. He said the majority of electricity in Pennsylvania is produced by investor-owned utilities and that North Dakota is unique in that a large amount of generation as well as distribution is provided by rural electric cooperatives.

Concerning Pennsylvania, Mr. Kane said, that state developed a new gross receipts tax and essentially left all the other taxes on the electric industry in place.

Concerning the New Hampshire Electric Power Tax Reform Act, Mr. Kane said, the Act repeals the New Hampshire gross receipts franchise tax within 30 days following implementation of the state's utility restructuring plan if implementation has not been done on or before January 1, 1998. He said the gross receipts franchise tax is replaced by an electricity consumption tax imposed at a rate of .055 cents per kilowatt hour. Thus, he said, the tax burden on electricity shifts to the consumer, including governmental units. He said the electricity consumption tax is scheduled to expire on June 30, 2002. He said nexus is not an issue in New Hampshire because the state requires that providers collect the tax from consumers and remit it to the state if the provider distributes, redistributes, or transmits electric energy for consumption in New Hampshire; the provider maintains a place of business or has transmission or distribution property in New Hampshire; or the provider has applied for and been granted permission to remit taxes annually.

Finally, Mr. Kane said, New Jersey imposes a sales and use tax on electricity of six percent and a corporate income tax on electric utilities of nine percent. He said an annual transitional energy facility assessment charge is imposed to compensate for the lost franchise and gross receipts taxes which are scheduled to be phased out by January 1, 2003.

In conclusion, Mr. Kane said, items to consider in any electric industry restructuring initiative are revenue erosion, collection and enforcement problems, incentives for in-state providers to export electricity, competitive inequities, and economic development issues. He said revenue erosion may arise from loss of market share, the participation of "mail order" sellers in a deregulated industry, "tax base" reductions, and loss of income for in-state utilities. He said states must also address collection and enforcement problems and may wish to provide incentives for in-state providers to export electricity. Finally, he said, the Legislative Assembly should keep the impact of electric industry restructuring on political subdivisions in mind when undertaking a restructuring initiative.

In response to a question from Senator Christmann, Mr. Kane said the nexus test required to tax an out-of-state entity is essentially an interstate commerce test. He said if an out-of-state entity does not avail itself of a state's services and does not have a physical presence in that state, then there is no nexus with that state and the entity cannot be assessed sales taxes. However, he said, the opposite of a sales tax is a use tax and a state always has jurisdiction over its residents for use tax purposes. Also, he said, the tax must be fairly related to the services received and fairly apportioned. He said most courts have found that if there is property located within a state, then the state has nexus with the out-of-state entity.

In response to a question from Representative Carlson, Mr. Kane said both New Jersey and Pennsylvania require out-of-state electricity retail sellers to register with the state and to maintain an office in the state. He said these states base this authority on their police power. However, he said, an out-of-state retail electricity supplier could argue that none of its sales are subject to Pennsylvania's gross receipts tax because all of the sales occur in interstate commerce. Also, he said, merely requiring an out-of-state electricity retailer to maintain an in-state office may not be a sufficient nexus in order to tax that entity. In response to a further question from Representative Carlson, Mr. Kane said many states have replaced their corporate income tax with gross receipts and higher property taxes.

In response to a question from Representative Carlson, Mr. Kane said North Dakota is in an enviable position in that it is a low-cost state and electric industry restructuring is an opportunity to provide in-state utilities with an opportunity to sell and earn a profit on electricity sold out of state. He said even though North Dakota is a low-cost state, it can still benefit from restructuring as everyone should benefit from restructuring of the electric industry, both high- and low-cost states.

At the request of Chairman Carlson, Mr. Jess Cooper, Vice President, Governmental Affairs, Greater North Dakota Association, addressed the committee. A copy of Mr. Cooper's written comments is attached as Appendix C.

At the request of Chairman Carlson, Mr. Arthur W. Wheeler, President, North Dakota Retail Association, addressed the committee. A copy of Mr. Wheeler's comments is attached as Appendix D.

At the request of Chairman Carlson, Mr. Charles E. Johnson, Commission Counsel, Public Service Commission, addressed the committee. A copy of Mr. Johnson's comments is attached as Appendix E.

In response to a question from Representative Klein, Mr. Johnson said the state's rural electric cooperatives are not required to file their electric rates with the Public Service Commission. In response to a further question from Representative Klein, Mr. Johnson agreed that the committee and the Legislative Assembly would need electricity consumption figures for both the state's investor-owned utilities and distribution cooperatives in order to develop a kilowatt per hour consumption tax.

In response to a question from Representative Carlson, Ms. Illona Jeffcoat-Sacco, Director, Public Utilities Division, Public Service Commission, said the Public Service Commission has authority over investor-owned utility rates, which includes the setting of rates, receiving complaints concerning rates, and the terms and conditions of electric service. She said the Public Service Commission also has jurisdiction over discrimination complaints, adequacy of service, quality of service, and limited authority over cooperatives. However, she said, the Public Service Commission does not have authority over rates charged by rural electric cooperatives. She said the primary area of authority over rural electric cooperatives is in the area of enforcing the Territorial Integrity

Act and authority to order the raising and lowering of electric transmission lines for oversized vehicles.

In response to a question from Representative Klein, Ms. Jeffcoat-Sacco said she is confident that individual investor-owned utilities, the rural electric cooperatives, as well as MAPP (Mid-Continent Area Power Pool), are addressing and dealing with the year 2000 problem.

At the request of Chairman Carlson, Mr. LeRoy Neubauer, Director, Valley City Public Works, Valley City, addressed the committee. He distributed a copy of an industry restructuring briefing book published by the Missouri Basin Municipal Power Agency, a copy of which is on file in the Legislative Council office. Copies of the overheads used in his presentation and a resolution adopted by the American Public Power Association urging Congress to preserve state and local authority in its consideration of policies to foster retail competition are attached as Appendices F and G, respectively. He said that electric industry deregulation is an attempt to provide local control or control by customers while municipal power systems already provide local control because the customer owns the municipal power system. He said no additional taxes should be imposed on the electric industry as municipal power systems already pay more taxes than either investor-owned utilities or rural electric cooperatives. As an example, he said, the tax rate per megawatt for the state's investor-owned utilities is $1.31 and $1.97 for the state's rural electric cooperatives, while the average rate for the state's municipal power systems is $5.71. He said the committee should go slow in the deregulation area and continue to investigate all options. He noted that it was suggested at a recent North Dakota League of Cities meeting that a five-year moratorium be placed on electric industry deregulation or restructuring in North Dakota.

At the request of Chairman Carlson, Mr. Harlan Fuglesten, Communications and Government Relations Director, North Dakota Association of Rural Electric Cooperatives, addressed the committee. A copy of his written comments is attached as Appendix H.

In response to a question from Senator Robinson, Mr. Fuglesten said rural electric cooperative wholesale electric rates have been stable and have actually declined in certain instances in recent years. However, he said, some rural electric cooperatives may have to make rate adjustments as a result of damage caused by the spring 1997 ice storms in North Dakota.

In response to a question from Senator Christmann, Mr. Fuglesten said the Association of Rural Electric Cooperatives will provide whatever information is available to the association regarding electric rates by electricity consumption and customer class.

At the request of Chairman Carlson, Ms. Connie Sprynczynatyk, Executive Director, North Dakota League of Cities, addressed the committee. She said the League of Cities represents the 361 incorporated cities in North Dakota. Of this number, she said, 12 have municipal power systems. Although the cities have many of the same interests, she said, the interests of the municipal power cities may diverge somewhat from the other cities in North Dakota. She said the North Dakota League of Cities has not requested a five-year moratorium on electric utility deregulation or restructuring legislation in North Dakota. She said the League of Cities is concerned about the loss of franchise fees, loss of revenue from decreased property taxes, and preemption of local zoning and land use laws. Finally, she said, as large consumers of electricity, cities have an interest in low-cost power for everyone as a result of deregulation of the electric industry.

At the request of Chairman Carlson, Mr. Dennis Boyd, Senior Governmental Affairs Representative, Public Affairs Department, MDU Resources Group, Inc., addressed the committee. A copy of his written comments is attached as Appendix I.

In response to a question from Senator Christmann, Mr. Boyd said Montana-Dakota Utilities, Inc., and the other investor-owned utilities will provide information on customer classifications, the amount of energy used by each class of customer, and the price charged rural and urban consumers.

At the request of Chairman Carlson, Mr. Fuglesten addressed the committee. A copy of his written comments concerning taxation of the electric utility industry in North Dakota is attached as Appendix J.

In response to a question from Senator Christmann, Mr. Fuglesten said that state corporate income taxes paid by investor-owned utilities must be included in any comparison of taxes paid by the state's investor-owned utilities and the rural electric cooperatives. He said if corporate income taxes are not included and if a similar type of tax were imposed on the rural electric cooperatives, then as the profits of the state's investor-owned utilities increased, the cost of electricity to rural electric cooperative consumers would increase correspondingly. He said distribution rural electric cooperatives operate on a cost basis while the state's investor-owned utilities are paying corporate income tax on profits above their cost basis.

## TERRITORIAL INTEGRITY ACT

At the request of Chairman Carlson, Mr. Fuglesten addressed the committee concerning territorial integrity issues. A copy of his written comments is attached as Appendix K.

At the request of Chairman Carlson, Mr. Scott Handy, Assistant General Manager, Cass County Electric Cooperative, Fargo, reviewed two disputes between Northern States Power Company and Cass County Electric Cooperative involving the Territorial Integrity Act.

At the request of Chairman Carlson, Mr. Ron Tipton, President and Chief Executive Officer, Montana-Dakota Utilities Company, addressed the committee. A copy of his presentation is attached as Appendix L.

At the request of Chairman Carlson, Mr. John MacFarlane, President, Otter Tail Power Company, Fergus Falls, Minnesota, addressed the committee. A copy of his written comments is attached as Appendix M.

At the request of Chairman Carlson, Mr. Michael Hanson, Chief Executive Officer-Dakotas, Northern States Power Company, Sioux Falls, South Dakota, addressed the committee. A copy of his written comments is attached as Appendix N.

At the request of Chairman Carlson, committee counsel distributed a series of publications by the National Council on Competition and the Electric Industry. Copies of these publications are on file in the Legislative Council office.

## COMMITTEE REQUEST AND STAFF DIRECTIVES

Senator Christmann requested that Mr. Neubauer provide information on taxes paid, megawatt hours sold, and the tax rate per megawatt hour for Hillsboro, Cavalier, Stanton, Maddock, Sharon, and Riverdale. Also, he asked Mr. Neubauer to provide information on the amount of electricity sold by customer class for each of the municipal power systems.

Senator Christmann requested that representatives of the Association of Rural Electric Cooperatives provide information on the transmission line tax and any suggestions for modification of the tax based upon the capacity of the transmission lines.

Senator Christmann requested that each investor-owned utility, rural electric cooperative, and municipal power system submit information on the amount of electricity sold by customer class. He also requested that the sales by residential class be divided between rural and urban customers.

Representative Klein requested that the Association of Rural Electric Cooperatives provide information on electricity sold by Cass County Electric Cooperative, Capital Electric Cooperative, NoDak Rural Electric Cooperative, Verendrye Electric Cooperative, and North Central Electric Cooperative in North Dakota as compared to the state's investor-owned utilities.

Representative Carlson requested that the investor-owned utilities review the tax information provided by the Association of Rural Electric Cooperatives and that the Association of Rural Electric Cooperatives review the tax information provided by the state's investor-owned utilities and report on any information that the respective entities disagree with.

Representative Carlson requested that the Legislative Council staff request the Public Service Commission to provide information on the number of miles, size, taxes paid on larger lines, and taxes not paid on smaller lines, for the state's electric transmission lines.

Senator Robinson requested that the Legislative Council staff request the Public Service Commission to provide information on the authority of North Dakota's Public Service Commission as compared to public utility commissions in other states.

Representative Klein requested that representatives of the state's investor-owned utilities and Association of Rural Electric Cooperatives provide information on where the distinction between transmission lines and distribution lines should be drawn, whether on a voltage basis or some other criteria.

Representative Carlson requested that the state's investor-owned utilities review the tax proposals developed by the Association of Rural Electric Cooperatives and that the Association of Rural Electric Cooperatives review the tax proposals developed by the state's investor-owned utilities and report on the one effect entity's proposals would have upon the other and whether any commonality exists for developing a tax proposal.

Senator Christmann requested that the Legislative Council staff provide information on whether the state could enact limited retail wheeling or a pilot project involving the state's investor-owned utilities while protecting the state's rural electric cooperatives and municipal power systems from retail wheeling.

No further business appearing, Chairman Carlson adjourned the meeting at 4:30 p.m.

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Jeffrey N. Nelson
Committee Counsel

ATTACH:14