MINUTES

MONTANA SENATE
56th LEGISLATURE - REGULAR SESSION

COMMITTEE ON TAXATION

Call to Order: By **CHAIRMAN GERRY DEVLIN,** on March 3, 1999 at 8:00 A.M., in Room 413/415 Capitol.

ROLL CALL

Members Present:
Sen. Gerry Devlin, Chairman (R)
Sen. Bob DePratu, Vice Chairman (R)
Sen. John C. Bohlinger (R)
Sen. Dorothy Eck (D)
Sen. E. P. "Pete" Ekegren (R)
Sen. Jon Ellingson (D)
Sen. Alvin Ellis Jr.(R)
Sen. Bill Glaser (R)
Sen. Barry "Spook" Stang (D)

Members Excused: None

Members Absent: None

Staff Present: Sandy Barnes, Committee Secretary
Lee Heiman, Legislative Branch

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:
Hearing(s) & Date(s) Posted: SB 83, 2/12/1999; SB 85, 2/12/1999; SB 86, 2/12/1999
Executive Action: SB 83, SB 86, SB 211

HEARING ON SB 83, SB 85 AND SB 86

Sponsor: **SENATOR MIKE HALLIGAN, SD 34, MISSOULA**

Proponents: **Tim Gregori, Big Horn Electric Co-op**
Ron deYong, Montana Farmers Union

<u>**Opponents**</u>: **Roger Petersen, PP&L Montana**
John Alke, Montana Dakota Utility Company
Tom Ebzery, PacifiCorp, Avista Corp, Puget Sound Energy, PGE
Dennis Burr, Montana Taxpayers Association
Neil Colwell, Avista Corp

<u>**Opening Statement by Sponsor**</u>:

SEN. MIKE HALLIGAN, SD 34, Missoula, told the committee that **SB 83** is a companion bill establishing a vote of the people on an act imposing a wholesale energy transaction tax on electric energy introduced on state transmission lines, and could be tabled. **SB 86** is also a companion bill which deals with a class change and could also be tabled at the discretion of the committee.

Regarding **SB 85, SEN. HALLIGAN** said that after **SB 390** was passed last session, the Revenue Oversight Committee, which he chaired, was charged with the responsibility of trying to deal with the impact of electric utility deregulation on taxes, competition, and recommending changes to the 1999 Legislature. He said it was the goal of the committee to guarantee full competition and full choice for the consumers.

SEN. HALLIGAN said that the Revenue Oversight Committee did adopt some guidelines during their 18-month study: 1) to assure revenue neutrality, 2) to assure that the tax burden was not shifted between ratepayers or classes of ratepayers, 3) to assure that local governments were held harmless, and 4) to assure that any tax policy would not impede competition. The Revenue Oversight Committee recommended a couple of options to the legislature, **REP. HIBBARD'S HB 174,** and **SB 85**, which is the coop proposal.

SEN. HALLIGAN said that **SB 85** reduces generation property taxes to a 7.5% rate, establishes a new wholesale transaction assessment to fill the revenue hole that could be created by going from 12% to 7.5%, maintains the existing local government tax reimbursement structure, creates a class 11 property which is taxed at 11% for transmission and distribution, and creates an adjustment for value of transmission and distribution facilities, which will create a level playing field by taxing everyone at 11%.

He said the most important part of the bill is that which deals with the wholesale energy assessment because it allows Montana, because we are a 40% exporter of our energy, potentially to not shift all of the costs of the reductions to our own consumers.

This allows for the possibility of shifting that cost to those purchasing power out of state. He also said there will be some amendments which are designed to make the bill revenue neutral.

Proponents' Testimony:

Tim Gregori, Big Horn Electric Coop, as provided in his written testimony, **EXHIBIT(tas48a01)**, and demonstrated by the slide presentation handout, **EXHIBIT(tas48a02)**, said that **SB 85**, with the technical amendments, **EXHIBIT(tas48a03)**, will meet the goals of the Revenue Oversight Committee in all instances. He said that Montana has a long tradition of providing natural resources and related goods and services to fuel economic prosperity, and clearly, Montana needs to create a business environment that will breathe new life and economic growth into our staggering economy. However, he said it is the sense of the co-ops that Montanans would prefer a tax policy on electric generation facilities that strikes a balance between the needs of our local communities, that provides opportunity for business prosperity and the ability of our ratepayers to bear a manageable burden of taxation. This bill, with the amendments, will provide that.

Ron deYong, Montana Farmers Union, said that deregulation has brought two bills forward in this session to deal with competitiveness and taxation, **SB 85** and **HB 174**. He said the Farmers Union believes that **SB 85** is the most appropriate for three reasons: 1) it taxes wholesale power both within the state and power going out of the state, 2) it treats electric coops fairly because of the valuation process which takes density factors into account, and 3) it comes much closer to being revenue neutral.

Opponents' Testimony:

Roger Petersen, President, PP&L Montana, PP&L Global, said that PP&L is in the process of completing acquisition of the Montana Power Company generation assets. He said that he has been working to promote **HB 174**, and that he opposes **SB 85** for two reasons: 1) generators will not be treated fairly in comparison to other industrials that are selling commodities in the state at a 6% tax value rate, this bill assumes 7.5%; and 2) the wholesale energy transaction tax is a tax that is discriminatory against the generators. He said there is no other state in the surrounding area that has a tax on generation.

Mr. Petersen said that PP&L will generate a competitive commodity, and he said in the electric business in the future, people will decide who they want to buy that commodity from. He provided a handout entitled "Competitive Taxation of Montana's

Electricity Generators," prepared by Price Waterhouse, **EXHIBIT(tas48a04)**, which is a comparison of the effective tax rates in the state of Montana as compared to Idaho, Washington, Utah, Oregon, Nevada and Wyoming. He said it demonstrates that Montana's tax rates are more than twice what they are in the other states. It also demonstrates the impact to Montana's consumers.

John Alke, Montana Dakota Utilities Company, said that Montana Dakota opposes **SB 85** for dramatically different reasons than PP&L. He said Montana Dakota has only a small amount of generating assets in the state of Montana, and a reduction in the property tax rate attributable to their generation does not entail significant benefits for the company. He said the reason MDU is opposing this bill is because of what they consider the real reason the co-ops have proposed this bill. **Mr. Alke** said this bill is not about the taxation of generation. It is about the dramatically different rate of property taxation on poles and wires.

Mr. Alke said that at the current time, MDU, and any other investor-owned utilities, pays 12% on its poles and wires, while co-ops pay 3%. This bill purports to create a unified class, but the actual plan of the co-ops is to take the property values for the co-ops and then discount them backwards to reflect things such as they have proposed, revenues per customer, miles of line per customer, numbers of customers per mile. The co-ops publish a relative density factor of about 25% of MDU. If this bill were to pass, on paper they would be able to say they were paying the same property tax rates as MDU because the number would be the same, 11%, but in fact, with the density discount factors that they anticipate if this bill passes, they will be paying 25% of the taxes paid by MDU on poles and wires.

Mr. Alke said that co-ops are entering the service territories of investor-owned utilities. He said that in **SB 390**, passed in the last legislature, there is a provision that says that when a co-op enters these service territories, they lose their preferential 3% tax rate for their investment in the urban areas, and they have to pay the 12% rate. It is the opinion of Montana Dakota Utilities that the purpose of this legislation is to preserve the differential in property taxation that applies to the poles and wires of cooperatives as opposed to poles and wires of an investor-owned utility.

Tom Ebzery, Puget Sound Energy, a 50% owner of Colstrip Units 1 and 2, and a 25% owner of Colstrip Units 3 and 4, **Portland General Electric**, a current 20% owner of Colstrip Units 3 and 4, **PacifiCorp**, a 10% owner of Units 3 and 4, and **Avista Corp**, formerly Washington Water Power, which owns 15% of Colstrip Units 3 and 4, and two dams in western Montana. He said two of those entities, Puget and Portland General Electric have announced their intention, along with Montana Power, to sell their generating assets.

Mr. Ebzery said he has been involved in this process for over two years with the Revenue Oversight Committee, and this issue all started because two years ago there was some talk that MPC, before announcing the sale of their generating assets, was considering restructuring so that they could come in at an industrial rate of around 6%, and the question was how is that dealt with in a competitive situation; and that was one of MPC's reasons, in that 12% was simply too high, the highest in the region. It has been the goal of the Revenue Oversight Committee to get to a competitive neutrality position. He said this bill is not the right solution to a very real problem facing electric utilities.

Mr. Ebzery said his companies oppose the density discount proposal for the same reasons as stated by **Mr. Alke**, and the wholesale energy transaction tax, which could result in an administrative nightmare because of the configuration of power grids in the system. He said they also oppose the proposed amendments and urge a do not pass.

Dennis Burr, Montana Taxpayers Association, said that his organization has been involved in **SB 174**, which is preferable to **SB 85** in solving some of the problems in this matter. He said taxes in Montana are extremely high, and in a competitive environment, that could affect the sale of electricity. In developing a bill to deal with this, it was their goal to do no harm to Montana consumers, to make generation competitive with generation in other states, and future generation in this state as well as generation from other states, and to minimize the loss to government. Again, he said he prefers **HB 174** over **SB 85**.

Neil Colwell, Avista Corporation, formerly Washington Water Power, said that the energy business in Montana has changed forever. What Montana has now are electric commodity generators that are in competition with other commodity producers. He said that **SB 85** imposes another tax on top of the existing generation tax which makes the commodity price less competitive against all the other states that produce energy, and then there is a reduction in the property tax, which is still well above taxes charged in other states. Montana needs to change its vision and start thinking with a little more concern about what now are Montana's commodity generators and how they are going to compete in this marketplace. He said prices are dictated regionally, and producers have to meet the price and have to be competitive. **HB 174** addresses the issue more completely and more equitably for the Montana consumer.

Questions from Committee Members and Responses:

SEN. ELLIS asked the wholesale cost of a kilowatt hour on the facilities PP&L bid on. He said he would like a comparison of what that power costs per tax structure, what this bill will do to that cost of power, and what Columbia Basin, which is the lowest priced market, costs and some comparisons with the higher priced markets. **Mr. Peterson** said PP&L would do some comparisons on those issues and provide that information to the committee. He said there are different ways that a kilowatt hour is produced and differences in how it is delivered, all of which affect the cost figures. **SEN. ELLIS** also asked for comparisons of the effect on the cost of a kilowatt hour at 6% on the generating facility as compared to 7.5%.

Mr. Paul Farr, Director of Finance and International Tax, PP&L Global, said that in analyses that have been done on **SB 85** in its current form, if you take the costs that MPC was paying on that asset purchase, PP&L Montana would be paying $1.8 million to $2 million more than even Montana Power Company was paying.

SEN. ELLIS asked **Tim Gregori** how in this proposal power generated at U.S. generating facilities like Yellowtail Dam and Libby Dam would be treated, and **Mr. Gregori** said that when that electric energy leaves Yellowtail Dam, which is a federal entity, and is received by a wholesale purchaser like Big Horn, the tax is paid at that point. He said even power from the Bonneville Power Administration that is currently not being taxed in Montana would now be taxed under the wholesale energy tax proposal.

SEN. ELLIS asked what the impact would be of lowering the rate to 6% from 7.5%, and **Mr. Gregori** said the revenue differential would be a $6,388,282 deficit.

CHAIRMAN DEVLIN said that the 195 mills used in the demonstration seemed low, and he asked if that was the overall state average, and **Mr. Gregori** said that he backed into that number to get the pieces to where he was working with the particular $33 million tax. He said the mills would not matter because either the mills move back and forth or the market value moves back and forth, but either way arrives at the roughly $6 million change. He said that 195 mills was an average mill figure.

SEN. ELLINGSON asked what markets PP&L intends to serve, and **Mr. Farr** said that the competitive market includes Wyoming, Oregon, Idaho, Montana, California, and Colorado. **SEN. ELLINGSON** asked what the market price of a kilowatt hour in California is now, and **Mr. Farr** said it was about $22 on peak currently. **SEN. ELLINGSON** asked what the marginal cost for a kilowatt hour is in California, and **Mr. Farr** said there are many factors which affect that cost, but that he would get that information for the committee.

SEN. ELLINGSON said that he would like that information on all of the different generational facilities, delivered to California, because he is hearing that they will not be competitive if this tax is imposed as set out by this bill. He said taxes are only one part of the costs involved, and he wants to know what the rest of the operating costs are so that he can determine whether or not they are going to be competitive. **Mr. Farr** said that most of the generating assets that will be PP&L's competition in the future are still underneath the umbrella of investor-owned utilities, so when you look at the operating cost structure, some of the tax information will be available through the information provided, but it will be difficult to compare PP&L to an investor-owned utility operating inside a regulated framework. He said he would try to benchmark it against IPP companies.

CHAIRMAN DEVLIN asked if part of that information is confidential, and **Mr. Farr** said it was.

SEN. ELLINGSON asked that when they provide the information as to the marginal cost per kilowatt hour delivered to California, that they also provide that information 1) under the variable that PP&L apparently assumed they would have, at 6%, and 2) under the scenario envisioned by **SB 85**, 7.5%, with the wholesale tax in place. **SEN. ELLINGSON** then asked if Montana could tax BPA facilities, and **Mr. Farr** said they could not directly tax them, and **SEN. ELLINGSON** asked if a substantial proportion of the generational facilities of some of the neighboring states are provided by BPA facilities. He said his impression is that Montana has a lower percentage of BPA facilities than the neighboring states, so consequently, if you added up all of the generational facilities in Idaho and Washington, for instance, and provided a tax rate on it, it is skewed because those BPA facilities don't have any property taxes imposed upon them.

Mr. Farr said that most of the output from BPA facilities is fully contracted with preferred customers that PP&L does not view as competition. He said that when they had Price Waterhouse prepare the study benchmarking Montana against all of those other states, they asked them to take all of the generating assets that are owned by nonfederally owned entities and put them in Idaho and have them generate power. They then asked what the tax situation would be that those private owners or IOUs would face in each of the respective states. Thus, he didn't think that the percentage of BPA capacity or the dollar amount of assets in the other states is relative when looking at the competitive environment that PP&L will be facing. He said the problem in all those is that Montana was foresighted enough to deal with deregulation in conceptual form but that now Montana is dealing with trying to fix the rest of the structural issues that the owners of the assets are going to be facing in the future.

SEN. ELLINGSON said that the graph demonstrating the tax comparisons appears as though somebody has taken all the electrical generating facilities in the state of Montana, Idaho, Washington, and so forth, and has totaled up all of the taxes paid by generational facilities and then shows that Montana is twice the rate of taxation of Idaho and Washington, and now it appears that is not the case. **Mr. Farr** said that was correct.

SEN. ELLINGSON asked, then, if it is not the case, what does this mean, and **Mr. Farr** said that he took the fair market value of the assets that are currently on the DOR's books and adjusted it for their purchase price in Montana, which totaled approximately $1.9 billion of fair market value of generating assets in the entire state, not just Montana Power Company, but from an industry perspective. If you located these assets, with the thermal breakout and the hydro breakout and the pollution control breakout, in Idaho, and you looked at what the taxes would be on those assets with a $1.9 billion value, in Idaho it would be 1.81%. In Montana it is 4%.

Mr. Farr said this is the property-tax-only scenario. If income tax is benchmarked, Montana is above the top end. Montana does not have a sales tax, but in the other states that do have a sales tax, all of them exempt fuel inputs, so there is really no impact on PP&L as a company from a sales tax perspective in operating in Montana versus operating in Idaho. None of the other states have a generating tax. He said he would get the committee an analysis state-by-state.

CHAIRMAN DEVLIN asked why electricity can't be metered, and **Mr. Colwell** answered that most people have a vision that there is a big meter at every leg of electricity's trip from generator to residence. He said that the only place that is true is the generating busbar and at the consumer's meter, and in between there are transactions between utilities that people in the power supply departments keep track of. **CHAIRMAN DEVLIN** asked how the other utility is charged if they don't know how much they use, and **Mr. Colwell** said that there are contracts.

CHAIRMAN DEVLIN asked what the delay time would be, and **Mr. Colwell** said it would be months after the fact. **CHAIRMAN DEVLIN** asked if this was amended to take care of that, whether the utilities could come up with an accurate number if time was allowed, and **Mr. Colwell** said that the tax managers are saying it is an administrative nightmare from their perspective. There is no other state in the United States that attempts a transmission tax.

CHAIRMAN DEVLIN asked **Mr. Alke** if **HB 174** became the prevalent vehicle in all of this, whether he would support it the way it was in the House, and **Mr. Alke** said MDU did not appear on **HB 174** at all. **CHAIRMAN DEVLIN** asked, then, how he would feel if the committee were to amend that bill to accommodate the average-customer-per-mile provision that is in this bill, and **Mr. Alke** said they would oppose that bill. **CHAIRMAN DEVLIN** asked if he would oppose it even though it might mean the same cost for each user out there on all the lines as far as tax load, and **Mr. Alke** said that their concern with **SB 85** is not on the generation side. It is what they believe prompted the co-ops to introduce it, and that is to preserve a huge tax advantage on the poles and wire side. He said that if you took **HB 174** and amended in the density discount provisions that are in this bill, MDU would become an opponent to **HB 174** for the same reason they are opposed to **SB 85**.

CHAIRMAN DEVLIN asked what the capacity of the intertie at Miles City between two different areas was and whether that could open up new markets to the east or not, and **Mr. Alke** said it does not. He said the intertie at Miles City in the state of Montana is one of a few states in the country where part of the state is an entirely different power pool and reliability council than the other portion of the state, and that is done so the faults that occur on the system allow a limited amount of power from west to east and east to west, and that intertie has a fixed capacity of 200 megawatts east to west and 170 west to east that is fully contracted for at the current time.

Mr. Alke also expanded on **SEN. ELLIS'S** question about the fact that the WET tax would apply to all power, including the power from Libby Dam and Yellowtail Dam. He said **Mr. Gregori** had answered yes. **Mr. Alke** said he did not believe that is true. He said one of the amendments addresses part of this problem, but the bill, Section 3(4) specifically says of the WET tax, which is at the transmission level, "Electricity that is transmitted through the state and electricity that is owned by a governmental agency are not subject to this tax." All the co-ops have to do to escape the tax is have the Hungry Horse power or the Libby Dam power or the Yellowtail Dam power delivered to their substation with the federal government holding title of the power up to the point of the substation, so MDU's view of this bill is that the WET tax has another advantage for the co-ops in that virtually every kilowatt of energy from MDU or an IOU will be charged the WET tax on every kilowatt hour. If 50% of the co-ops' power is federal preference power, the way MDU reads the bill, they will not pay the WET tax on the portion of their power that is federal preference power.

CHAIRMAN DEVLIN asked **Mr. Petersen** if he supports **HB 174**, and whether, if the customers per mile of line were written into that bill, how he would view that bill then, and **Mr. Petersen** said that the issue of customers per mile is not their issue as a generator. Their issues are with the generation tax, the WET tax and the amount of property tax.

SEN. ECK asked what portion of PP&L Global is PP&L Montana, and **Mr. Petersen** said that Montana has an asset value of about $1.8 billion, and the total company has an asset value of around $10 billion. He said it is the largest asset that PP&L Global has purchased worldwide.

SEN. ECK asked if the Public Service Commission had done an audit of the viability of the whole business of PP&L, and **Mr. Petersen** said they have all the Public Service Commission approvals. **SEN. ECK** asked the condition of PP&L, and **Mr. Petersen** said that PP&L is growing. He said it is a situation in the competitive market where you need to grow or you're going to be consumed. PP&L Global is a healthy company, but PP&L Montana will stand on its own. It will have its own financing and its own credit rating.

SEN. ECK asked **Mr. Alke** about density and the fact that there are a lot of customers that are harder to serve. She wondered how we can be sure that particular areas that require lots of poles and lots of lines have someone who will serve them, and he responded by saying that if we went back two years in time, before deregulation, before the co-ops began getting interested in a broad range of services beyond simply supplying electricity, he would agree that that is one of the justifications for the 3% rate for the co-ops and 12% for the utilities, but what is happening is that the co-ops want to compete with the IOUs by expanding into urban areas that are densely populated and are not rural. Their growth is not in the county, it is in the areas that traditionally have been served by IOUs.

SEN. ECK asked, though, who will assure that everybody has someone willing to serve them, and **Mr. Alke** said the electric side is the only utility function in Montana where service territories are divided up. Under **SB 390** all the IOUs and the co-ops were required to draw up territorial agreements in which the co-ops and the IOUs would divide up who is going to serve where. So Montana, through these agreements and the Territory Integrity Act, has been divided into territories where service will be provided by either an IOU or a rural co-op.

SEN. GLASER said that Montana has been putting hidden taxes into the utilities to fund local governments, schools, windmills, subsidizing rural customers at the expense of the cities and the industry customers, and that is the heart of the problem with this particular piece of legislation. He wondered whether we can live up to this commitment, these hidden taxes and what they support. **SEN. HALLIGAN** said that the cost-of-service approach has been used for a long time and the Public Service Commission allowed the taxes to be part of that cost of service and passed into the energy bills that are not articulated on the bills but are certainly part of the bill. He said it has been regressive in the way it has been handled, but part of it also is covered by this bill which takes a look at the exportability of some of that tax, and that seems to be a fairer approach since at times 40% to 50% of that can be exported and still be competitive. He does not feel that this tax should be used to fund all of the extra issues.

SEN. ELLIS said that **Mr. Gregori** had referred to 195 average mills, and he said his understanding is that the average mill rate is 416 mills. **Mr. Gregori** said that the average mill figure simply demonstrates the location of the generation facilities, not the average mill rate around the state. Secondly, he was simply saying from a mathematical perspective that those numbers can be moved around and can even be changed, and he was trying to back into the number to show what would happen if the tax was reduced and what that tax reduction would be.

SEN. ELLIS reiterated that the premise of everything that was shown was to hold communities where these generating facilities are totally harmless so they would not have to raise the mill levy to have the same amount of revenue, and **Mr. Gregori** said that was correct.

SEN. ELLIS then asked if there is a mechanism in this bill as amended that in those areas where the urban areas are moving out into the co-op areas, that the coops would pay a rate more equivalent to what Montana Power pays, and **Mr. Gregori** said that the tax differential in these instances was changed in the last legislative session. **SB 390** says that in any area where the population is greater than 3500, not only will co-ops pay a similar tax, they pay the same rate on those facilities. He said that **SB 85** would do the same thing.

SEN. STANG asked how sales to the Columbia Falls Aluminum Plant would be handled and whether they would be exempt, and **Mr. Gregori** said Columbia Falls Aluminum purchases at the retail level which is not affected by this bill, which deals with wholesale transactions.

Closing by Sponsor:

SEN. HALLIGAN said the committee could now probably see why the Revenue Oversight Committee could not agree on one bill. Having excellent proponents and excellent opponents makes it easier to see the whole picture and know better how to deal with the issues. He said it is now the job of this committee to make a determination.

SEN. HALLIGAN said this bill attempts to make things more simple, dealing with one rate. Just dealing with a wholesale energy assessment tax is far more efficient than taxing the 300,000 or 400,000 consumers on their bills. Those bills are now going to be unbundled so taxpayers will see how everything breaks out. It will also make it possible to tax energy going out of the state as well as coming in, and maybe all of it won't be placed on the consumers' bill and yet it will still be part of the general mix of having everybody pay rather than just the ratepayers in the state of Montana.

SEN. HALLIGAN said it also attempts tax balance and a leveling of the playing field, and it also attempts to hold everyone harmless. **SB 85** is a serious effort to deal with the generation issue and the competitive nature of deregulation and the electricity industry and all the unknowns that go with that.

EXECUTIVE ACTION ON SB 83, SB 86

Motion/Vote: **SEN. STANG MOVED THAT SB 83 BE TABLED. Motion carried 7-0.**

Motion/Vote: **SEN. STANG MOVED THAT SB 86 BE TABLED. Motion carried 7-0.**

EXECUTIVE ACTION ON SB 211

Motion/Vote: **SEN. STANG MOVED THAT SB 211 BE TABLED. Motion carried 7-0.**

ADJOURNMENT

Adjournment: 10:15 A.M.

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SEN. GERRY DEVLIN, Chairman

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SANDY BARNES, Secretary

GD/SB

EXHIBIT(tas48aad)