

Approved: 1-21-99  
Date

MINUTES OF THE SENATE ASSESSMENT AND TAXATION.

The meeting was called to order by Chairperson Senator Audrey Langworthy at 11:10 a.m. on January 19, 1999, in Room 519-S of the Capitol.

All members were present except:

Committee staff present: Chris Courtwright, Legislative Research Department  
April Holman, Legislative Research Department  
Don Hayward, Revisor of Statutes Office  
Shirley Higgins, Committee Secretary

Conferees appearing before the committee: Matthew Brown, National Conference of State Legislatures

Others attending: See attached list.

The minutes of January 13 and 14, 1999, were approved.

Senator Langworthy requested the introduction of a bill on behalf of Water District No. 1 in Johnson County. She explained that Water District No. 1 has its own statutes and has a system different from most other utilities. The bill regards the exemption of their retirement benefits from state income taxes.

Senator Hardenburger moved to introduce the bill, seconded by Senator Stephens. The motion carried.

Senator Langworthy called upon Matthew Brown, National Conference of State Legislatures, to present an overview on retail wheeling. She informed the Committee that Mr. Brown testified before the Special Committee on Assessment and Taxation during the 1998 interim regarding retail wheeling and related tax issues. She encouraged committee members to read the interim committee's report on retail wheeling issues.

Mr. Brown reported that currently 13 states have passed legislation that will allow individual customers to choose any electric provider who has offered them service. He noted that the first three states that passed electricity restructuring legislation did not address taxation implications; however, other states which followed with similar legislation included specific state and local tax provisions. Although some states have not decided to move forward with restructuring, they have passed major changes to their energy tax law, and some other states are currently seriously contemplating changes in their energy tax laws. Mr. Brown explained that the necessity to change energy tax laws is a result of a great deal of change in the electric industry in recent years due to mergers with other types of companies.

Over the past four years, a new type of entity, the power marketer, which is not a utility, began selling electric power; but it is not being taxed as a utility. Mr. Brown noted that power marketers are now a very dominant force in the energy industry. He commented, if Kansas decides to move forward with allowing power marketers to sell to retail customers through restructuring, then it will be necessary to investigate the way the power marketers are taxed versus the way that traditional utilities are taxed. In this regard, Mr. Brown called attention to copies of a sample electric bill from California. (Attachment 1) He noted that the California electric bill is unbundled, meaning that the bill is broken up into its component pieces. He explained that the "electric energy charge" detailed on the bill is the competitive portion of the power generation business. He further noted that the generation business is the portion affected by taxation issues which need to be addressed when considering electricity restructuring legislation.

In response to questions regarding the reaction of the energy industry in states which have declined to pass retail wheeling legislation, Mr. Brown noted that legislatures in states with large electricity use were pressured to allow retail wheeling; and most of the very high cost states passed legislation allowing retail wheeling. However, in the middle to lower cost states, the political motivation is not as great as in states where industrial users may be paying significantly more for electricity.

## CONTINUATION SHEET

Mr. Brown commented further that two low cost states, Montana and Oklahoma, have passed retail wheeling legislation. Montana moved largely because its legislature meets every two years and there was a concern that the federal government would pass retail wheeling legislation before it could. Oklahoma passed retail wheeling legislation for economic development reasons. Also, there was a particular senator who was a strong motivator in passing the legislation. However, the Oklahoma legislation passed only after a study determined that a consumption tax system to insure equal taxation for all could be put in place.

Mr. Brown pointed out two reasons why taxation must be considered when contemplating retail wheeling legislation, (1) the impact of competition on the tax system and (2) the impact of taxation on competition. With regard to reason number one, he noted that there will be players who have not been taxed as utilities; therefore, there will be tax revenue issues to consider. Further, a tax revenue issue could arise as some power plants may shut down earlier than they would have under a regulated environment. Also, a much larger number of out-of-state players will be selling power to the states, and the question arises if, as out-of-state providers, they can they be taxed. Reason number two involves public power issues. Mr. Brown explained that companies will be competing in a marketplace where a very small difference in price will determine who is successful in getting business. For example, when a company such as Boeing looks at the total number of kilowatt hours it uses over a period of time and multiplies it by a small savings, resulting in a large number, the issue will be, if that large number results from a difference in the way the electricity providers are taxed.

Mr. Brown also discussed nexus, the legal issue as to at what point the state has the ability to tax an out-of-state electric power provider and the transactions in which the companies engage. The gross receipts tax, the income tax, and the sales tax all will be affected by the nexus issue.

Another issue to be considered is property tax. Mr. Brown noted that property taxes, in general, have been essentially assessed by the state on the entire utility and have been based upon income projections of the utility or the market price. The income projections and market prices are going to change in a restructured environment because there will be a movement from a fully integrated company with generation, transition, and distribution to power plants that are perhaps owned by a non-utility that is a generator only. The generation business will be competitive and will entail more risk than the regulated business of generating electricity. The income projections for generators may be lower because they will be more subject to income fluctuations than the old regulated business of generating electricity. Additionally, in the sale of a power plant from a utility to a non-utility, many states have found that their method of assessment of property value on a utility is different from the assessment on a non-utility, resulting in a big difference in the way the property is taxed.

Mr. Brown discussed solutions to the nexus issue. Some states have required that a generator have a presence in the state. New Jersey is the first state to require that an out-of-state generator have an office in the state if it does business with the state. New Jersey reasoned that, because electricity is a necessary part of the economy of the state, the nexus requirement is for the health and welfare of the citizens of New Jersey. Although the New Jersey ruling has not been challenged, Mr. Brown believes it will be challenged as a burden on interstate commerce. The Pennsylvania approach requires generators selling electricity to the state to agree in writing to be subject to state taxes.

Another approach to the nexus issue has been to change the tax system altogether. Illinois changed their tax system to a user tax, which essentially put the tax at the lowest level. Taxes are collected from consumers by the electric distribution company which is also a company located within the state. Although this approach eliminates the nexus issue, it involves the issue of equity. Connecticut essentially removed taxes on the generation part of the business and increased the tax on the regulated parts of the business, transmission and distribution. This approach eliminates the problems of tax parity among different taxpayers. New Hampshire established a single-tiered consumption tax. Iowa has changed the taxes on generation, transmission, and distribution to a three-tiered taxation. It has imposed a small tax on generation and relies more heavily on a transition tax based on the number of power lines located in the state and the voltage of the power lines. The distribution company collects a tax assessed on the customer on a per kilowatt hour basis.

Mr. Brown noted that the property tax issue effects certain localities more than others. For instance, Connecticut, Massachusetts, and New Jersey have recognized that they have a significant property tax issue but have handled it by phasing out property tax value over a ten-year period to allow cities to become accustomed to no property tax on utilities.

Mr. Brown distributed a handout titled, "Electric Industry Restructuring in the States," which lists the thirteen states which have passed restructuring legislation, the general results, and an update on California's utility market. (Attachment 2)

Senator Langworthy noted that one issue related to the nexus issue which Mr. Brown did not discuss is the franchise tax on utilities collected by cities. In this regard, Mr. Brown noted that the City of Portland revamped its whole franchise fee structure to be less reliant on the power generator and to be more reliant on the company which clearly has nexus which, in this case, is the electric distributor.

The meeting was adjourned at 12:03 p.m.

The next meeting is scheduled for January 20.





JANE SAMPLE  
JJQ 99 99999-9

**ELECTRIC ACCOUNT DETAIL**

Rate Schedule: E1 XB Bundled Service  
Service: From 05/11/98 To 06/10/98 Billing Days: 30 Electric Meter #: J99999

	Prior Meter Read	Current Meter Read	Difference	Constant	Usage
ELECTRIC	86467	86967	500	1	500 Kwh

Total Electric Charges	\$60.99
Legislated 10% Reduction	6.10-
Net Charges	\$54.89

The net charges shown above include the following components. Please see definitions on Page 2 of the bill.

Electric Energy Charge	\$0.02400*	\$12.00
Transmission		2.03
Distribution		17.72
Public Purpose Programs		2.10
Nuclear Decommissioning		0.26
Competition Transition Charge (CTC)		12.70
Trust Transfer Amount (TTA)		\$8.08

\* This rate is based on the weighted average costs for purchases through the Power Exchange. This service is subject to competition. You may purchase electricity from another supplier. (Call 1-800-743-0040 for a supplier list).

ELECTRIC	Kwh	Price
Baseline Quantities	324	
Baseline Usage	324	@ \$0.11589
Over Baseline Usage	176	@ 0.13321

Usage Comparison	Days	Kwh Billed	Kwh per Day
This Year	30	500	16.7
Last Year	29	493	17.0

Note: All customers pay a Competition Transition Charge as part of the charges above, including those who choose an electricity supplier other than PG&E.

JJQ 99 99999-9



Senate Assessment & Taxation  
1-19-99 Attachment 1

# ***Electric Industry Restructuring in the States***

*Matthew H. Brown, NCSL*

## **I. Thirteen states have now passed restructuring legislation**

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- New Hampshire
- Rhode Island
- California
- Pennsylvania
- Oklahoma
- Montana
- Arizona
- Nevada
- Maine
- Massachusetts
- Illinois
- Virginia
- Connecticut

In addition, New York and Michigan are moving quickly because of regulatory orders. Other states have orders, but need legislation.

Of those states, four have begun the transition to competition:

- Rhode Island: December, 1997
- Massachusetts: March, 1998
- Pennsylvania: Large pilot programs begun
- California: March 31/April 1, 1998

### **The general results are as follows:**

- Competition is slow to take hold, partly because of mandatory rate reductions in several states.
- Large electricity users are receiving much more attention than small commercial or residential electricity users.
- Cost reductions are not in general exceeding the "standard offer" legislated rate reduction for residential or small commercial customers.
- Companies appear to be differentiating their products by some reference to a "green" product mix and by offering incentives.
- The mechanics of the system appear to be working well to this point.
- Restructuring is already causing a fundamental change in the way that electric utilities and other electricity providers operate and structure their businesses.

*Senate Assessment & Taxation  
1-19-99  
Attachment 2*

# California Update

## California's Market is Up and Running

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### I. What does "up and running" mean?

Three investor-owned utilities, the Sacramento Municipal Utility District and others now compete for their customers. The new system began on March 31. New and old entities serve new purposes:

- The *power exchange* and the *independent system operator*, manage power flows, maintain reliability, monitor market power abuses and provide a way for everyone to know the current market clearing price.
- The *California Public Utilities Commission* monitors market power abuses, certifies power providers and assists in consumer education programs.
- The *California Energy Commission* provides information to consumers and runs a multi-million dollar set of programs on renewable energy and energy efficiency.
- Over 200 *registered power marketers* attempt to sell power, at retail, to customers.

Customers have different options.

1. Do nothing: continue to buy from the same utility, and receive a 10 percent rate cut.
2. Change supplier: buy from a new electricity retailer and receive a rate cut and, perhaps other service options or incentives.

But few people have switched suppliers, although the number is increasing:

Approximately 3 percent of residential customers have switched providers. Up to 13 percent of the total load has switched to a new provider.

The relatively small number of people who have switched is partly because of the 10 percent rate cut that took effect on January 1, 1998. Most people see

little immediate need to go through the trouble of pursuing new electricity suppliers.

Note that this rate cut had nothing to do with restructuring: witness that competition didn't begin until March 31, 1998, while the rate cut kicked in on January 1.

## II. *Mechanics of the New California Power Markets*

1. Utilities sell to the power exchange.
2. The power exchange is a non-profit independent corporation that schedules power transactions by matching electricity supply with demand.
3. Buyers purchase power from the power exchange.
4. Both buyers and sellers currently submit their needs to the exchange 24 hours in advance of the need. In the future, the buyers and sellers will be able to do so just an hour in advance.
5. Buyers include any purchaser who want to buy power, but notably includes the three investor owned utilities as well as any other power provider. The three utilities must purchase their power from the power exchange, since they are the companies that serve the customers who decided not to switch electricity providers, also known as the default provider.
6. Buyers aside from the three utilities can also buy power from sources other than the power exchange.
7. In practice, this means that a power marketer could sign up a customer for a year's time at a certain price. Perhaps the marketer also agrees to sell power that is 50 percent "green." The marketer would then could buy 50 percent of its power from the "green" suppliers like wind power generators, and could then buy the remaining 50 percent of its remaining "non-green" power from the power exchange.

## III. *Changes at the Utilities*

California's investor owned utilities were required by AB 1890 to divest some of the fossil-fired power plants. They have done so and more, having announced the sale of most of the generating plants in the state. In general, these power plants have



sold for greater than their book value, resulting in a surprising influx of new cash for the utilities.

#### IV. *Securitization*

California's three investor owned utilities issues approximately \$7 billion of "securitization bonds." Moody's gave these bonds a very high quality rating, and they sold very quickly. In general the proceeds from these bonds were used to buy back expensive debt and equity.

#### V. *Billing*

Electricity customers in California now see a very different electricity bill. Instead of a single charge for power delivered, they see separate charges for generation, transmission, distribution, stranded cost recovery, securitization, stranded benefit charges and also a 10 percent rate cut. Customers also see information on the environmental characteristics of their electricity purchase.

#### VI. *Ballot Initiative*

Consumers who oppose the securitization attempted to pass a ballot initiative that would have repealed certain provisions of the restructuring law. That measure failed by a margin of 3:1 in the November, 1998 election.

#### VII. *Stranded Benefits*

The California Energy Commission manages a fund to support renewable energy and energy efficiency. The fund amounts to approximately \$500 million.

Company	Capacity	Sale amount	Book Value	Buyer
Boston Edison	1983	\$657	N/a	Sithe Energies
DQE	276	N/a	N/a	AYP Capital
Edison International	7532	1100	421	AES, Houston Industries, NRG Energy & Destec, and Thermo
NEES	4600	1590	1100	US Generating Co.
Pacificorp	412	N/a	N/a	NRG Energy
PG&E Corp.	2,745	501	380	Duke Energy
Unicom	1598	240	N/a	Southern Energy and Dominion Energy