NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

ENERGY DEVELOPMENT AND TRANSMISSION COMMITTEE

Thursday, March 8, 2018
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator Rich Wardner, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators Rich Wardner, Brad Bekkedahl, Jim Dotzenrod, Merrill Piepkorn, David S. Rust, Jessica Unruh; Representatives Mike Brandenburg, Ben Koppelman, Corey Mock, Todd Porter, Gary R. Sukut

Member absent: Representative Tracy Boe

Others present: See Appendix A

It was moved by Representative Mock, seconded by Senator Rust, and carried on a voice vote that the minutes of the January 24, 2018, meeting be approved as distributed.

Chairman Wardner said the committee is gathering information on tax incentives related to the committee's study of wind energy taxation. He said the committee continues to study the oil and gas tax allocation formulas and will receive information regarding the funding needs of selected oil-producing counties and the three hub cities.

ENERGY TAX INCENTIVES

Overview

Ms. Emily L. Thompson, Counsel, Legislative Council, presented a memorandum entitled *Comparison of Coal-, Natural Gas-, and Wind-Powered Energy Sources*. She said wind power in the United States is anticipated to increase from 6.3 percent in 2017 to 6.9 percent in 2019 according to a study by the Energy Information Administration (EIA). She said the EIA also conducted a study to compare the cost of electricity from different generation sources. She said the study identified natural gas power as the most economical source of electrical generation before any consideration of state or federal tax incentives. She said the EIA attributes the favorable economics of natural gas power primarily to low natural gas prices.

Ms. Thompson presented a memorandum entitled *State Tax Incentives for Coal, Oil and Gas, and Wind*. She said the state imposes a coal severance tax and a coal conversion tax and provides exemptions under certain conditions for these two taxes. She said natural gas is subject to the oil and gas gross production tax as well as a generation tax if the natural gas is used to produce 100 kilowatts or more of electricity. She said wind power is subject to property tax or payments in lieu of property tax. She said the state provided a sales tax exemption for materials used to construct wind turbines and an income tax credit based on the cost of installing wind turbines, but both tax incentives expired on December 31, 2016.

Ms. Thompson presented a memorandum entitled *Federal Tax Incentives for Coal, Oil and Gas, and Wind*. She said the memorandum provides information on the general structure of the federal tax incentives, but does not include information on the dollar amounts associated with the utilization of the incentives. She said the primary federal tax incentives related to coal include income tax deductions for the depletion of minerals and for mining exploration costs. She said the primary federal tax incentives related to oil and natural gas include income tax deductions for intangible drilling costs and for the depletion of oil and natural gas wells. She said the federal government provides a production tax credit for wind energy, but the credits are in the process of being phased out.

Senator Unruh said a federal tax incentive related to carbon dioxide sequestration could impact the coal industry as carbon capture technology advances making carbon dioxide capture and storage technologically feasible.

Representative Brandenburg distributed a copy of a newspaper article (Appendix B) regarding federal tax incentives for the coal industry. He said wind turbines benefit from the federal production tax credit, but the coal industry also benefits from federal tax incentives.

Chairman Wardner requested the Legislative Council staff to provide information at a future meeting on the wind energy tax collections by county and the dates when wind turbine projects will transition from property taxes to payments in lieu of property taxes.

Senator Unruh suggested the Legislative Council staff provide information at a future meeting on the distribution of coal tax revenues and oil and gas tax revenues.

Tax Department

Mr. Ryan Rauschenberger, Tax Commissioner, presented information (Appendix C) regarding a comparison of the estimated fiscal impact of sales tax exemptions for coal-, natural gas-, and wind-powered facilities. He said the state collected approximately $52.6 million of coal conversion tax revenues and $22 million of coal severance tax revenues during the 2015-17 biennium. He said property taxes on wind turbines provided approximately $7.9 million to local taxing districts while the payments in lieu of property taxes associated with wind turbines provided approximately $4.4 million to local taxing districts during the 2015-17 biennium. He said the cost of wind power from new wind turbines could increase by approximately $.71 per megawatt hour because the sales tax exemption for materials used in the construction of wind turbines expired in December 2016.

In response to a question from Representative Brandenburg, Mr. Rauschenberger said the state has not collected any sales taxes related to wind turbine projects based on publicly available data for permitted projects.

Representative Brandenburg said the taxing structure of wind energy is important for attracting new wind turbine projects to the state. He said the projects provide an economic benefit to the state and local communities. He said a new 150 megawatt wind turbine project could generate approximately $7 million in sales taxes for the state. He said the tax benefits the state but increases the cost for wind developers. He said some wind turbine projects may be moved to South Dakota if North Dakota's tax structure becomes unfavorable.

Senator Unruh said the property taxes from wind turbines benefit local political subdivisions but do not provide revenue to the state. She said electricity generated from coal power is subject to an electrical generation tax as well as taxes associated with the mining of the coal while electricity generated from wind power does not have a tax imposed on its fuel source, which is wind.

In response to a question from Senator Dotzenrod, Mr. Rauschenberger said local political subdivisions may also benefit from the sales tax on the materials used in the construction of wind turbines because some cities and counties also impose a local sales tax.

Representative Porter suggested the Tax Department provide information at a future meeting regarding tax revenue collected by the state from electrical generation during the past 5 bienniums, including details on the amount of tax collected by generation type; the amount of electrical generation by generation type; and the estimated impact to the tax collections as the type of electrical generation changes.

Industrial Commission

Ms. Karlene Fine, Executive Director and Secretary, Industrial Commission, presented information (Appendix D) regarding an overview of the lignite research fund. She said the 2017 Legislative Assembly changed the allocation of coal severance tax allocations to increase the funding for the lignite research fund. She said the 2017 Legislative Assembly also provided an allocation from oil and gas tax revenue collections and provided a transfer from the strategic investment and improvements fund to add funding for advanced energy technology development.

In response to a question from Senator Piepkorn, Ms. Fine said lignite marketing includes television advertisements, newspaper advertisements, and staff time to meet with editorial groups. She said the Industrial Commission contracts with marketing agencies for lignite marketing services and the agencies are chosen through an application process.

NextEra Energy Resources, LLC

Mr. Jason Utton, Vice President, Renewable Development, NextEra Energy Resources, LLC, North Palm Beach, Florida, presented information (Appendix E) regarding the marketing of wind energy projects. He said NextEra has invested $2 billion to develop 1,250 megawatts of wind turbine projects in North Dakota. He said the cost of wind energy nationally decreased from an average of $60 per megawatt in 2010 to an average of $19 per megawatt in 2016. He said the cost of wind energy is projected to decrease to an average of $15 per megawatt by 2020. He said NextEra builds wind turbine projects and sells power to utilities based on a power purchase agreement (PPA). He said the PPA determines the price of the electricity and the schedule for delivering the electricity. He said the federal production tax credits encourage wind turbine development and the tax benefits are passed on to end users through lower electricity prices in the PPA. He said NextEra is in the process of planning for the repowering of some older wind turbines. He said the repowering process replaces the rotor blades and turbine equipment to increase the generating capacity of the wind turbine. He said improvements in batteries may provide opportunities for cost-effective solutions to store and distribute electricity when wind turbines are not generating.

In response to a question from Representative Porter, Mr. Utton said cost-savings and tax incentives are factored into PPAs and benefit the end users. He said the benefits are passed along to the end users in the wholesale electricity rates. He said other costs, such as transmission line construction and power plant repairs are also factored into end users' utility bills. He said increases in these other costs may offset any savings from lower wholesale electricity rates resulting in increased costs for the end user.

In response to a question from Senator Piepkorn, Mr. Utton said NextEra partners with other companies to conduct research and development related to battery technology. He said NextEra has some facilities operating in the United States that use batteries to store the electricity generated from wind and solar power.

Public Comments

Mr. Jason Bohrer, President and Chief Executive Officer, Lignite Energy Council, provided comments (Appendix F) regarding energy tax incentives. He said federal energy tax incentives impact both energy markets and the states' economies. He said federal energy tax incentives have a larger fiscal impact than state taxes and state tax incentives. He said federal energy tax incentives can be compared based on the direct financial impact or based on the amount of energy produced. He said renewable energy resources have received more federal tax incentives per kilowatt hour of electricity compared to coal, natural gas, and nuclear power.

NATURAL GAS PRICING

Chairman Wardner distributed information (Appendix G) regarding an overview of natural gas pricing related to a report on the study of the valuation of oil and gas pursuant to Section 21 of 2017 Senate Bill No. 2013. He said the handouts include a diagram and a list of the steps involved in the processing of natural gas. He said the handouts are intended to provide background information to the committee members in preparation for a report from the Tax Department later in the interim.

OIL- AND GAS-PRODUCING COUNTIES

Four County Study

Mr. Geoff Simon, Executive Director, Western Dakota Energy Association, said the Western Dakota Energy Association sponsored a study to evaluate the funding needs of the oil- and gas-producing counties located in the core of the Bakken. He said the four counties located in the core are Dunn County, Mountrail County, McKenzie County, and Williams County. He said the counties produce approximately 90 percent of the state's oil and have funding needs in addition to the needs of the hub cities.

Ms. Linda Svihovec, Program Coordinator, Advanced Engineering and Environmental Services, Inc., Grand Forks, presented information (Appendix H) regarding a study of the operational and financial needs of selected counties in western North Dakota. She said from 2010 to 2016, the population increased by 23 percent in Dunn County, 98 percent in McKenzie County, 33 percent in Mountrail County, and 53 percent in Williams County. She said staffing levels increased by 31 percent in Dunn County, 225 percent in McKenzie County, 46 percent in Mountrail County, and 84 percent in Williams County from 2010 to 2017. She said the total property taxes levied from 2010 to 2017 increased by 107 percent in Dunn County, 424 percent in McKenzie County, 107 percent in Mountrail County, and 121 percent in Williams County. She said $987 million was invested in road projects in the four counties between 2010 and 2017 with an estimated $1,576 million needed by 2036 according to a study by the Upper Great Plains Transportation Institute. She said the cumulative budgetary gap for road project funding needs between 2018 and 2022 totals $67 million for Dunn County, $143 million for McKenzie County, $34 million for Mountrail County, and $115 million for Williams County.

Dunn County

Mr. Reinhard Hauck, Commissioner, Dunn County, provided comments (Appendix I) regarding the impact of oil and gas activity on the roads in Dunn County. He said some county roads require extra maintenance due to truck traffic hauling gravel and water to well sites. He said dust control is a health and safety concern and the application of magnesium chloride can cost $10,000 per mile. He said Dunn County spent $2 million on dust control during the summer of 2017.

McKenzie County

Ms. Karolin Jappe, Emergency Manager, McKenzie County, provided comments (Appendix J) regarding the impact of oil and gas activity on the emergency services in McKenzie County. She said fire departments and emergency medical services providers in McKenzie County rely on volunteers. She said recruiting and retaining volunteer emergency personnel is a challenge, particularly when the responsibilities conflict with work and family life. She said oil and gas impact grants helped provide funding for equipment and training, but the grants may not be available to help with future needs.

Williams County

Ms. Helen Askim, Human Resources Director, Williams County, presented information (Appendix K) regarding the impact of oil and gas activity on staffing changes in Williams County. She said staffing levels increased from 140 employees in 2010 to 272 employees in 2017 while annual payroll expenses increased from $4.7 million to $16.2 million during the same period. She said the departments with the largest increase in staff include the planning and zoning department and the Sheriff's office. She said employee turnover rates are as high as 63 percent for employees working in the county jail. She said the county is in the process of planning for a new building to accommodate the growth in county staff.

North Dakota Association of Counties

Mr. Aaron Birst, Legal Counsel, North Dakota Association of Counties, provided comments (Appendix L) regarding the impact of oil and gas development on the district court system in western North Dakota. He said criminal jury trials increased from 48 in 2011 to 123 in 2016 in the Northwest Judicial District. He said caseloads and jail capacity doubled during the oil boom. He said the oil industry has been cooperating with law enforcement agencies to maintain and improve safety in western North Dakota.

HUB CITIES

Hub City Study

Mr. Shawn Gaddie, Division Manager, Advanced Engineering and Environmental Services, Inc., Grand Forks, presented information (Appendix M) regarding a review of a study of the operational and financial needs of the hub cities. He said the hub cities are competing with other oil basins for investment and employees. He said Dickinson debt levels increased from $6 million in 2008 to $92 million in 2018. Debt levels for Minot, he said, increased from $63 million in 2008 to $104 million in 2018. He said debt levels for Williston increased from $39 million in 2008 to $340 million in 2018. He said the annual population growth rates are projected to be 3.5 percent in Dickinson, 2 percent in Minot, and 2.8 percent in Williston. He said the cumulative budgetary shortfall for 2018 through 2023 is $128.8 million for Dickinson, $112.4 million for Minot, and $181.3 million for Williston. He said the major revenue sources for the hub cities include oil and gas gross production tax allocations, sales taxes, property taxes, and utility rate revenues. He said the percentage of revenue related to each major revenue source varies significantly between the hub cities. He said approximately 40 percent of Williston's revenue is from oil and gas gross production tax allocations compared to 30 percent in Dickinson and 5 percent in Minot. He said approximately 32 percent of Minot's revenue is from property taxes compared to 9 percent in Dickinson and 8 percent in Williston.

Dickinson

Mr. Scott Decker, Mayor, Dickinson, presented information (Appendix N) regarding a review of Dickinson's operating challenges and finances. He said the Dickinson Public School District expanded three elementary schools, built a new elementary school, and built a new middle school because of increasing student enrollments. He said a new elementary school and a new high school will be needed within a few years based on the current increases in enrollment. He said the Theodore Roosevelt Airport is in the process of completing a $62 million project to reconstruct the main runway. He said the fire department's responses to incidents doubled from 2008 to 2017 and the full-time staff for the fire department quadrupled during the same period. He said approximately $395 million of infrastructure was constructed between 2008 and 2017, including road, water, and sewer projects as well as new and expanded public buildings.

In response to a question from Senator Piepkorn, Mr. Decker said the City of Dickinson is evaluating the possibility of using the former hospital building to provide behavioral health services.

Minot

Mr. Tom Barry, City Manager, Minot, presented information (Appendix O) regarding a review of Minot's operating challenges and finances. He said the city of Minot is strategically located as a gateway to the Bakken and provides regional services for water supply, solid waste, and transportation. He said the city's population increased by 35 percent from 2007 to 2016 and the city limits increased by 85 percent during the same period. He said calls for police services increased by approximately 38 percent from 2007 to 2016. He said the police department increased the number of sworn officers by 25 percent to address the increased demand for services, but the department has had challenges filling the positions with turnover rates averaging 14 percent. He said the city invested approximately $250 million in capital asset improvements from 2007 to 2016 due to the growth of the city.

Williston

Mr. Howard Klug, Mayor, Williston, presented information (Appendix P) regarding a review of Williston's operating challenges and finances. He said student enrollments in the Williston Public School District increased by 83 percent from 2010 to 2017. He said city staff increased by 170 percent from 120 employees in 2006 to 323 employees in 2017. He said the city invested $283 million in infrastructure improvements related to sewer and water projects, a new law enforcement center, and two new fire stations. He said the city relies on local sales tax revenue for infrastructure and public safety expenses, but sales tax collections are a volatile revenue source. He said the city has identified future infrastructure needs of $169 million, including $83 million for road projects, $60 million of local financing for the new airport, $25 million for a new public works building, and $1 million for city hall renovations.

Representative Mock asked the hub cities for information on their current bond ratings. Subsequent to the meeting, the City of Williston provided information (Appendix Q) identifying a bond rating of A, and the City of Dickinson provided information (Appendix R) identifying a bond rating of BBB+. The City of Minot provided information to the Legislative Council staff indicating the city has a bond rate of Aa2.

Senator Rust said the hub cities receive a separate set of oil and gas tax revenue allocations and are excluded from the regular allocations to cities under the oil and gas tax revenue allocation formulas, which benefits the other cities in the oil-producing counties.

Representative Brandenburg said oil and gas tax revenues also provide a benefit to the state and other political subdivisions in non-oil-producing counties.

No further business appearing, Chairman Wardner adjourned the meeting at 3:45 p.m.

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Adam Mathiak
Senior Fiscal Analyst

ATTACH:18