NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

ELECTRIC UTILITIES

Tuesday, December 16, 1997
Brynhild Haugland Room, State Capitol
Bismarck, North Dakota

Representative Al Carlson, Chairman, called the joint meeting of the Electric Utilities Committee and the Taxation Committee 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 October 9, 1997, meeting be approved as mailed.

JOINT MEETING WITH TAXATION COMMITTEE

Representative Carlson, Chairman, Electric Utilities Committee, said the committee was meeting jointly with the Taxation Committee to receive information concerning the tax implications to the state and its political subdivisions of electric utility restructuring. He said reviewing the current tax structure of the electric industry as well as the potential impact to the state and its political subdivisions of electric utility restructuring on taxes levied and collected was integral in its study of the impact of competition on the generation, transmission, and distribution of electric energy in North Dakota. He said experience has shown that those states that enacted electric utility restructuring initiatives without first addressing the tax implications have encountered problems that the Electric Utilities Committee would like to avoid. He requested the Legislative Council staff distribute a series of publications by the National Conference of State Legislatures' Partnership on State and Local Taxation of the Electric Industry entitled *Introduction to Electric Industry Taxation*, *Property Taxes in the Changing Electric Industry*, *Franchise Taxes and Corporate Net Income Taxes in the Changing Electric Industry*, *Gross Receipts Taxes in the Changing U.S. Electric Industry*, *Sales Tax in the Changing Electric Industry*, *Overview of Effects of the Changing Electric Industry on State and Local Taxes*, *Franchise Fees in the Changing U.S. Electric Industry*, and *Payments in Lieu of Taxes in the Changing Electric Industry*. Copies of these publications are on file in the Legislative Council office.

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 B.

At the request of Chairman Carlson, Mr. Gary A. Lund, General Tax Supervisor, MDU Resources Group, Inc., addressed the committee regarding tax implications of electric industry restructuring. A copy of his presentation is attached as Appendix C.

In response to a question from Senator Naaden, Mr. Lund said investor-owned utilities pay $869,335 in coal conversion taxes while generation and transmission cooperatives pay $10,912,675 in coal conversion taxes. He said the difference is because generation and transmission cooperatives have a much larger generation capacity in North Dakota than do the state's investor-owned utilities.

In response to a question from Senator Christmann concerning the tax comparison chart for 1996, Mr. Lund said Montana-Dakota Utilities Company did not separate the property tax into real property taxes and personal property taxes.

In response to a question from Representative Klein, Mr. Boyd said investor-owned utilities and the generation and transmission cooperatives pay a monthly coal conversion tax on any coal-fired generation facility of 120 megawatts or larger. He said Montana-Dakota Utilities Company operates two plants that generate less than 120 megawatts. He said these are the RM Heskett Unit 1 and RM Heskett Unit 2 Stations at Mandan. He said Unit 1 has a 75-megawatt generation capacity and Unit 2 has a 25-megawatt generation capacity.

In response to a question from Senator Naaden, Mr. Boyd said there are no other power plants in North Dakota that generate less than 120 megawatts. He reminded the committee, however, that Montan-Dakota Utilities Company does pay property taxes on the RM Heskett facilities.

In response to a question from Representative Huether, Mr. Boyd said the term "phantom" taxes is a misnomer for deferred taxes that are paid by corporate income tax payers. He said these taxes are merely taxes that, as a result of corporate tax adjustments and deferrals, are paid at a later date.

In response to a question from Representative Carlson, Mr. Boyd said Montana-Dakota Utilities Company's generation facilities that are located in North Dakota are a 25 percent interest in the Coyote Station at Beulah and the two RM Heskett units located at Mandan. He said Montana-Dakota Utilities Company receives 25 percent of the generation or

107 megawatts from the Coyote Station. He said this plant was constructed in 1981. He said Unit 1 of the RM Heskett Station was constructed in 1954 and Unit 2 was constructed in 1963. He said the RM Heskett facilities are old and expensive to operate. He said Montana-Dakota Utilities Company's generation facilities located outside North Dakota include a 22 percent interest in Otter Tail Power Company's Big Stone Station in South Dakota. He said Montana-Dakota Utilities Company takes 100 megawatts from this plant, which was constructed in 1975. He said Montana-Dakota Utilities Company also owns a small 50-megawatt plant at Sidney, Montana, the Lewis and Clark Station, which was constructed in 1958. He said Montana-Dakota Utilities Company has a contract with Basin Electric Power Cooperative to take 66 percent of the generation capacity of Antelope Valley Station Unit No. 2. He said Montana-Dakota Utilities Company takes power under a 20-year contract that commenced in 1986. He said the baseload generation capacity of Montana-Dakota Utilities Company is 423 megawatts and 70 percent of the electricity generated by this capacity is sold in North Dakota. In addition, he said, Montana-Dakota Utilities Company owns three peaking plants--a 25-megawatt plant at Miles City which was constructed in 1971, a 35-megawatt plant at Glendive which was constructed in 1979, and a 10-megawatt plant at Williston which was constructed in 1954. He said these are natural gas-fired plants.

In response to a question from Representative Carlson, Mr. Boyd said peaking plants are designed to provide additional generation capacity when the baseload capacity is at maximum generation capacity. He said this occurs on very warm or very cold days.

In response to a question from Representative Klein, Mr. Boyd said peaking plants are much more expensive to operate than baseload plants and are not operated very frequently.

At the request of Chairman Carlson, Mr. Bruce J. Kopp, Government and Community Relations Manager, Northern States Power Company, Grand Forks, addressed the committee regarding tax impact schedules. A copy of a chart used in his presentation is attached as Appendix D. He also distributed information concerning Northern States Power Company's generation and power purchases. Copies of this information is attached as Appendices E and F, respectively. He said as the state moves from a monopolistic to a competitive environment, there is a risk to the tax base if generation capacity moves out of state and if power marketers based out of state sell energy into North Dakota. As a result, he said, the committee should examine developing a new energy utility tax structure for the state. He said this new tax system must provide the state with a steady stable revenue stream, be fair for all consumers in the state, and be competitively neutral. He said there should be equality in the form of tax policy and regulation parity among all energy providers in the state and all consumers should pay the same tax per kilowatt hour. He said a consumption tax or tax per kilowatt hour would be more equitable for all consumers.

At the request of Chairman Carlson, Mr. Kerry Caseman, Property Tax Division, Otter Tail Power Company, Fergus Falls, Minnesota, presented a tax breakdown relating to 1996 property taxes paid in 1997 by Otter Tail Power Company. A copy of the chart used in his presentation is attached as Appendix G. Committee counsel also distributed copies of the Otter Tail Power Company's 1995 and 1996 annual reports. Copies of these reports are on file in the Legislative Council office.

In response to a question from Senator Naaden, Mr. Caseman said Otter Tail Power Company's generation capacity includes part ownership of the Coyote Plant, a majority interest in the Big Stone Power Plant in South Dakota, and sole ownership of the Hoot Lake Plant in Minnesota. He said these are coal-fired generating plants. He said Otter Tail Power Company also operates six hydroelectric plants on the Otter Tail River in Minnesota and has two peaking plants.

In response to a question from Representative Belter, Mr. Caseman said the Otter Tail Power Company's peaking plants are gas-fired generating plants.

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

In response to a question from Senator Naaden, Mr. Fuglesten said the two percent gross receipts tax does not apply to generation subject to the coal conversion tax. He said power sold to investor-owned utilities is usually sold by generation and transmission cooperatives, which pay a coal conversion tax, rather than by distribution cooperatives, which pay the gross receipts tax.

In response to a question from Representative Carlson, Mr. Fuglesten said the percentage of power received from the Western Area Power Administration varies for each distribution cooperative. He said the percentage of Western Area Power Administration power may vary from five percent up to 60 percent of the power used by a distribution cooperative.

In response to a question from Senator Christmann, Mr. Dennis Hill, Executive Director, North Dakota Association of Rural Electric Cooperatives, Mandan, said the distribution cooperatives formed generation and transmission cooperatives in order to obtain a better rate for preference power. For example, he said, rather than each distribution cooperative in a region having a separate power contract with the Western Area Power Administration, several distribution cooperatives would join together and form a generation and transmission cooperative to negotiate a single contract with the Western Area Power Administration. He said the preference power allocation for each distribution cooperative would then be blended or averaged among the member cooperatives in the generation and transmission association.

In response to a question from Representative Carlson, Mr. Hill said North Dakota's rural electric cooperatives are a net exporter of power.

At the request of Chairman Carlson, Mr. LeRoy Neubauer, Director, Valley City Public Works, Valley City, addressed the committee. He distributed a copy of a letter he had sent to Ms. Marcy Dickerson, State Tax Department, concerning transfers made by the Valley City Public Works Department to the city of Valley City, a copy of a printout of average revenue per kilowatt hour for 1995 for North Dakota utilities, and a copy of a printout concerning North Dakota residential electric rates prepared by the Public Service Commission. Copies of these documents are attached as Appendices J, K, and L, respectively.

In response to a question from Representative Carlson, Mr. Neubauer said the cities in North Dakota with publicly owned or municipal utilities are Cavalier, Grafton, Hillsboro, Hope, Lakota, Maddock, Northwood, Park River, Riverdale, Stanton, and Valley City.

Mr. Neubauer said the payment or transfer made by each of these city's municipal utility varies among the cities in North Dakota. He said that many cities operate municipal facilities with revenue from their electric utilities. He said his colleagues in other states have told him that North Dakota is taking the right approach in taking a measured approach to restructuring the electric utility industry and addressing the tax implications first. He said North Dakota is a low-cost state when compared to East and West Coast states but any change would lead to higher electric costs for the state's municipal power utilities. He said electric utility restructuring or deregulation will result in higher power costs for North Dakota and other midwestern states. He said it will also increase rates for muncipally owned utilities, and he urged the committee to move slowly in restructuring North Dakota's utility industry.

At the request of Chairman Carlson, Mr. Terry Traynor, Assistant Director, North Dakota Association of Counties, addressed the committee. A copy of Mr. Traynor's written comments is attached as Appendix M.

In response to a question from Representative Klein, Mr. Traynor said that as a result of the restructuring of telecommunications taxes by the 1997 Legislative Assembly, political subdivisions lost approximately $1 million in property taxes and gained $300,000 in gross receipts taxes for a net loss of $700,000. However, he emphasized that the $700,000 loss has been shifted to other taxpayers and while the political subdivisions may not have lost revenue there has been a shift to other taxpayers.

At the request of Chairman Carlson, Ms. Marcy Dickerson, Utility Tax Appraiser, State Tax Department, addressed the committee. A copy of her presentation is attached as Appendix N.

Chairman Carlson recessed the joint meeting of the Electric Utilities Committee and the Taxation Committee and reconvened the Electric Utilities Committee.

ELECTRIC UTILITIES COMMITTEE MEETING

At the request of Chairman Carlson, committee counsel reviewed a memorandum on the history and operation of the Territorial Integrity Act that had been presented at the October 9, 1997, committee meeting.

At the request of Chairman Carlson, Mr. Fuglesten addressed the committee. He said the North Dakota Association of Rural Electric Cooperatives believes that the Territorial Integrity Act is working well and is serving the purpose for which it was enacted. He reminded the committee that the state's investor-owned utilities have exclusive territories within the state's municipalities that the rural electric cooperatives cannot penetrate. He said the Act also avoids the costly duplication of utility infrastructure. He said states that have deregulated their electric utility industry have strengthened their territorial integrity laws in the process. He said electric industry restructuring or deregulation means that there will be competition for the generation or supply of electricity but that a customer will still be served by their present electricity provider and allowing competition in the distribution of electricity would only lead to the unnecessary duplication of distribution facilities.

In response to a question from Representative Klein, Mr. Fuglesten said there are five cases before the Public Service Commission involving the Territorial Integrity Act. He said this is an unusually large number of cases.

At the request of Chairman Carlson, Mr. Kopp addressed the committee. He said Northern States Power Company believes that the Territorial Integrity Act is not serving the purpose for which it was intended and should be reviewed in conjunction with the committee's utility restructuring study.

STAFF DIRECTIVES

Senator Naaden requested the Legislative Council staff arrange for information to be presented to the committee comparing the taxes received in a city block served by an investor-owned utility to a city block served by a rural electric cooperative.

Senator Robinson requested that the representatives of the state's investor-owned utilities and the North Dakota Association of Rural Electric Cooperatives develop suggestions and proposals for utility tax legislation based upon their presentations which in their view would be more equitable than the present tax system.

Representative Klein requested that representatives of the state's investor-owned utilities and the North Dakota Association of Rural Electric

Cooperatives be requested to develop suggestions and proposals for a kilowatt per hour consumption tax that would retain the current coal conversion tax, coal severance tax, and sales tax but would achieve equity in their view between the investor-owned utilities and the rural electric cooperatives.

Representative Klein requested that representatives of the Public Works Department of Valley City be requested to recalculate its cost per kilowatt hour of electricity.

Senator Naaden requested that representatives of the investor-owned utilities and the North Dakota Association of Rural Electric Cooperatives be invited to comment on the electric industry restructuring information prepared by the National Conference of State Legislatures.

Representative Carlson requested that representatives of the Greater North Dakota Association, North Dakota Association of Manufacturers, and the North Dakota Retail Association be invited to comment on the study.

No further business appearing, Chairman Carlson adjourned the meeting at 2:00 p.m.

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Jeffrey N. Nelson
Committee Counsel

ATTACH:14