

MICROFILM DIVIDER

OMB/RECORDS MANAGEMENT DIVISION

SFN 2053 (2/85) 5M



ROLL NUMBER

DESCRIPTION

2309

2005 SENATE INDUSTRY, BUSINESS AND LABOR

SB 2309

2005 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. SB 2309

Senate Industry, Business and Labor Committee

☐ Conference Committee

Hearing Date 1-26-05

Tape Number	Side A	Side B	Meter #
1		x	4650-end
2	x		0-4409
Committee Clerk Signature <i>Lisa VanBerkum</i>			

Minutes: **Chairman Mutch** opened the hearing on SB 2309. All Senators were present.

SB 2309 relates to the distribution of electric cooperative capital credits.

Senator Tollefson, District 38, introduced the bill. See attached testimony.

Senator Espgaard : I'm familiar with the discounting of capital credits, but from the stand point that they came to me, and asked if I wanted to have my capital credits retired. In that regard, they gave me a discount. I believe that most of the other capital credits, upon the death of the holder of the credit, they get paid in full.

Senator Tollefson: The second portion of the handout (see attached), there is a typical example of some settlements on capital credits after the patron has passed away. In that particular case, I think the total credits were some five hundred and three dollars. The settlement was two hundred and twenty six dollars and eighty seven cents. That's not uncommon. This was brought to my attention by a constituent. This person had a difficult time, not only financially, but

understanding why they were not able to receive all of their capital credits after her husband passed away.

Senator Espegard : Do you think this was held by both the husband and the wife?

Senator Tollefson: This particular case, she was his second wife. He upheld his property, apparently, by himself, not in joint. So after he passed away, she asked for a settlement of those capital credits. In other cases, this was the example that was brought to my attention.

Senator Espegard : I do here, and get offered myself, to get the capital credits now, at a discount, and the time value of money. I was under the understanding that when someone died, they were paid out one hundred percent.

Senator Tollefson: There was a rural telephone company, which was involved in the same settlement. She was paid all of the capital credits. But it seems to vary around the state and the condition of the REC situation.

Senator Nething : In your testimony, page two, you indicate that anyone making an investment expects a return from it. I thought these capital credits had accumulated because they were part of a patronage dividend, as opposed to any dollar investment.

Senator Tollefson: That's correct. The term used is margins, rather than profit. I'm in reference to the investment on the part of the patron by leaving their capital credits in place. That seems to deserve some return on the investment.

Senator Nething : Isn't that part of the agreement that the individual has made when they became a member of the co-op?

Senator Tollefson: I don't know for sure if they have agreed.

Senator Mutch : The whole problem is the whole misconception as to who owns the cooperatives. You don't have stock in it.

Senator Espegard : I see benefits in paying off at the time of death. I see detriment in requiring these co-ops to add to their expense which is ultimately passed to the members at three percent interest on their capital. I don't see where that helps the co-op any. When a co-op structure is in place, the members benefit. They benefit because they have the service or cheaper service, to expect that they are also going to get a three percent return mandated on that investment would seem to be double-dipping. Also anti-productive to bottom line profitability.

Senator Tollefson: The payoff is decided by the board.

Senator Fairfield : Isn't local control a good thing? Aren't they better equipped to manage their cooperatives than we are?

Senator Tollefson: I'm arguing the point that when you have a patron that passes away and has accumulated many dollars in capital credits and cannot get those without taking a severe discount or losing them entirely, doesn't seem proper.

Senator Heitkamp : You said this is his second wife, did the first wife get the other half?

Senator Tollefson: I don't know.

Senator Heitkamp : The figure is just scary close to half.

Chairman Mutch : The impression I have is that you can agree to settle for twenty five percent. The amount of capital credit that you had. And if you didn't do that, then I didn't assume that you would lose it, but you'll probably never get it anyway. It's a form of liquidating their liabilities, when they made another merger of another co-op.

Senator Tollefson: In that case, you would go back into the regular rotation. Our co-op is a twenty year rotation.

Senator Espgaard : Fundamentally, a co-op is different than a business, but in one way, if I own a business and my equity is one hundred thousand dollars. And subject to the profit and loss of the yearly business, my equity goes up and down. Should I also expect that the company pay me three percent on my equity?

Senator Tollefson: The average interest rate that co-ops pay is five to seven percent. If you are using the capital credits to gain financial position, three percent is rather cheap. It is really used for the ongoing services of that co-op.

Senator Klein : Can we really try to stipulate that?

Chairman Mutch : My thought in this whole bill that was upon death they would have to pay whatever has been determined. After that and until they get around to paying, the three percent would apply, am I right?

Senator Tollefson: That's correct.

Senator Nething: I think it says annually until they are paid.

Chairman Mutch : I am assuming annually, AFTER death.

Chairman Mutch : The co-op is not supposed make any money anyway, they are nonprofit.

Senator Nething : There's a difference in making money and making profit.

Senator Fairfield: In the last sentence of the bill, I presume that is any unpaid bills. Because otherwise, doesn't the last sentence say that even if the board says that they want to pay them out early that they can't. It has to be paid upon the death of the member.

Senator Tollefson: Unretrieved capital credit.

Senator Krebsbach: Do you know of any other states that have such a mandate to pay out capital credits upon death.

Senator Tollefson: I didn't check that. We could.

Senator Heitkamp : This still goes away from the general concept of whatever policy is in place today, weren't they decided by the member-owners that were elected from the members, themselves?

Senator Tollefson: I understand that that is correct.

Chairman Mutch allowed opposition to the bill.

Harlan Fuglesten, Communications and Government Relations Director for the North Dakota Association of Rural Electric Cooperatives, spoke in opposition to the bill.

See attached testimony.

Senator Klein : I think the biggest issue here is the credits for deceased members.

Harlan: My parents died and they had capital credits that remained unretired and the co-op had a retirement rotation scheduled, they discounted those capital credits to the extent that the payment was made earlier than the expected rotation schedule.

Chairman Mutch : Is each cooperative required to have their own rotation program?

Harlan: Under chapter 10-13-06, the law has given the cooperative board the discretion to determine the manner in which they rotate the capital credits, based on the best financial interests of the cooperative. That is the key concept.

Senator Espegard: Is the rotation schedule on a deceased person different than on a living person?

Harlan: The rotation system is based upon the financial conditions of the cooperative, and will be determined from year to year.

Senator Nething : You have 250,000 consumers, you say, how do you arrive at what a consumer is?

Harlan: Actually those are people we serve. We serve about 126,000 meters. Average family size.

Reginal Rudolf, Manager of McLean Electric Cooperative, Inc, spoke in opposition of the bill. See attached testimony.

Chairman Mutch : Do you have a rotation program of retiring capital credit?

Rudolf: Yes, we do.

Chairman Mutch : Then if they die, how is that taken into consideration? Do you discount them?

Rudolf: McLean Electric has a retirement program that discounts six percent per year, over a twenty year cycle.

Senator Fairfield : If there was a member out cry, couldn't they change the by-laws at the annual meeting?

Rudolf: There are two forms. The first specifies that it is at the discretion of the board of directors, the members can also bring forth a by-law amendment.

Chairman Mutch : Would you have any objection to the proposed amendments?

Rudolf: I guess that decision would lie with the board of directors.

Shawn Deisz, Manager of Accounting at Basin Electric Power Cooperative, spoke in opposition. See written testimony.

Page 7

Senate Industry, Business and Labor Committee

Bill/Resolution Number SB 2309

Hearing Date 1-24-05

Senator Nething : I presume that you are opposed to this?

Shawn: Yes, sir.

Chairman Mutch : How would Basin Electric have a contingent liability towards an individuals death?

Shawn: The way the bill is written right now, it indicates that all patronage must be paid to members. Basin does have members, although, they aren't individuals.

Senator Krebsbach: You members are the distribution cooperatives?

Shawn: Yes.

Senator Krebsbach: You accumulate capital credits for the distribution members.

Shawn: We have our own patronage capital and we create our own margin. That margin is then allocated to our members.

Martin Dahl, Verendrye Electric, stated their opposition to the bill for the record.

Woody Barth, North Dakota Farmers Union, stated their opposition to the bill as well.

Hearing was closed. No action was taken.

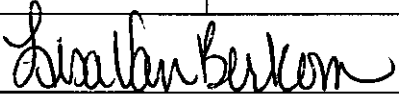
2005 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. SB 2309

Senate Industry, Business and Labor Committee

☐ Conference Committee

Hearing Date 1-26-05

Tape Number	Side A	Side B	Meter #
3	xxx		1273-1678
Committee Clerk Signature 			

Minutes: **Chairman Mutch** opened committee discussion on SB 2309. All Senators were present. SB 2309 relates to distribution of electric cooperative capital credits.

Chairman Mutch submitted an amendment for the committee to review. (see attached)

Chairman Mutch : What the amendment does is if one person dies, from that point and on, they could request whatever capital credits there are and until such time that they pay them after their death, it would be three percent interest.

Senator Heitkamp : Does this allow for them to pay them when they pay them.

Chairman Mutch : Yes, but when they pay them, they pay them three percent interest.

Senator Fairfield : So they are only paid upon death now? Because some of them actually do pay out earlier.

Senator Klein moved to adopt the amendments.

Senator Espegard seconded.

Roll Call Vote: 7 yes. 0 no. 0 absent.

Page 2

Senate Industry, Business and Labor Committee

Bill/Resolution Number SB 2309

Hearing Date 1-26-05

Senator Espegard moved a DO NOT PASS AS AMENDED.

Senator Heitkamp seconded.

Roll Call Vote: 6 yes. 1 no. 0 absent.

Carrier: Senator Heitkamp

January 25, 2005

[Handwritten signature]
1/27/05

PROPOSED AMENDMENTS TO SENATE BILL NO. 2309

Page 1, line 15, remove "Any unpaid capital credits"

Page 1, remove line 16

Page 1, line 17, remove "credits are paid to the member, the member's estate, or the member's beneficiaries."

Page 1, line 18, after the underscored period insert "Unpaid capital credits accrue interest at the rate of three percent per annum compounded annually until the capital credits are paid to the member's estate or the member's beneficiaries."

Renumber accordingly

Date: 1-26-05

Roll Call Vote #: 1

2005 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 7300

Senate Industry, Business and Labor Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken Adopt Amend

Motion Made By Klein Seconded By Espgaard

[illegible]

Total (Yes) 7 No 0

Absent 0

Floor Assignment

If the vote is on an amendment, briefly indicate intent:

Date: 1-26-05
Roll Call Vote #: 2

2005 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 2309

Senate Industry, Business and Labor Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken DN-P AS AMENDED

Motion Made By Espegard Seconded By Heitkamp

Senators	Yes	No	Senators	Yes	No
Senator Mutch, Chairman	X	X	Senator Fairfield	X	
Senator Klein, Vice Chairman	X		Senator Heitkamp	X	
Senator Krebsbach	X				
Senator Nething	X				
Senator Espegard	X				

Total (Yes) 6 No 1

Absent 0

Floor Assignment Heitkamp

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

SB 2309: Industry, Business and Labor Committee (Sen. Mutch, Chairman) recommends AMENDMENTS AS FOLLOWS and when so amended, recommends DO NOT PASS (6 YEAS, 1 NAY, 0 ABSENT AND NOT VOTING). SB 2309 was placed on the Sixth order on the calendar.

Page 1, line 15, remove "Any unpaid capital credits"

Page 1, remove line 16

Page 1, line 17, remove "credits are paid to the member, the member's estate, or the member's beneficiaries."

Page 1, line 18, after the underscored period insert "Unpaid capital credits accrue interest at the rate of three percent per annum compounded annually until the capital credits are paid to the member's estate or the member's beneficiaries."

Renumber accordingly

2005 TESTIMONY

SB 2309

TESTIMONY SB 2309
SEN. BEN TOLLEFSON
JANUARY 24, 2005

CHAIRMAN MUTCH, MEMBERS OF THE SENATE IBL
COMMITTEE,

MY NAME IS SEN. BEN TOLLEFSON, DISTRICT 38. SENATE BILL
2309 IS A SIMPLE BILL. IT REQUIRES THE ELECTRIC CO-OPS
OF NORTH DAKOTA TO PAY OFF, IN FULL, CAPITAL CREDITS
HELD BY A DECEASED MEMBER'S ESTATE AND REQUIRES
INTEREST OF 3% PER ANNUM BE PAID ON CAPITAL CREDITS
NOT RETRIEVED.

CAPITAL CREDITS ARE A DEBT THAT MUST BE PAID BACK.
THE SETTLEMENT OF A DECEASED MEMBER'S ESTATE IS
OFTEN IMPOSSIBLE WITHOUT A FULL REPAYMENT BY THE
CO-OP. SOME CO-OPS ARE ATTEMPTING TO SETTLE FOR AS
LITTLE AS 50% OF THE CREDIT VALUE (SEE COPY ATTACHED),
WITH THE BALANCE TO BE PAID TO HEIRS OF THE ESTATE
YEARS TO COME. CO-OP MEMBERS THAT I HAVE DISCUSSED
THIS ISSUE WITH HAVE BEEN VERY DISTURBED BY THE
PRACTICE OF DISCOUNTING ESTATE SETTLEMENTS.

ANYONE MAKING AN INVESTMENT EXPECTS A RETURN FROM
IT. THE NOMINAL 3% INTEREST ON THESE CAPITAL CREDITS
THAT HAVE NOT BEEN RETRIEVED BY THE CO-OP IS
REASONABLE AND FAIR TO ALL PARTIES.

SB 2309 OFFERS UNIFORMITY TO A VERY SERIOUS PROBLEM.

YOUR "DO PASS" RECOMMENDATION WILL MOVE THIS
FAIRNESS ISSUE ALONG.

THANK YOU,

SEN. BEN TOLLEFSON

AFFIDAVIT FOR COLLECTION OF PERSONAL PROPERTY
OF THE DECEDENT

TO:

RECEIVED
JUN 20 1999

VERENDRYE
ELECTRIC

STATE OF _____)
COUNTY OF _____) ss.

079100200990

9166

31344

Name: _____

Address: _____

City: _____

State: _____

Zip: _____

being duly sworn, states the following:

1. Affiant is/are the successor of Robert Lewis, Minot - Member# 9166
SS # 502-22-0584 who died on April 13, 1999. Affiant is/are successor because:
(relation, etc.) wife
2. The value of the entire estate of the decedent, wherever located, less liens and encumbrances, does not exceed \$15,000.00.
3. Thirty days have elapsed since the death of the decedent.
4. No application or petition for the appointment of a personal representative of the decedent's estate is pending or has been granted in any jurisdiction.
5. The affiant, as successor of the decedent, is entitled to the payment of all capital credits and patronage allocations owed the decedent in the amount of \$ 503.15. Please refund by the selected option:

(Choose one Option)

☒ Retire all capital credits of decedent now. The discounted amount to be paid is \$ 226.87 ok

Signed: _____

☐ Retire all capital credits of decedent through Verendrye Electric's normal retirement policy.
Please assign the decedent's account to:

Name: _____

Address: _____

City: _____

State: _____

Zip: _____

Subscribed and sworn to before me this 28th day of June, 1999.

(SEAL)

Notary Public

Ward

County, North Dakota

My commission expires: July 1, 2003

OPPOSED

Shawn Deisz - Basin Electric Power Cooperative
North Dakota Senate Bill No. 2309
~~House Finance and Taxation Committee~~
January 24, 2005

Mr. Chairman and members of the committee, my name is Shawn Deisz, and I am the Manager of Accounting at Basin Electric Power Cooperative.

This bill impacts much more than the cost of interest on Patronage Capital held by the cooperative, although the financial impact of the interest would be substantial. This bill seeks to penalize cooperatives for their philosophy and business structure and because of that we strongly oppose its passage.

One provision of this legislation mandates that a cooperative pay its owners interest on their investment in the cooperative. Paying interest on Patronage Capital indicates that the Patronage Capital is a liability (i.e. a loan) rather than equity.

Turning equity into a liability eliminates the cooperative principle of member ownership and turns every cooperative member owner into a lender. A cooperative's Patronage Capital is the same as a for-profit company's retained earnings. They represent the equity of the company. This bill will have the same effect as forcing an investor-owned utility to charge interest on its retained earnings and pay it to their shareholders at the time the retained earnings are paid to them. This would occur each time a dividend is paid, and ultimately upon their death.

Patronage Capital (or Retained Earnings) represents ownership in an entity and by its very nature ownership does not carry an interest rate. You cannot increase your ownership value by charging yourself interest. Since cooperatives are not-for-profit organizations owned by their customers, it would mean increasing the cost to your owners, to increase their investment. There is no logic in that arrangement. They would be charging themselves to pay themselves.

Senate bill 2309 would also require a change in financial reporting for all electric cooperatives in North Dakota that is radically different than any other cooperative in the United States. Adoption of a recently issued authoritative pronouncement by the Financial Accounting Standards Board (FASB) related to this very issue was indefinitely deferred for cooperatives when the FASB was informed of the impact the pronouncement would have on the financial structure of cooperatives. The pronouncement said that if an event that is sure to occur triggers an obligation to pay, it must be recorded as a liability. Since most of our member owners are human, their death is sure to occur. So if a cooperative has a bylaw that says the cooperative will pay out all patronage capital due to a member at the time of death it was affected by the pronouncement. This bill proposes a state law to make those payouts mandatory, which will require patronage capital to be recorded as a liability and virtually eliminate all electric cooperative equity.

As you all know the electric generation and distribution industry is one of the most capital intensive in the world. Basin Electric and its membership have spent years

developing and protecting its credit worthiness with bond rating services on Wall Street. These bond ratings are an evaluation of a company's credit standing and impact the interest rate the company will pay to finance construction projects. Basin Electric currently has very high credit rating with Moody's (A1), and Standard and Poors (A+). During the past few years many other utilities have had their ratings downgraded due to scandals and attempts at deregulation. Due to the cooperative structure and conservative mindset, Basin's ratings were upgraded during the same time period. These ratings allow Basin Electric to borrow money in the public market where Basin has financed 88% of its new debt in the last 5 years.

In the final analysis, this bill would drastically reduce our equity, which would reduce our bond ratings, increase our interest rates on some existing debt and all future debt, increase our rates to North Dakota customers currently served by rural electric cooperatives and stop any future investment in the state of North Dakota. If this requirement were to be placed on the investor-owned utilities in the state, the effects I have just described for Basin Electric would be the same for them.

Mr. Chairman and members of the committee, this concludes my testimony. I would be happy to answer any questions you may have.

OPPOSED

TESTIMONY OF REGINAL RUDOLPH
MANAGER OF McLEAN ELECTRIC COOPERATIVE, INC.
TO THE SENATE INDUSTRY, BUSINESS AND LABOR COMMITTEE
SENATE BILL 2309
MONDAY, JANUARY 24, 2005

Good morning, my name is Reginal Rudolph. I am the General Manager of McLean Electric Cooperative in Garrison, ND.

McLean Electric serves 3,000 meters located within McLean County. Comparatively, McLean Electric is the second smallest distribution cooperative in the state of North Dakota.

This morning I would like to explain the effects adoption of Senate Bill 2309 would have on the members of McLean Electric Cooperative.

Senate Bill 2309 would have an immediate negative impact. This proposed bill would require an increase in rates of 3.6% the first year just to cover the interest accrued on general capital credit allocations. There would be an additional cost to retire capital credits without discount to estates of deceased members.

McLean Electric's equity is derived through the patronage capital of its members. Capital also comes from the allocated margins of our federated cooperatives, Basin Electric and Central Power. Of McLean's total equity, 59% has been generated from our distribution operations and 41% from power supply and transmission allocations.

Our cooperative maintains patronage allocations to 4,546 members. Of this total, 2,230 or 49% are inactive members.

Capital credits serve a variety of purposes including, maintaining financial strength, meeting mortgage requirements, funding new construction and maintaining fairness across generations of members.

All businesses need capital to operate, which is usually supplied by a combination of equity and debt. A stock company, such as an investor-owned utility, can raise equity by selling shares of stock. An electric cooperative cannot generally issue stock and pay dividends to the general public. Yet, it still needs to maintain an adequate level of equity to ensure financial health and stability.

Serving the members of McLean Electric is very capital intensive. For every dollar invested in plant only twenty-five cents in revenue is generated annually. Therefore, equity management is critical. Investments in utility plant made today are expected to maintain a useful life of thirty to fifty years. To pay for these investments a combination of debt and equity is required to provide the lowest rate to the membership. Senate Bill 2309 unfairly adds three percent to the member's equity costs.

Maintaining fairness across generations is another important concept for electric cooperatives. Under McLean's capital credit retirement system, present members receive lower rates because of the internal financing provided by equity capital. Likewise, the equity capital generated today will be available to build infrastructure for

the benefit of future consumers, and today's consumers will have their capital credits retired as the financial condition of the co-op allows. The goal is to charge a rate that is equitable to today's member without shifting a burden to future rate paying members.

McLean Electric also has an objection to the bill language regarding capital credit retirements in full for decedents. Costs of an asset put into service today are amortized over its useful life so all future rate payers bear their equitable cost of the benefit. At McLean Electric, our members have approved bylaws that retire capital credits on a first in first out (FIFO) basis. The only exception is when a member dies, the deceased member's estate is given the option of continuing in line or receiving a discounted amount since the payment is accelerated ahead of others.

There is a real cost to the other members of the cooperative to retire capital credits out of sequence, as is proposed under Senate Bill 2309. Discounting capital credits provides a fair way to recognize special circumstances while continuing to treat all members equally. Discounting is used to calculate the present value of an amount that would otherwise be received in the future to reflect the time value of money.

In closing, it seems ironic to tell members of McLean Electric that the cooperative is raising rates 3.6% so they can receive interest on their capital credit allocations. Furthermore, I am not aware of any other law that mandates a business to make a prescribed distribution of dividends to its owners. This bill isn't good for business, no matter what form it operates under. I urge the committee to give SB 2309 a DO NOT PASS recommendation. Thank you for your consideration.

OPPOSED

Testimony of Harlan Fuglesten,
Communications and Government Relations Director
For the North Dakota Association of Rural Electric Cooperatives
In Opposition to SB 2309
Before the Senate Industry, Business and Labor Committee
January 24, 2005

Mr. Chairman and members of the committee, my name is Harlan Fuglesten. I am appearing this morning in opposition to SB 2309 on behalf of the North Dakota Association of Rural Electric Cooperatives.

Out of the thousands of business corporations and hundreds of cooperative corporations operating in North Dakota, SB 2309 singles out for special treatment 19 electric cooperatives that are organized under chapter 10-13 of the North Dakota Century Code. No other business in North Dakota is or would be required to pay interest on retained earnings or equity capital to its owners. It seems odd that electric cooperatives, which are organized under North Dakota law to operate as non-profit entities, would be required to violate their non-profit status and their cooperative philosophy by being forced to pay compound interest on allocated but unretired capital credits or retained earnings. The potential consequences of this law would be devastating to electric cooperatives and their members. Passage of this bill would lead to rate increases and other negative consequences that we will discuss. First, however, I would like to provide a little background on cooperative capital credits.

Allocating and eventually retiring capital credits allows an electric cooperative to operate at cost. This is a fundamental requirement to be recognized as a cooperative under federal tax law and to operate in a non-profit manner under our state enabling law, chapter 10-13 of the North Dakota Century Code.

To understand why SB 2309 is unnecessary and harmful to electric cooperatives and their members, one needs to understand the nature of capital credits. Every business, even a non-profit business like an electric cooperative, must operate in the black in order to survive. When annual revenues exceed expenses, a margin is created. Capital credits represent the allocation of this margin to the cooperative's members in proportion to their business with the cooperative. Until the capital credits are returned, the unretired capital credits serve as an important source of working capital for the cooperative in the same way retained earnings are used by a business corporation. For the electric cooperative, however, instead of increasing profits, the use of internal capital helps maintain rate stability by providing a source of low cost financing.

North Dakota law is similar to the law in most other states in vesting an electric cooperative's board of directors with discretion to determine the manner and timing of the return of capital to its members. Electric cooperatives have operated in this way in North Dakota for over 60 years. Our co-ops generally return capital credits, as the current financial condition of the co-op allows, on a First In First Out (FIFO) basis, although

some co-ops have also given bill credits or used a combined Last In First Out (LIFO) and FIFO payment system.

When a member receives a capital credit allocation today, the member does not have an immediate right to the return of his or her equity. Instead, the allocated capital credits are retained by the co-op for the benefit of all members, just as the equity of the earliest members was retained for the benefit of the next generation of members and so on. Because a member has no vested right to the principal in his allocated capital credits account until it is retired, it follows that the member should have no right to the payment of interest on this account.

In fact, the North Dakota Supreme Court has recognized that an allocated capital credit is only a contingent interest and not a vested right to payment. In Evanenko v. Farmers Union Elevator, 191 N.W.2d 258 (N.D. 1971), the court indicated that under the principle behind cooperative law, capital credits are a contingent interest that "becomes vested only when the board of directors, in the exercise of its sound discretion, determines that such payments can be made in cash without causing undue financial hardship to the cooperative." In most electric co-ops, the return of capital credits occurs in a 15 to 30 year rotation. This is similar to the practice for electric cooperatives throughout the nation.

For most current co-op consumers, SB 2309 would cause an increase in electric rates that would far outstrip any benefits these consumers would receive in interest on their capital credit allocations. Those who stand to benefit from this legislation are those who are former members of the cooperative who will not have to absorb the rate increases necessary to pay the interest. While we do not have data on exactly who these former members are, we do know, for example, that a significant amount of capital credits in western North Dakota are owed to companies that moved out of state following the last oil boom and bust. It is likely that many former residential members also left the state. Thus, this bill would have the effect of transferring wealth out of North Dakota. This might be okay if it was done to correct some unfairness, but it does not. Instead, SB 2309 would give windfall benefits to former members who already received the benefits of low electric rates resulting from the existing capital credit rotation system of their local electric co-op.

Following the introduction of SB 2309, we surveyed our 17 retail distribution cooperatives to determine the financial impact this legislation would have on current utility rates. What we determined is that the first year interest cost on the unretired capital credits as of the end of 2004 would be \$6.5 million. There would be an additional cost for making payments in full to estates. Had this law been in effect in 2004, that additional cost would have been \$266,000. Based on our analysis, retail rates for electric co-ops would have to rise, on average, by about three percent during the first year just to provide additional revenue to pay back capital credits.

The impact of compound interest would only necessitate additional rate increases in future years. Failure to raise rates would mean extending current capital credit rotations

further, making the interest charges even more burdensome, and resulting in much higher rates in the future.

There are others who will address the impact the mandatory requirement for payment in full of capital credits to estates would create, but I would like to make a brief comment about payments to estates. Fourteen of our cooperatives discount capital credits when making accelerated payments to estates. This reflects the time value of money to be paid in the future. In most cases, I believe the co-op gives the estate representative the option to wait for full payment under the co-op's rotation schedule. Three co-ops have chosen not to discount the capital credits paid to estates. In every case, however, these decisions remain with the local co-op board and the co-op members and are based on the best financial interests of the co-op. The owners of electric co-ops do not need the state dictating the terms on which their own capital is returned to them.

I believe SB 2309 would also jeopardize the income tax exempt status that our distribution co-ops have under 501(c)(12) of the Internal Revenue Code. One of the requirements for tax exemption under this section is that the entity must operate on a cooperative basis. Operating on a cooperative basis includes, among other things, the subordination of capital. This means that the purpose of the business is not to return interest or dividends to owners, but rather it is for the mutual benefit of all members. It seems to me that this proposed legislation violates that key principle.

There are other negative consequences to cooperatives and their members that this legislation would cause, some of which will be addressed by other presenters. I hope you can see, however, that the ramifications of this legislation go well beyond just the substantial rate increases this bill would cause.

On behalf of North Dakota's electric cooperatives and the 250,000 consumers we serve, I respectfully request that you vote DO NOT PASS on SB 2309.

Thank you.

OPPOSED

**TESTIMONY OF MARTIN D DAHL
MINOT SERVICE AREA MANAGER
VERENDRYE ELECTRIC COOPERATIVE
January 24, 2005**

Mr. Chairman and members of the committee, my name is Martin Dahl, Minot Service Area Manager for Verendrye Electric Cooperative, Minot, North Dakota. Verendrye is a "member owned" electric cooperative, which serves 10,100 meters in six counties over 4,300 miles of power line surrounding Minot. I offer this written testimony with great concern over Senate Bill 2309. I respectfully request a no vote for this bill based on the following items.

1) An electric cooperative required to pay 3% interest on \$1 million in unpaid Capital Credits would need to include an additional \$300,000 in operating margins to pay this interest. In many cases this would cause a rate increase, which in effect would negate any interest benefit to consumers realized by passing this bill.

2) If this is truly a concern of our members, they are able to bring this concern to the annual meeting. If at that time they get a favorable vote from the membership they could get interest. This is a matter for our members to decide democratically and should not be brought to a very busy legislature.

3) Interest payments on Capital Credits would cause a need for a by-law change for Cooperatives. One of the items covered by the by-laws of our Cooperative is that interest will not be paid on Capital Credits. These by-laws are given out to all new members when signing up for service.

4) Our Board of Directors does a fine job setting the Capital Credit payment amounts each year as part of our annual budget process. This is part of doing business. The legislature does not set an investor owned utility dividend so why would you want to

force cooperatives to accelerate Capital Credit payments. Accelerated Capital Credit payments will only cost your constituents money.

Please vote to not implement this 3% interest discussed in SB 2309

Sincerely,

Martin D. Dahl P.E.
Minot Service Area Manager

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