NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

ELECTRIC INDUSTRY COMPETITION COMMITTEE

Thursday, August 26, 1999
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

At the request of Chairman Carlson, Mr. John D. Olsrud, Director, Legislative Council, reviewed the Legislative Council supplementary rules of operation and procedure.

At the request of Chairman Carlson, committee counsel reviewed a memorandum entitled *Impact of Competition on the Generation, Transmission, and Distribution of Electric Energy Study - Background Memorandum* describing the statutory duties and structure of the committee. He also reviewed the background of electric industry restructuring, federal actions to promote competition, electric industry restructuring initiatives in other states, electric utility taxation in other states, and federal restructuring initiatives.

At the request of Chairman Carlson, Mr. Harlan Fuglesten, Communication and Government Relations Director, North Dakota Association of Rural Electric Cooperatives, addressed the committee. A copy of the material used in his presentation is attached as Appendix B. He presented an electric utility tax plan, as outlined in a letter to the committee dated November 12, 1998. He said the North Dakota Association of Rural Electric Cooperatives recommends the proposal as the starting point for discussion of changes to the electric utility tax system in North Dakota. He said the plan would create an equitable electric utility tax structure and prepare the state and its political subdivisions for any changes in the electric utility industry or corporate structures that might occur in the future. He said the goals of the plan are to be fair to the utilities and taxpayers, to be revenue neutral to the state's political subdivisions, and to be easy to administer. He said the proposal calls for a system of taxation to replace the current property and in lieu of property tax system. He said the plan calls for taxation of the three main functions of the electric industry--generation, transmission, and distribution.

Concerning the generation function, Mr. Fuglesten said, the rural electric cooperative tax proposal does very little to change the current generation tax. He said the proposal would leave in place the current coal conversion taxes, which are competitively neutral.

Mr. Fuglesten said the rural electric cooperative tax proposal calls for changes in transmission and distribution taxes. He said current transmission and distribution taxes have lead to inequities in the taxation of electric utilities and taxpayers.

Mr. Fuglesten emphasized that the transmission and distribution property of investor-owned utilities is centrally assessed by the state as a single entity and that these assessments are transferred back to the local units of government. He said the rural electric cooperatives pay a high voltage transmission line tax, a two percent gross receipts tax, a land tax, and a city privilege tax. He said generally municipal utilities are not taxable but make payments in lieu of taxes to their municipal governments. He said the tax proposal would make the same transmission and distribution taxes applicable to the state's investor-owned utilities, rural electric cooperatives, and municipal utilities. He said the tax proposal calls for a tax on all transmission facilities based on a line mile basis. He said the transmission line tax would generate approximately $2 million. Because the plan is revenue neutral, he said, and the current system of taxation generates approximately $11.5 million, then approximately $9.5 million must be raised from the distribution side of the tax formula.

Mr. Fuglesten said the distribution tax formula contained in the tax proposal has two parts--a flat tax of 62 cents per megawatt-hour of delivered power and one percent of revenue collected on the retail sale of kilowatt-hours of electricity. He said 50 percent of the required revenue is raised by each half of the distribution tax formula.

Mr. Fuglesten said the tax proposal applies equally to all three types of utilities--investor-owned utilities, rural electric cooperatives, and municipal utilities. However, he said, the tax proposal is not neutral to all utilities. Finally, he noted, the tax is not a consumption tax but is an embedded tax in the price of electricity and thus can be passed on to the federal government and Indian tribes as well as other entities. Also, he said, the plan eliminates double taxation.

In response to a question from Representative Carlson, Mr. Fuglesten said it is true that the electric rates of rural electric cooperatives are not regulated by the Public Service Commission. However, he said, this is because rural electric cooperatives are consumer-owned and their rates are effectively set by the members of the cooperative. He said the taxes applicable to rural electric cooperatives and investor-owned utilities should be the same regardless of whether they are regulated by the Public Service Commission. In response to a further question from Representative Carlson, Mr. Fuglesten said rural electric cooperatives do not need authority from the Public Service Commission to extend their lines in rural areas outside incorporated cities. However, he said, rural consumers can request service from an investor-owned utility and in that case, the investor-owned utility must make application to the Public Service Commission which would then determine whether it is in the public interest to allow the investor-owned utility to serve that rural customer.

In response to a question from Representative Klein, Mr. Fuglesten said under the recently enacted Iowa electric utility tax plan, electric competitive service areas are essentially the service territories of utilities. Thus, he said, the tax imposed in Iowa is different for each competitive service area and the line mile tax is different for each utility because the bill was designed to be revenue neutral and essentially replicates the old system in a new system.

At the request of Chairman Carlson, Mr. Dennis Boyd, Montana Dakota Utilities Company, MDU Resources Group, Inc., addressed the committee. A copy of his written comments is attached as Appendix C. Concerning restructuring initiatives in other states, he said, generally transmission remains under the jurisdiction of the Federal Energy Regulatory Commission and distribution remains under the state public utilities commissions. He said consumers will be able to contract with a power supplier, power marketer, or generator for their electricity which will be delivered over existing lines with metering and billing functions that may or may not be regulated. He said the issue of stranded costs must also be addressed by the committee. He noted that the state's investor-owned utilities are subject to a corporate income tax while the state’s rural electric cooperatives are not. He said not only is this inherently unfair but that net income is taxed and then taxed again when distributed to a utility’s shareholders. He said investor-owned utilities pay a personal property tax--a tax no other taxpayer in North Dakota pays. One idea that may have some merit, he said, is a consumption tax, but this type of tax would have to be studied further by the committee.

Mr. Boyd volunteered to summarize each of the tax proposals studied by the electric industry taxation working group and to present this information at a future meeting.

In response to a question from Senator Naaden, Mr. Boyd said he also would include an analysis of the proposal presented by the Association of Rural Electric Cooperatives. In response to a question from Senator Naaden, Mr. Boyd said the state's investor-owned utilities would present information on the impact of the Association of Rural Electric Cooperatives tax proposal on the state's investor-owned utilities and tax alternatives supported by the state's investor-owned utilities.

In response to a question from Senator Christmann, Mr. Boyd said the state's investor-owned utilities pay approximately $2.5 million in state corporate income taxes annually.

At the request of Chairman Carlson, Mr. Kent Larson, Chief Executive Officer, Northern States Power - Dakotas, addressed the committee. A copy of the overheads used by Mr. Larson in his presentation is attached as Appendix D. He said investor-owned utilities and rural electric cooperatives pay coal conversion taxes on the electricity generated by their facilities. However, concerning transmission and distribution, he said, investor-owned utilities pay a centrally assessed property tax based on value and income as well as state and federal income taxes while rural electric cooperatives pay a transmission line mile tax and a gross receipts tax. He said the coal conversion tax comprises the largest percentage of electric utility tax revenue followed by the gross receipts tax, property taxes, income taxes, and the transmission line mile tax. He said the electric industry of tomorrow will no longer be vertically integrated and will be composed of unbundled services. Concerns that Northern States Power has about the current tax policy, he said, are that except for generation, there is no similarity between the taxes on other functions and there is no connection to valuation or net investment in the state. This, he said, in a restructured environment could lead to revenue erosion for the state. He said the objectives of a tax policy should be predictable revenue, workability in a restructured environment, opportunity for state revenues to mirror investments, a valuation-based approach for all electric providers, and elimination of cross-customer subsidies.

Mr. Larson said Northern States Power is proposing that coal conversion taxes be maintained "as is," and that the current transmission and distribution taxes, consisting of property, gross receipts, and transmission line mile taxes, be replaced with a valuation-based tax. He said the valuation-based tax would include all the electric transmission and distribution assets in the state, including the assets of investor-owned utilities, cooperatives, and municipal utilities. He said Northern States Power is also proposing a one percent gross receipts tax on power marketers. He said that when property taxes are linked to physical assets, state revenue streams are stable and benefits flow to political subdivisions where these assets are located; that a valuation-based tax policy provides a closer alignment between facility cost and customer benefit; that these taxes are consistent with other businesses; and that they provide an opportunity for state revenue growth.

Mr. Larson suggested the committee request the North Dakota Tax Department to gather tax valuation information from all transmission and distribution providers in the state, to recommend a tax rate that provides the required state revenue, to analyze the impact on political subdivisions, and to present this information to the committee. Next, he suggested, the committee solicit information on the impact of this information from counties and other political subdivisions, accept or modify the plan, and request the preparation of appropriate legislation.

Chairman Carlson recognized Mr. Fuglesten. Mr. Fuglesten reminded the committee that the rural electric cooperative tax proposal has been on the table since November and the cooperatives have not received a reasoned response to the proposal outlining the objections, if any, that the state's investor-owned utilities and municipal utilities have to the proposal. He noted that the proposal is uniform in that it treats everyone equally. If the investor-owned utilities or municipal utilities object to a formula or number in the rural electric cooperative tax proposal, he said, they should come forward with an alternative suggestion. Concerning the Northern States Power proposal, he said, it is unclear how the property would be valued--whether original cost, revenue stream, depreciated value, or some other method would be used. He noted that Iowa moved away from a property valuation system and rejected this model for a restructured industry.

Chairman Carlson recognized Senator Robinson. Senator Robinson urged the rural electric cooperatives, investor-owned utilities, and municipal utilities to continue their dialogue to determine whether there is any agreement that can be reached on changing the state's method of taxing electric utilities.

At the request of Chairman Carlson, Ms. Mary Christensen, North Dakota SEED Coalition, addressed the committee. She said SEED stands for sustainable energy for economic development. She said there are SEED coalitions in many states and these coalitions are involved in the restructuring of the electric industry to promote the use of alternative energy sources.

Chairman Carlson recognized Representative Huether. Representative Huether said the rural electric cooperative tax proposal is simple, easy to administer, fair, and is an honest attempt to be fair to consumers, the state, and political subdivisions. He said the proposal protects the state and its political subdivisions as well as the state's lignite industry.

In response to a question from Representative Carlson, Mr. Larson said Northern States Power could provide specific information on its tax proposal, but it would be helpful if Northern States Power had the taxable valuation of all utility property in the state in order to complete its proposal.

In response to a question from Senator Christmann, Mr. Fuglesten said the Association of Rural Electric Cooperatives would provide information to the committee on the revenue raised by the proposed increase in the line mile tax.

No further business appearing, Chairman Carlson adjourned the meeting at 12:00 noon.

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Jeffrey N. Nelson
Counsel

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