NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

# ELECTRIC UTILITIES COMMITTEE

Wednesday, September 23, 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 Representative Huether, and carried that the minutes of the April 7, 1998, meeting be approved as distributed.**

At the request of Chairman Carlson, committee counsel distributed a copy of 1998 Iowa Senate Bill No. 2416; 1997 Illinois House Bill No. 0362; an analysis of 1998 Iowa Senate Bill No. 2416, Iowa's utility property replacement tax, prepared by Arthur Andersen; a National Conference of State Legislatures state legislative report entitled *Restructuring and Small Electric Customers*; and a letter form Mr. Bruce J. Kopp, Government Relations Manager, Northern States Power Company, concerning Northern States Power's 1997 sales by customer class, operating revenue by class, the average cost per kilowatt sold, and transmission line miles by voltage. Mr. Kopp's letter is attached as Appendix B and the other items are on file in the Legislative Council office.

At the request of Chairman Carlson, Mr. Matthew Brown, Program Principal, Environment, Energy, and Transportation Program, National Conference of State Legislatures, Denver, addressed the committee. A copy of the overheads used by Mr. Brown in his presentation is attached as Appendix C. He said there are several motivating factors for restructuring the electric industry in the United States. Among these, he said, is changing technology. He said electric industry technology has changed rapidly but not as quickly as telecommunications technology which has led to deregulation of the telecommunications industry. He said from the 1930s until the 1960s it was more economical to build larger and larger power plants which produced electricity more efficiently on a per kilowatt hour basis. However, he said, beginning in the 1970s and 1980s and accelerating into the 1990s new technologies have accelerated the construction of smaller power plants. He said this has made it easier for competitors to enter the electricity supply market. He said states with the highest cost electricity are the states with the greatest interest in restructuring. He said restructuring is more difficult in states with lower costs. However, he said, there are several exceptions to this generalization. He said the first 13 states to restructure their electric industries were California, Nevada, Arizona, Montana, Oklahoma, Illinois, Pennsylvania, Virginia, Maine, New Hampshire, Massachusetts, Connecticut, and Rhode Island. Of these 13 states, he said, Arizona, Montana, Oklahoma, and Illinois are low-cost states. He said those states that have moved forward with restructuring their electric utility industry have done so by establishing rules for the marketplace. Thus, he characterized these state activities as restructuring rather than deregulation or, in effect, a different type of regulation.

Concerning developments at the federal level, Mr. Brown said, it appears and becomes more certain with each passing day that there will be no legislation enacted by the current Congress concerning electricity restructuring. In addition, he said, of the 10 proposals that have been introduced at the federal level, three of the congressmen who proposed them are retiring. In addition, he said, several of the Senate committees that will have a say in electricity restructuring are dominated by western senators who are not as receptive to restructuring as legislators from the coasts. He said most of the federal proposals contain grandfather provisions that would exempt those states that have already enacted restructuring legislation. However, he said, aspects of the legislation which may not be grandfathered in would be public benefits requirements such as renewable requirements, low energy assistance, and energy efficiency programs as well as a renewable energy portfolio standard that could not be waived. He said the federal legislation may also require source labeling requirements that would indicate to the consumer the source of the electricity that person is purchasing. Concerning stranded costs, he said, the federal legislation that has been proposed to date allows each state to handle the issue as it believes best or is best suited to that state.

Concerning restructuring activities at the state level, Mr. Brown said, three states, Massachusetts, Rhode Island, and California, have moved the fastest toward restructuring their electric utility industries. He said one important provision of these early restructuring initiatives is how they address the immediate benefit issue. He said the immediate benefit issue is whether the restructuring legislation provides an immediate benefit to ratepayers that legislators who support the measure can show their constituents. For example, he said, California's electric restructuring legislation contains an immediate 10 percent rate reduction for electricity consumers. However, he said, the problem with providing immediate benefits in the restructuring legislation is that it removes the incentive for consumers to change providers. Thus, for example, he said, there have been relatively few consumers changing providers in California because it is difficult for alternate providers to beat the initial 10 percent rate reduction in order to attract another provider's customer. He said the states of Massachusetts, Connecticut, Rhode Island, Pennsylvania, Illinois, Oklahoma, Nevada, and California provided an immediate rate freeze or rate cut in their restructuring legislation. As a result of the difficulty for other providers to enter the market, he said, some power marketers, such as Enron Corporation, have withdrawn from the residential markets in these states. For example, he said, in California only .83 percent of Pacific Gas and Electric's customers, 1.2 percent of Southern California Edison's customers, and 1.2 percent of San Diego Gas and Electric's customers have switched to another provider.

Concerning stranded costs, Mr. Brown said, California has implemented a competition transition charge (CTC) that every customer pays, based upon the amount of electricity used, to retire the stranded costs of utilities. Another side effect of restructuring, he said, is that many public utilities are selling their generation assets because of the unpredictability of earning a sufficient rate of return from these assets.

The fourth state to enact electric restructuring legislation, Mr. Brown said, was Pennsylvania. Unlike California, Massachusetts, and Rhode Island, he said, Pennsylvania did not mandate an immediate rate reduction. He said the Pennsylvania legislation provides a shopping credit or price that an electric provider will have to better in order to provide service to a specific customer. The result, he said, is that there is much more competition in many more markets in Pennsylvania than there is in states that provided an immediate rate reduction such as California. Concerning stranded costs, he said, these costs are not allowed under Pennsylvania law and the emphasis is on competition rather than rate reduction. He said rural electric cooperatives and municipal utilities are allowed to opt in or opt out of competition, similar to what is allowed in Montana. He said some states, such as California, have provided incentives for municipal utilities and rural electric cooperatives to opt into competition. Usually, he said, the legislation provides that if municipal utilities and rural electric cooperatives opt into competition, they are allowed to recover their stranded costs.

Oklahoma, Mr. Brown said, is a midwestern plains state similar to North Dakota that has enacted electric industry restructuring legislation. He said Oklahoma is a low-cost state similar to North Dakota and electric utility restructuring legislation in that state was pushed by an individual legislator in that state as an economic development incentive measure. He said the legislation calls for restructuring the state's electric industry by 2002 but if associated tax issues are not resolved by that time, the restructuring initiative will sunset.

Montana, Mr. Brown said, is another interior state with low electric rates that has enacted electric restructuring legislation. However, he said, Montana was concerned about federal preemption and did not deal with the associated tax issues.

In summary, Mr. Brown recommended that the committee look to Pennsylvania and its unique approach and contrast it to Massachusetts, Rhode Island, and California in developing any electric industry restructuring legislation.

In response to a question from Representative Huether, Mr. Brown said large consumers and power marketers have historically driven electric industry restructuring, but to some extent investor-owned utilities are also now driving electric industry restructuring in the United States.

In response to a further question from Representative Huether, Mr. Brown said he has seen studies that indicate that restructuring may result in a national averaging of electricity rates with high-cost states coming down and low-cost states staying the same or perhaps even increasing slightly. On the other hand, he said, he has seen other studies that indicate electricity rates will come down with the high-cost states decreasing more than the low-cost states.

Concerning taxation of the electric utility industry in a restructured environment, Mr. Brown said, electric industry taxes will have to be changed along with the electric utility industry. Historically, he said, state taxation of the electric utility industry has worked very well in a monopolistic environment but will have to change in a restructured environment. He said utilities are very efficient tax collectors in a monopolistic environment because many of the taxes are hidden and can be passed on to ratepayers. He said in a restructured industry with unbundled segments, the taxes paid by ratepayers will become more visible to them.

Among the state and local tax issues that must be addressed in electric utility restructuring, Mr. Brown said, are nexus concerns, revenue stability concerns, and property tax issues. He said the nexus issue is basically whether an out-of-state electricity provider has a significant enough presence in a state to be subject to taxation by that state. He said New Jersey addressed this problem by requiring out-of-state energy producers and power marketers selling electricity in New Jersey to maintain an office in that state. He said Pennsylvania requires out-of-state electricity producers and power marketers to have a license to sell electricity in that state and one of the requirements of the license is that the producer or marketer voluntarily submits to Pennsylvania taxation as a condition of licensure. Finally, he said, a state may switch to reliance on taxes where nexus is more easily established. To address revenue concerns, Pennsylvania has developed a formula to require taxpayers to pay the same amount of taxes as in a base line year, he said. Other states, he said, where the property tax constitutes a significant portion of the state's tax revenue, subsidize hard-hit municipalities but gradually phase out the subsidy and move away from reliance on property taxes. An example of such a state is Kansas, he said. Another state that requires an instate office before a marketer can sell electricity in that state is New Jersey. However, he said, New Jersey's legislation probably is an unconstitutional infringement on interstate commerce.

In Connecticut, Mr. Brown said, the tax system was addressed by shifting that state's electric industry taxes to those areas where the state more clearly had nexus and where the utilities could pass on some of these taxes to consumers. Thus, he said, Connecticut increased the gross earnings tax on distribution and transmission with the understanding that these utilities would pass the taxes on to their customers. Thus, he said, Connecticut continued its utility taxes by taxing the transmission and distribution systems that are still regulated and removing the tax on the unregulated generation segment. The only New England state that has not enacted electric restructuring legislation is Vermont, he said.

Illinois, Mr. Brown said, has moved away from reliance on property taxes to a consumption tax. He said one advantage of a consumption tax is that it addresses the nexus problem and also lessens reliance on property taxes as a revenue source. Finally, he said, a consumption tax addresses concerns of large power users.

Iowa, Mr. Brown said, is another midwestern state similar to North Dakota that has enacted utility tax legislation. However, he characterized the Iowa tax as a replacement tax and not electric industry tax relief. He said the Iowa legislation consists of a generation tax, transmission tax, and distribution tax and also contains authority to pass the tax through to power marketers.

In response to a question from Representative Carlson, Mr. Brown said a consumption tax solves the nexus problem, is easy to administer, and is perceived as fair. However, he said, the downside of a consumption tax is that the tax appears on a consumer's bill and thus is visible to consumers.

Chairman Carlson called on Ms. Kristi Pfliger, Administrator, North Dakota Community Action Association, who addressed the committee. A copy of Ms. Pfliger's written comments is attached as Appendix D. Her comments concerned the potential impacts of electric utility restructuring on low-income consumers. She said restructuring measures should enhance existing and emerging social policies and programs and that there should be affordable and accessible basic electricity services in North Dakota for all households, regardless of income or location. She said any utility restructuring initiative should contain consumer protection measures and provide an opportunity for consumers to participate in the deregulation process.

Chairman Carlson called on Mr. Harlan Fuglesten, Communications and Government Relations Director, North Dakota Association of Rural Electric Cooperatives, who addressed the committee. A copy of his written comments is attached as Appendix E. He reviewed the activities of the Electric Industry Tax Task Force and information prepared by the distribution and transmission cooperatives concerning a replacement tax system that he characterized as fair and equitable, easy to administer, and that would minimize the burden of tax shifting that may result from moving to a different tax system. He said the rural electric cooperatives submitted a draft proposal to the Electric Industry Task Force which proposed that the high-voltage transmission tax paid by the rural electric cooperatives be made applicable to investor-owned utilities and that the public utility property tax and gross receipts tax be eliminated and replaced with a tax of $1.42 per megawatt hour. He also distributed a report entitled *Electric Industry Tax Task Force* which contains the minutes of the task force and its data subcommittee and a report entitled *North Dakota Electric Utilities Statistics 1995-1997*. These reports are attached as Appendices F and G.

Chairman Carlson called on Mr. Dennis Boyd, MDU Resources Group, Inc., who addressed the committee. A copy of his written comments is attached as Appendix H. He commented on the Electric Industry Tax Task Force activities and presented a proposal or concept developed by the state's investor-owned utilities. This concept, he said, would impose a flat rate consumption tax on electric sales on a per kilowatt or per megawatt hour basis. He said under the proposal all existing taxes would be designated as in lieu of the new consumption tax and the proposal called for a sunset clause to ensure that the Legislative Assembly will readdress the consumption tax at a future date. He said the net effect of this proposal would be that no current taxpayer would pay more taxes than are currently being paid, but that the tax would capture out-of-state marketers because they do not pay any of the current state taxes.

At the request of Chairman Carlson, Mr. John Walstad, Code Revisor, Legislative Council, reviewed the activities of the interim Taxation Committee. He said the interim Taxation Committee recently concluded its work without recommending any legislation concerning taxation of the state's lignite industry. However, he said, the committee did receive a report on the lignite industry from Dr. David Ramsett which showed that Wyoming Powder River Basin coal is competitive with North Dakota lignite and becomes even more so if North Dakota's coal severance tax on out-of-state coal is declared unconstitutional. Thus, he said, one consideration that may be raised for the Legislative Assembly is the shifting of reliance from the coal severance tax to the coal conversion tax, which taxes coal converted to electricity in North Dakota's power plants. He said the North Dakota Lignite Energy Council will be working with concerned parties to develop legislation for the 1999 Legislative Assembly which may include proposals for coal industry tax relief.

At the request of Chairman Carlson, committee counsel presented a bill draft relating to the power of the Public Service Commission to address the year 2000 problem. He said the bill draft would give the Public Service Commission authority to request from any North Dakota electric, gas, telephone, or pipeline public utility and generation and transmission rural electric distribution cooperatives, status reports, and information on steps taken by that utility or cooperative to ensure that the state's utilities are addressing the year 2000 computer problem in a timely manner. He said the Act would expire on July 31, 2001, and contains an emergency clause.

Senator Robinson suggested that the bill draft be amended to include authority to require contingency plans as well as status reports and information on steps taken by electricity providers.

In response to a question from Representative Carlson, Mr. Chuck Johnson, Commerce Counsel, Public Service Commission, said the commission could issue an order to comply and fine a utility up to $5,000 if a utility failed to comply with a commission request under the bill draft.

Senator Christmann noted that it is in a company's own best interests to ensure that it is Y2K ready on December 31, 1999, and oversight by the Public Service Commission is not necessary.

In response to Senator Christmann's comments, Representative Klein noted that although each company will ensure that it is Y2K compliant, the Public Service Commission will ensure that the companies work together and that the state's electric utility industry is Y2K compliant.

**It was moved by Senator Robinson, seconded by Representative Klein, and carried on a voice vote that the Legislative Council staff be requested to redraft the bill draft relating to the power of the Public Service Commission to address the year 2000 problem to include contingency plans.**

**It was moved by Representative Klein, seconded by Senator Robinson, and carried on a roll call vote that the bill draft, as amended, relating to the power of the Public Service Commission to address the year 2000 problem, be approved and recommended to the Legislative Council.** Representatives Carlson, Huether, and Klein and Senators Naaden and Robinson voted "aye." Senator Christmann voted "nay."

Chairman Carlson called on Ms. Susan Wefald, Commissioner, Public Service Commission, who addressed the committee. She said the commission views the bill as merely an information-gathering function rather than a means to penalize companies for not complying. She said merely gathering this information and disseminating it will inform companies about the year 2000 problem.

Chairman Carlson called on Mr. Johnson, who said the Public Service Commission has received a publication from the National Research Institute entitled *In the Public Interest: Public Utility Commission Leadership in Y2K Mitigation and Preparation*, a resource packet for commissions published in September 1998. He said this publication is on file in the Public Service Commission office. He said the commission has also participated in sending a letter to United States Senator Wendell Ford concerning restructuring the electric industry in this country. He said the letter requests that low-cost electric states be given adequate consideration in any electric restructuring legislation. A copy of this letter is attached as Appendix I.

Representative Klein addressed the committee. He said he is still interested in pursuing legislation revising North Dakota's transmission line tax, but he was not prepared to make a suggestion at this time.

**It was moved by Senator Robinson, seconded by Senator Naaden, and carried that the chairman and the staff of the Legislative Council be requested to prepare a report and the bill draft recommended by the committee and to present the report and recommended bill draft to the Legislative Council.**

No further business appearing, Chairman Carlson adjourned the meeting at 2:45 p.m.

Jeffrey N. Nelson
Committee Counsel

ATTACH:9