NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

ELECTRIC INDUSTRY COMPETITION COMMITTEE

Friday, January 16, 2004
Roughrider Room, State Capitol
Bismarck, North Dakota

Representative Matthew M. Klein, Chairman, called the meeting to order at 9:00 a.m.

Members present: Representatives Matthew M. Klein, Arden C. Anderson, George Keiser, James Kerzman; Senators Duane Mutch, David P. O'Connell, Larry Robinson, Ben Tollefson, Thomas L. Trenbeath, Herb Urlacher

Members absent: Representatives Wesley R. Belter, Jim Kasper

Others present: See Appendix A

It was moved by Senator Robinson, seconded by Senator O'Connell, and carried on a voice vote that the minutes of the September 8, 2003, meeting be approved as distributed.

At the request of Chairman Klein, committee counsel distributed information concerning property taxation of rural electric cooperatives compiled by the Tax Department. A copy of this information is attached as Appendix B.

LIGNITE VISION 21 PROGRAM

Chairman Klein called on Mr. John W. Dwyer, President, Lignite Energy Council, who addressed the committee. A copy of his written presentation is attached as Appendix C. Mr. Dwyer said the objective of the Lignite Vision 21 program is to build a clean coal generating station in North Dakota. He said lignite has many strengths, including the fact that it is an abundant resource; North Dakota has an 800-year supply; plants using lignite as a fuel source are among the lowest cost plants in the United States; North Dakota plants are close to electrical markets--500 miles closer than Montana and Wyoming competition; and North Dakota provides a healthy business climate for the lignite industry. He said the Lignite Vision 21 program is important for the state because one 500-megawatt power plant means three million more tons of coal mined; 1,300 more jobs; $140 million more business volume; and $6 million more in tax revenue to the state. He said some of the best-paying jobs in North Dakota are located in coal country and the average individual personal income for persons employed in the lignite industry is $44,000 per year. He said the strategy of the State of North Dakota and the Lignite Energy Council contained in the Lignite Vision 21 program is to lower the risk to developers so lignite is the fuel of choice by lowering overall project costs. He said the program is designed to help identify problems, find solutions, eliminate government "show-stoppers," and prevent government delays in siting and constructing a new power plant in North Dakota. He said the program is industry-driven and market-based and the bottom line of the program is to activate state help for the benefit of lignite developers. He said the Lignite Vision 21 program has the unqualified support of legislators and the Industrial Commission. He noted the Industrial Commission has approved $10 million in matching funds for the development phase of each project and $2 million in nonmatching funds for management, feasibility assistance, and marketing efforts. He said the Industrial Commission has designated the Lignite Energy Council to manage the Lignite Vision 21 program.

Mr. Dwyer said the Lignite Vision 21 program has two applicants under contract with the Industrial Commission--MDU/Westmoreland Coal Company and Great Northern Power Development. He said MDU/Westmoreland Coal Company is examining a site near Gascoyne and Great Northern Power Development is examining a site near South Heart. He said both applicants have completed preliminary studies, including environmental, water availability, mine plan, socio-economic, generation technology, transmission, coal quality, site, economic, and market studies. He said all of these studies were successful. Concerning the status of the two applicants, he said, MDU/Westmoreland Coal Company is evaluating the economics of 175-, 250-, and 500-megawatt plants. He said the next step is the decision whether to move into Phase 2, the permitting and engineering phase, which will be made in July 2004. Concerning Great Northern Power Development, he said, the Industrial Commission approved Phase 2 project funding on June 18 and Great Northern Power Development submitted its air quality impact modeling protocol to the State Department of Health on August 27. He said Great Northern Power Development is now pursuing a power purchase agreement.

Mr. Dwyer said there are two critical challenges still remaining in building Lignite Vision 21 projects in North Dakota--environmental issues and transmission issues. He said the three primary issues in the environmental area are the prevention of significant deterioration, mercury, and visibility issues. Concerning the prevention of significant deterioration, he said, the issue is whether there are "modeled" exceedences of air quality standards in Class I areas. He said the primary Class I area in North Dakota is Theodore Roosevelt National Park. He said actual measurements show no deterioration and the trend in sulfur dioxide emissions in North Dakota is down. He said North Dakota is one of 16 states in compliance with all ambient air quality standards and North Dakota air is clean and getting cleaner. He said the State Department of Health has conducted two hearings concerning the prevention of significant deterioration and the State Health Officer determined there are no violations of Class I increments, no deterioration of Class I air quality, and the state's state implementation plan and prevention of significant deterioration program are adequate. From the state and the Lignite Energy Council perspectives, he said, solutions to these problems exist that protect air quality from deterioration, allow existing operations to operate at current levels, and allow Lignite Vision 21 projects to be permitted. However, he said, if there is litigation, it will delay development of a power plant in North Dakota. He said the Environmental Protection Agency and the state are negotiating a memorandum of understanding, but the Dakota Resource Council has sued the Environmental Protection Agency to enforce earlier modeling determinations. He said the state, the Lignite Energy Council, and individual companies have all intervened in this lawsuit and resolution is expected at the United States district court level over the next 12 months.

Mr. Dwyer said the other significant problem facing construction of a new coal generating station in North Dakota is transmission. He said the Lignite Energy Council has been requested by the Congressional Delegation, Governor, and the Industrial Commission to assist with the resolution of North Dakota export constraints for the Lignite Vision 21 program. He said the future growth of the lignite industry is largely dependent on resolution of North Dakota export constraints. He said adding new transmission is difficult because of both physical and regulatory constraints and uncertainties which lead to increased financial risk for the development of new transmission. He said physical constraints include long transmission distances and the operation of a complex transmission system. Solutions, he said, include adding equipment to maximize the use of existing lines, upgrading existing lines, and building new lines. He said there are a number of transmission constraints between North Dakota and its logical energy markets. He said the regulatory climate for transmission is in flux and uncertainty exists about the ability to get transmission permitted and built and the long-term costs of building new transmission. He said the Industrial Commission has formed a coal/wind transmission coalition to identify and advocate solutions to resolve transmission constraints that limit export of electrical energy. He said committees have been formed to examine transmission technical solutions, rules, regulations, and policies; national interest transmission bottlenecks; and siting, routing, and construction of new transmission. He said environmental problems may be difficult, but resolution of the transmission problem is key to construction of a new coal generating station in North Dakota.

In summary, Mr. Dwyer said two Lignite Vision 21 program participants are moving forward, obtaining a favorable "go" decision from at least one applicant is the primary objective, and the focus is on resolving environmental and transmission issues so a favorable decision is made.

In response to a question from Senator Robinson, Mr. Dwyer said studies are ongoing concerning increasing the carrying capacity of existing transmission lines.

In response to a question from Senator O'Connell, Mr. Dwyer said the proposed federal energy bill contains provisions concerning national interest transmission bottlenecks but, in the interim, the Department of Energy has established a transmission office to work to resolve transmission issues.

In response to a comment from Representative Keiser, Mr. Dwyer agreed that some companies and states are avoiding the transmission problem by constructing new generation facilities near load centers and transporting coal to these load centers.

Chairman Klein called on Mr. Dennis Boyd, Senior Governmental Affairs Representative, Public Affairs Department, MDU Resources Group, Inc., who introduced Mr. Duane Steen, Administration and Project Manager, Montana-Dakota Utilities Company and Project Manager for the Gascoyne project.

Mr. Steen reviewed the construction of new peaking plants by Montana-Dakota Utilities Company in Montana and reported the progress on the MDU/Westmoreland Coal Company Gascoyne project. A copy of his written presentation is attached as Appendix D. He said past integrated resource plans filed with the Public Service Commission indicated that Montana-Dakota Utilities Company would need to add 40 megawatts of peaking capacity during the 2003-04 timeframe. He said the economic turndown in new power plant construction at the end of 2002 provided an opportunity for Montana-Dakota Utilities Company to purchase an aero-derivative generator.

Concerning the Vision 21 Gascoyne project, Mr. Steen said MDU/Westmoreland Coal Company entered into a contract with the Industrial Commission in September 2001. In September 2002, he said, the contract was amended to allow MDU/Westmoreland Coal Company additional time to study the proposed project. In February 2003, he said, the contract was amended to allow investigation of a 250-megawatt project and in November 2003 MDU/Westmoreland

Coal Company requested an amendment to study a 175-megawatt power plant. He said 175 megawatts is the largest capacity that can be integrated into MDU's system at this time. He said the study has identified two hurdles to development of a power plant at Gascoyne--air permit issues and transmission issues. To resolve transmission issues, he said, Montana-Dakota Utilities Company has joined a resource coalition consisting of Basin Electric Power Cooperative, Montana-Dakota Utilities Company, Minnkota Power Cooperative, Missouri River Energy Services, and Heartland Consumers Power District. He said this Upper Great Plains Resource Coalition is examining construction of a 600-megawatt coal-based power plant and a 100-megawatt wind generation facility. He said proposed locations include Gascoyne and Stanton in North Dakota, Mobridge and Yankton in South Dakota, and Modale in Iowa.

Mr. Boyd addressed the committee. A copy of his written comments is attached as Appendix E. He discussed activities related to the acquisition of the NorthWestern Energy Company regulated assets and taxation of the electric utility industry in North Dakota.

ELECTRIC INDUSTRY TAXATION

Chairman Klein called on Mr. Harlan Fuglesten, Communications and Government Relations Director, North Dakota Association of Rural Electric Cooperatives, who addressed the committee. Mr. Fuglesten reviewed electric utility statistics for the period 1998-2002 and presented a tax proposal prepared by the Association of Rural Electric Cooperatives. A copy of the electric utility statistics is attached as Appendix F; a copy of Mr. Fuglesten's written comments is attached as Appendix G; and a copy of a bill draft, including several changes suggested by the Association of Rural Electric Cooperatives, is attached as Appendix H. He said that while coal and hydropower generation remain largely unchanged over the past several years, nearly all of the wind generation--67 megawatts--has been added during the past two years. He said North Dakota's electric utility industry has paid over $73 million in coal conversion taxes over the past five years, with the amount of taxes increasing from around $12 million in 1998 to nearly $21 million in 2002. He said the increase in coal conversion revenue resulted from legislative changes enacted by the 2001 legislative session with the most significant change being an increase in the coal conversion tax formula and a corresponding decrease in the coal severance tax formula. Additionally, he said, the Legislative Assembly amended the coal conversion tax to make it applicable to smaller coal-based plants and accordingly, the 86-megawatt Heskett plant in Mandan, owned by Montana-Dakota Utilities Company, is now subject to the coal conversion tax rather than the public utility property tax. He also reviewed gross receipts taxes paid by rural electric cooperatives, city privilege taxes paid by rural electric cooperatives, public utility property taxes paid by investor-owned utilities, real estate taxes paid by rural electric cooperatives, state income taxes paid by investor-owned utilities, and payments in lieu of taxes made by municipal electric utilities to their city general funds from the revenues of their utility operations. He presented a summary of all taxes paid directly by electric utilities in North Dakota during the past three years for generation, transmission, and distribution of electricity.

Concerning the rural electric cooperative tax proposal, Mr. Fuglesten said the proposal is based on three principles--taxes be revenue neutral; taxes be fair and equitable; and taxes be easy and inexpensive to administer, collect, and distribute. He said the rural electric cooperative tax proposal eliminates the public utility property tax on investor-owned utilities, eliminates the 2 percent gross receipts and city privilege taxes on rural electric cooperatives, and eliminates the high-voltage transmission line tax on rural electric cooperatives. He said the proposal retains the coal conversion tax, wind tax incentives under North Dakota Century Code Section 57-02-27.3, property taxes on land owned by electric utilities, and city franchise fees on electric utilities. Concerning the generation function of producing electricity, he said, the rural electric cooperative tax proposal leaves the current coal conversion tax in place, continues tax incentives for wind generation facilities, and makes the conversion tax applicable to noncoal or wind generation plants of five megawatts or more. Concerning the transmission function of electricity generation, he said, the proposal taxes all transmission facilities on a line-mile basis based on an increasing tax based on transmission line voltage. Concerning the distribution function of electricity production, he said, the proposal implements a two-part formula. He said the two parts are a flat tax of 52 cents per megawatt-hour of delivered power and .88 percent of revenue collected on the retail sale of kilowatt-hours of electricity. Although it is a political decision, he said, in the interest of presenting a complete proposal it contains an allocation of the tax revenues. Under the proposal, he said, revenue from the transmission line tax would be allocated to counties and taxing districts based on transmission line miles and rates of tax in each taxing district. He said revenue from the megawatt-hour tax would be allocated to the county in which the retail sale is made and allocated among taxing districts in proportion to their most recent property tax levies in dollars. He said revenue from the tax on retail revenue would be allocated according to the ratio of miles of distribution line in a county compared to the total number of miles of distribution lines the utility has in the state. He said revenue would be allocated among taxing districts in proportion to their most recent property tax levies in dollars. In summary, he said, the rural electric cooperative tax proposal is revenue-neutral with both the current and proposed tax systems raising approximately $11.2 million on transmission and distribution property, is fair to utilities with benefits and burdens shared among rural electric cooperatives and investor-owned utilities and rural electric cooperatives and investor-owned utilities being taxed the same, and is easy to administer as the plan is understandable and easy to apply. However, he said, under the proposal, certain utilities may realize an increase in their tax burden and thus the Association of Rural Electric Cooperatives would be open to phasing in the proposal over a reasonable period of time provided the goal of revenue neutrality is preserved.

In response to Mr. Fuglesten's presentation, Representative Klein said he still believed that transmission lines should be taxed on their carrying capacity rather than their voltage. However, he thanked Mr. Fuglesten for bringing a taxation proposal forward.

Chairman Klein called on Mr. Bob Graveline, President, Utility Shareholders of North Dakota, who addressed the committee. A copy of his written comments is attached as Appendix I. Mr. Graveline said the committee should request that the Tax Department conduct a study of changing the method of property taxation for cooperatives from a gross receipts basis to an ad valorem basis in order to determine whether that method may be a more equitable method of taxation.

Chairman Klein called on Mr. Scott Handy, President/CEO, Cass County Electric Cooperative, Kindred, who addressed the committee. A copy of his written comments is attached as Appendix J. Mr. Handy discussed growth projections for electric utilities in the Fargo/West Fargo area and offered perspectives from an electric cooperative that is experiencing growth.

In response to a question concerning ad valorem taxation, Ms. Marcy Dickerson, State Supervisor of Assessments, Tax Department, said the department determines the unit value for each public utility operating in the state. Under this system, she said, the department values the entire company, including out-of-state assets, to determine the unit value. She said the department then determines the total value of the company. She said this is the generally accepted method of taxation. She said most states that centrally assess utility property use the unit valuation method. She said the department then uses income and asset valuation to value the in-state portion of the company. Once the North Dakota portion is valued, she said, the property is then further broken down into all taxing districts where company assets are located. She said this methodology could be used for rural electric cooperatives, but the department does not currently collect the information from rural electric cooperatives that would be required to calculate the ad valorem property tax liability of rural electric cooperatives. Also, she said, if the department is required to do so it would probably have to add one-half of one full-time equivalent position to gather this information.

In response to a question from Senator Tollefson, Ms. Dickerson said adopting an ad valorem property taxation methodology would not be more or less difficult than the current system, only a different method of calculating tax liability.

WIND ENERGY DEVELOPMENT STUDY

Chairman Klein called on Mr. Joe Richardson, President, Harnessing Dakota Wind, Fargo, who addressed the committee. A copy of his written comments is attached as Appendix K. Mr. Richardson discussed the development of wind energy in North Dakota. He said North Dakota and South Dakota are unable to export much more electricity produced from wind or any other form of power because of transmission constraints. He said this means that the states are locked out of the fastest growing markets and could become the world's largest stranded wind resource. He said if competing states lay the infrastructure to reach eastern markets, that infrastructure will serve those states for decades to come and given that wind works well with biogeneration and hydrogen production, the loss to North Dakota will be even greater. To solve this issue, he said, the state could implement a development goal and focus on reaching it by the year 2020, adopt regional or national renewable portfolio standards, and advance marketing strategies to get to the market first.

In response to a question from Senator O'Connell, Mr. Richardson said Otter Tail Power Company purchases 21 megawatts of the 67 megawatts of wind power-generated electricity produced in North Dakota with the remaining megawatts purchased by cooperatives. However, he said, 97 percent of the wind towers and turbines are owned and operated by Florida Power and Light.

In response to a question from Senator O'Connell, Mr. Bruce Carlson, Manager, Verendrye Electric Cooperative, Velva, said Verendrye Electric Cooperative is paying 2.5 cents to each of its small generators, the same it charges for electricity generated by its prairie winds power. In response to a further question from Senator O'Connell, Mr. Carlson said the highest efficiency the wind turbines operated by Verendrye Electric have achieved is 32 percent capacity but usually run a little less than 30 percent.

In response to a question from Representative Klein, Mr. Carlson said the problems associated with the voltage dip at the wind turbine generating facilities have been resolved.

STAFF DIRECTIVES

Senator O'Connell requested that the Association of Rural Electric Cooperatives and each of the state's three investor-owned utilities provide information on their average electricity cost per consumer.

In response to a request from Representative Klein, Mr. Carlson said the cooperative would work with the Legislative Council staff and Tax Department to provide information to determine the impact of implementing an ad valorem property tax system on a typical rural electric cooperative in North Dakota.

No further business appearing, Chairman Klein adjourned the meeting at 2:30 p.m.

Jeffrey N. Nelson
Committee Counsel

ATTACH:11