NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

ELECTRIC INDUSTRY COMPETITION COMMITTEE

Thursday, October 24, 2002
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 Duane Mutch, Larry J. Robinson, Herb Urlacher

Others present: See Appendix A

Concerning the minutes of the July 16, 2002, meeting, committee counsel said on page 4 the sentence "He said Montana-Dakota Utilities Company pays from $2.4 million to $2.5 million in corporate income taxes annually" should be revised to read "He said the state's investor-owned utilities pay from $2.4 million to $2.5 million in corporate income taxes annually."

It was moved by Senator Robinson, seconded by Senator Urlacher, and carried on a voice vote that the minutes of the July 16, 2002, meeting be approved as corrected.

TAXATION OF ELECTRIC UTILITIES

Chairman Carlson called on Mr. John Walstad, Code Revisor, Legislative Council, who reviewed a bill draft [30138.0400] relating to taxation of the generation, distribution, and transmission of electric power. Mr. Walstad said the bill draft restructures taxation of the electric industry by eliminating property taxes centrally assessed under current law for the state's investor-owned utilities, eliminating the gross receipts tax as currently assessed for the state's rural electric cooperatives, and replacing those taxes by a tax on the transmission and distribution of electricity. He said the bill draft would impose a transmission line mile tax based on a transmission line's nominal operating voltage of from $75 per mile to $900 per mile. Also, he said, a distribution company would be subject to a distribution tax at the rate of 54 cents per megawatt-hour for the retail sale of electricity delivered through a distribution line to a consumer and a tax at the rate of ninety-two hundredths of 1 percent of the company's gross revenue from the retail sale of electricity delivered through a distribution line to a consumer. He said the distribution taxes would not apply to the sale of electricity to a coal conversion facility subject to taxation under North Dakota Century Code Chapter 57-60. He said revenue from the tax on transmission lines would be allocated among counties based on the miles of transmission lines and the rates of tax on those lines within each county. He said the bill draft contains two alternatives for distribution of the revenue from the distribution company tax. Alternative A, he said, provides that revenue from the distribution company tax would be allocated to the county in which the retail sale to which the tax applied was made. Alternative B, he said, provides that revenue from the taxes paid by a distribution company would be allocated to each county in which that distribution company's distribution lines are located in the ratio in which the number of miles of its lines in each county bears to the total number of miles of lines of the distribution company in the state.

Chairman Carlson called on Ms. Marcy D. Dickerson, State Supervisor of Assessments, Office of State Tax Commissioner, who addressed the committee. A copy of her written presentation is attached as Appendix B. Ms. Dickerson noted that the schedule of transmission lines contained in her testimony excludes transmission lines owned by municipal utilities while those lines should be included. She said inclusion of these lines would increase the transmission line mile tax revenue by approximately $2,000. She said preliminary calculations indicate the total proposed taxes will generate approximately $800,000 to $950,000 less per year than the amount levied on distribution and transmission companies in 1998 through 2000. She said the average electric utility taxes for the period 1998 through 2000 was $13,210,084, while the estimated total proposed tax based on estimated 2002 figures is $12,205,335.

In response to a question from Representative Carlson, Ms. Dickerson said land under a locally assessed system will be taxed higher than land under the existing centrally assessed system.

In response to a question from Representative Carlson, Ms. Dickerson said the proposed tax system would not be any more difficult to administer than the current system. However, she said, if the committee adopts Alternative A for the distribution tax formula, it will benefit counties where the consumers reside, while Alternative B will benefit the counties where the transmission lines are located.

Chairman Carlson called on Mr. Harlan Fuglesten, Communications and Government Relations Director, North Dakota Association of Rural Electric Cooperatives, who addressed the committee. A copy of his written comments is attached as Appendix C. Mr. Fuglesten discussed the bill draft relating to taxation of the generation, distribution, and transmission of electric power and presented a schedule showing the impact of the proposal on the state's distribution cooperatives, generation and transmission cooperatives, and investor-owned utilities.

Chairman Carlson called on Mr. Dennis Boyd, Senior Governmental Affairs Representative, Public Affairs Department, MDU Resources Group, Inc., who addressed the committee. A copy of his written comments is attached as Appendix D. Mr. Boyd discussed the bill draft relating to taxation of the generation, distribution, and transmission of electric power and taxation of electric utilities. He said there is no prospect on the horizon for deregulating the retail sale of electricity, and consequently there is no longer any reason to proceed with adjusting the taxation system unless the committee wants to do something to encourage the construction of additional transmission lines. He said Montana-Dakota Utilities Company cannot support the tax proposal for several reasons. He said there is no offset or credit for the corporate income taxes paid by investor-owned utilities on electric earnings. He said the transmission line mile tax segment of the proposal transfers tax obligations away from the rural electric cooperatives and shifts them to the state's investor-owned utilities. He said the proposal does nothing to encourage the construction of additional transmission facilities in the state.

Chairman Carlson called on Mr. Danny E. Kvenvolden, Supervisor, Property Taxes, Otter Tail Power Company, Fergus Falls, Minnesota, who addressed the committee. A copy of his written comments is attached as Appendix E. Mr. Kvenvolden said the state's rural electric cooperatives and one investor-owned utility are looking at new generation projects in conjunction with the Lignite Energy Council's Vision 21 program. In conjunction with this program, he said, new transmission lines would be necessary to bring this power to North Dakota customers and to utilities in other states. He said Otter Tail Power Company is proposing to change the taxation method for transmission lines that are 230 kilovolts or larger and built on or after January 1, 2002. He said this proposed legislation would not impact the revenue received on the transmission lines currently in service but would provide additional revenue for the taxing jurisdictions in which investor-owned utilities build new lines; equalize new transmission costs for both the rural electric cooperatives and investor-owned utilities; reduce the transmission cost for exporting excess energy to other utilities, making the cost of this energy more competitive; and support the Vision 21 program and the Lignite Energy Council's goals to generate more power from North Dakota lignite and export this power at the most competitive price.

In response to a question from Representative Carlson, Mr. Kvenvolden said Otter Tail Power Company also opposes the bill draft relating to taxation of the generation, distribution, and transmission of electric power.

Chairman Carlson 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 F. Mr. Graveline discussed the taxation of electric utilities and said the Utility Shareholders of North Dakota urges the committee to propose legislation to place all utility organizations on the same taxation footing by repealing all payments made in lieu of personal property taxes for electric cooperatives and placing all electric cooperative property, not included in specific generation or transmission tax codes, on centrally assessed ad valorem tax rolls.

In response to a question from Representative Carlson, Mr. Graveline said the Utility Shareholders of North Dakota opposes the proposal relating to the taxation of the generation, distribution, and transmission of electric power.

In response to the comments of Mr. Boyd, Mr. Kvenvolden, and Mr. Graveline, Mr. Fuglesten said the proposal advanced by the state's rural electric cooperatives actually advances the interests of the state's lignite industry, but to the extent it does not, the solution is to place everyone on a common tax basis and then examine incentives to promote the construction of transmission facilities.

LIGNITE VISION 21 PROGRAM

Chairman Carlson recognized Mr. John W. Dwyer, President, Lignite Energy Council, who reviewed the Lignite Vision 21 program. A copy of his written presentation is attached as Appendix G. Mr. Dwyer said the Lignite Vision 21 program is a state and industry initiative to build one or more 500 megawatt lignite-fired power plants in the state. He said this initiative is important because one 500 megawatt power plant means three million more tons of coal mined in the state, 1,300 more jobs, $140 million additional business volume, and $6 million additional tax revenue to the state. He said the Lignite Vision 21 program has provided over $1 million for feasibility studies to address environmental, generation, and transmission issues. He said Phase I studies were completed on June 30, 2000, and Phase II studies were completed on July 1, 2001. He said Phase III studies are scheduled to be completed by June 30, 2003. He said the Lignite Vision 21 program has provided up to $10 million in grants for detailed feasibility and permitting assistance for each project and provided over $26 million of state tax credits for each project. He said a marketplace analysis shows that the Mid-Continent Area Power Pool projects a 5,000 megawatt generation deficit by 2006, 3,000 megawatts of which is in Minnesota alone. He said the Lignite Vision 21 program has received three applications. He said applications have been received from Great River Energy Company, Montana-Dakota Utilities

Company and Westmoreland Coal Company, and Great Northern Power Development. The two critical challenges in building Lignite Vision 21 program projects, he said, are environmental issues and transmission issues. The four major environmental issues, he said, are prevention of significant deterioration, mercury emissions, visibility issues, and regional haze issues. Although significant, he said, the Lignite Vision 21 program can resolve the environmental issues, but transmission export constraints are the primary challenge to developing new generation in North Dakota.

Concerning the bill draft relating to taxation of the generation, distribution, and transmission of electric power, Mr. Dwyer said the Lignite Energy Council is opposed to any increase in transmission taxes. He said the Lignite Energy Council views the transmission tax and any increase in the transmission tax as a production tax because it adds cost to the expense of transporting electricity and thus adds cost to the Lignite Energy Council's primary product making it less competitive. He said the proposed increase in transmission taxes will not kill the lignite industry, but it certainly will not help the industry or the Lignite Vision 21 program. If the state determines that it needs additional revenue, he said, the revenue should be generated by income or sales taxes which are paid by everyone rather than a tax that targets one sector of the economy.

In response to Mr. Dwyer's comments, Representative Klein said the current low transmission line mile tax means North Dakota residents are in essence subsidizing out-of-state consumers of electricity generated in the state.

In response to a question from Representative Carlson, Mr. Dwyer said the Lignite Energy Council would consider a moratorium on transmission taxes for new construction to encourage development of transmission assets, but not if it meant the transmission taxes would be increased from current levels when the moratorium expires.

TERRITORIAL INTEGRITY ACT, REGULATION OF ELECTRIC COOPERATIVES, AND FRANCHISING OF ELECTRICITY PROVIDERS

Chairman Carlson recognized Ms. Susan Wefald, President, Public Service Commission, who reviewed the regulation of electric cooperatives by public service or public utility commissions in Iowa, Kansas, Minnesota, Montana, Nebraska, South Dakota, and Wyoming. A copy of her written presentation is attached as Appendix H.

At the request of Chairman Carlson, committee counsel distributed a letter from Mr. Nevin Van de Streek, City Attorney, Minot, concerning the Territorial Integrity Act; a letter from Mr. Robert Frantsvog, Finance Director, Minot, concerning the Territorial Integrity Act; a letter from Mr. Howard D. Swanson, City Attorney, Grand Forks, concerning the Territorial Integrity Act and enclosing a copy of the electric utility franchise agreements between Grand Forks and Xcel Energy, Inc., and between Grand Forks and Nodak Electric Cooperative; and a copy of the franchise agreement between Xcel Energy, Inc., and the City of Fargo. Mr. Van de Streek's and Mr. Frantsvog's letters are attached as Appendices I and J and Mr. Swanson's letter and enclosures and the Xcel Energy, Inc., franchise agreement are on file in the Legislative Council office.

Chairman Carlson called on Mr. Kent Costin, Director of Finance, Fargo, who addressed the committee. Mr. Costin aid the City of Fargo has franchise agreements with Xcel Energy, Inc., and Cass County Electric Cooperative. He said the franchises are working well and the city does not intervene in Territorial Integrity Act issues between Xcel Energy, Inc., and Cass County Electric Cooperative.

In response to a question from Representative Carlson, Mr. Costin said the franchise agreements are nonexclusive and both electricity providers are given an opportunity to serve a specific area.

Chairman Carlson called on Mr. William C. Wocken, City Administrator, Bismarck, who addressed the committee. A copy of his written comments is attached as Appendix K. Mr. Wocken reviewed Bismarck's franchise agreements with Montana-Dakota Utilities Company and Capital Electric Cooperative. He said the city has not experienced any significant problems with either provider and there has been only one service delivery question within recent memory which was resolved by the providers operating under their franchise agreements.

Chairman Carlson recognized Mr. Jerry Hjelmstad, Assistant Director, North Dakota League of Cities. Mr. Hjelmstad said cities do not designate service areas but the electricity providers have done so between themselves in service area agreements. He said franchises are nonexclusive and cities do not have the power to designate service areas.

In response to a question from Representative Carlson, Mr. Scott Handy, President, Cass County Electric Cooperative said as the city of Fargo expands or annexes property served by Cass County Electric Cooperative, Cass County Electric Cooperative must file documents with the city stating its intent to serve that area. However, he said, both Xcel Energy, Inc., and Cass County Electric Cooperative have franchises with the City of Fargo and can serve areas within the city of Fargo. He said if Xcel Energy, Inc., desires to serve an area annexed by Fargo that is currently being served by Cass County Electric Cooperative, then the Territorial Integrity Act comes into play to determine which provider will serve the area.

In response to a question from Representative Carlson, Mr. Mark Nisbet, Xcel Energy, Inc., Fargo, said there is nothing in the franchise agreement that Xcel Energy, Inc., has with the city of Fargo which prohibits it from serving any area within the city limits of Fargo. He said the problem is caused by the Territorial Integrity Act which prohibits Xcel Energy, Inc., from serving areas annexed by Fargo which are being served by Cass County Electric Cooperative.

Chairman Carlson recognized Mr. Fuglesten who said there are several misconceptions concerning the interplay between the state's Territorial Integrity Act and the franchising power of cities. Mr. Fuglesten said the constitutional and statutory scheme is clear that cities have the right of self-government when it comes to franchising public utilities. He said Article 7, Section 11, of the Constitution of North Dakota provides that the Legislative Assembly may not abridge the right of a municipal government to franchise public utilities and similar services. He said confusion is caused by state law which provides that franchises may not be exclusive and cities are not precluded from granting another franchise to another public utility should they choose to do so. However, he said, cities are not required to do so. In fact, he said, a city could divide its territory between two or more providers. The usual practice, he said, is as a city expands through annexation and it enters territory served by a rural electric cooperative, the cooperative applies for a franchise to serve the new area. He said the city can approve or deny the franchise and cities have done both. He said the Territorial Integrity Act of 1965 did not establish exclusive service areas but provided that in areas outside incorporated cities, rural electric cooperatives are the presumed provider and do not need authority from the Public Service Commission to serve those rural areas. In contrast, he said, investor-owned utilities which were not serving those areas are required to obtain a certificate of public convenience and necessity from the Public Service Commission to serve in those areas. He said the Territorial Integrity Act does not preclude investor-owned utilities from serving rural areas but requires them to obtain a certificate of public convenience and necessity from the Public Service Commission to do so. He said the Public Service Commission has granted over 3,000 certificates to allow investor-owned utilities to serve in rural areas. He said the Territorial Integrity Act comes into play in urban areas if there is unreasonable duplication of services. He said the Territorial Integrity Act does not result in an automatic "win" for a rural electric cooperative. In fact, he said, representatives of the Otter Tail Power Company have testified that it serves 90 percent of the new territory around the cities of Jamestown and Wahpeton. He said rural electric cooperatives do not have franchises in those cities.

Chairman Carlson recognized Mr. Boyd who discussed the operation of the Territorial Integrity Act. A copy of his written comments is attached as Appendix L.

In response to earlier comments, Mr. Boyd said franchise agreements are nonexclusive and merely give a utility the right to use streets and alleys to provide its services. He disagreed with Mr. Wocken concerning the Territorial Integrity Act and said the dispute between Montana-Dakota Utilities Company and Capital Electric Cooperative had been settled by the city commission. He said the area assigned to Montana-Dakota Utilities Company within the city limits of Bismarck will be completely developed within a year or two and thereafter Montana-Dakota Utilities Company will not be able to add any new consumers.

In response to a question from Representative Klein, Mr. Fuglesten said some cities, including Fargo and Grand Forks, impose a 2 percent franchise fee. He said this fee is separate and distinct from the 2 percent gross receipts tax.

Chairman Carlson recognized Mr. George Berg, Chief Executive Officer, Nodak Electric Cooperative, Grand Forks. Mr. Berg discussed the operation of the Territorial Integrity Act and service area agreements around Grand Forks. He said Nodak Electric Cooperative has always felt that the service area agreements were very generous to Xcel Energy, Inc., as they gave everything within a line from a quarter mile to two miles outside the city limits of Grand Forks to Xcel Energy, Inc., in 1964 and 1965 when they were drawn. He said there has been very little conflict between Nodak Electric Cooperative and Xcel Energy, Inc., in Grand Forks because much of the new area annexed by Grand Forks is being served by Xcel Energy, Inc., because it was inside the service area agreements negotiated in 1964 and 1965.

Chairman Carlson recognized Mr. Fuglesten who reviewed a bill draft which would allow rural electric cooperatives to purchase public or municipal utilities on a willing buyer-willing seller basis, regardless of geographic location. A copy of the bill draft is attached as Appendix M. He said the proposed legislation would give rural electric cooperatives an unlimited right to serve in urban areas and make urban consumers members of the cooperative. He said the sale of investor-owned utility property would be subject to Public Service Commission approval and approval of the local political subdivision. He said the bill draft would be advantageous for investor-owned utilities because it would give them more potential buyers should they ever decide to sell their utility assets in North Dakota.

Mr. Fuglesten reviewed capital credit payments and forfeitures or unclaimed credits. A schedule of capital credit payments for Burke-Divide Electric Cooperative, Mor-Gran-Sou Electric Cooperative, and Verendrye Electric Cooperative is attached as Appendix N.

Mr. Boyd addressed the committee. He said Montana-Dakota Utilities Company is strongly opposed to the willing buyer-willing seller legislation proposed by the Association of Rural Electric Cooperatives. He said the bill draft, if enacted, has the potential to cause mischief in the cities served by investor-owned utilities. He said the effect of these changes would allow electric cooperatives to purchase much larger investor-owned or municipal-owned utility electric systems than allowed under current law. He said the bill draft would encourage electric cooperatives to entice municipalities to acquire by purchase or eminent domain existing electric utilities from investor-owned utilities. He said the electric cooperative could subsequently repurchase the facilities from the municipality and thereby effectively remove the investor-owned utility from the community in a manner that could not otherwise be accomplished under current law. He said electric cooperatives would also have a substantial advantage in competing with investor-owned utilities for the purchase of other investor-owned or municipal-owned electric utilities. He said an investor-owned utility's rates are set based upon the net book value of its investment rate base and the Public Service Commission generally will not allow an acquisition premium in an investor-owned utility's rate base. Thus, he said, an investor-owned utility would not have a realistic opportunity to recover through its rates any premium paid above book value for the facilities acquired. If an investor-owned utility attempted to purchase utility assets, he said, it could only bid up to the book value of the assets because it could not recover any excess in its rates, while a rural electric cooperative could bid two or three times the book value and thus an investor-owned utility could not compete with a rural electric cooperative in purchasing assets that may come up for sale.

CONSIDERATION OF BILL DRAFTS

It was moved by Representative Huether, seconded by Senator Mutch, and defeated on a roll call vote that the bill draft relating to taxation of generation, distribution, and transmission of electric power be revised to provide that the 54 cent per megawatt-hour for the retail sale of electricity tax be distributed to each county in which the distribution company's distribution lines are located in the ratio in which the number of miles of its lines in each county bears to the total number of miles of lines of the distribution company in this state and that the ninety-two hundredths of 1 percent tax of the company's gross revenue from the retail sale of electricity be allocated to the county in which the retail sale to which the tax applied was made, and as revised be approved and recommended to the Legislative Council. Representatives Carlson and Huether voted "aye." Representative Klein and Senators Mutch, Robinson, and Urlacher voted "nay."

Chairman Carlson recognized Representative Klein who reviewed a bill draft [30181.0100] relating to a property tax exemption for new electric transmission lines. Representative Klein said the bill draft provides that a transmission line of 230 kilovolts or larger which is initially placed in service after December 31, 2002, would be exempt from property taxes for the taxable year in which the line is initially put into service, and property taxes as otherwise determined by law on the transmission line must be reduced by 75 percent for the second taxable year of operation of the transmission line, 50 percent for the third taxable year of operation of the transmission line, and 25 percent for the fourth taxable year of operation of the transmission line. He said the bill draft should be revised to include upgrades of existing transmission lines of 230 kilovolts or more if the carrying capacity is increased 50 percent or more. He said the bill draft is an attempt to encourage construction of new transmission facilities in North Dakota.

Mr. Dwyer addressed the committee. He said the Lignite Energy Council opposes the bill draft because although it provides an incentive to construct new transmission assets, the bill draft raises the transmission line mile tax when the tax moratorium expires.

It was moved by Representative Klein, seconded by Senator Mutch, and carried on a voice vote to amend the bill draft to make existing transmission lines of 230 kilovolts or more that are upgraded on or after December 31, 2002, so that their carrying capacity is increased 50 percent or more eligible for the tax incentive.

It was moved by Representative Klein, seconded by Senator Mutch, and failed on a roll call vote that the bill draft relating to a property tax exemption for new electric transmission lines, as amended, be approved and recommended to the Legislative Council. Representatives Carlson and Klein voted "aye." Representative Huether and Senators Mutch, Robinson, and Urlacher voted "nay."

It was moved by Representative Huether that the bill draft relating to the purchase of public or municipal utilities on a willing buyer-willing seller basis be approved and recommended to the Legislative Council. Chairman Carlson declared the motion failed for lack of a second.

It was moved by Senator Robinson, seconded by Senator Mutch, and carried on a voice vote that the chairman and the staff of the Legislative Council prepare a final report and present the report to the Legislative Council.

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

Jeffrey N. Nelson
Committee Counsel

ATTACH:14