
Electric Industry Restructuring in a Nutshell

The traditional electric industry in the United States is changing. Driven initially and primarily by industrial customers in states with high electricity rates, policy makers in several states have acted to break up the traditional utility industry structure, in order to replace regulation of electricity generation with customer choice and competition.

The United States Congress, along with nearly every state (including Minnesota), currently is analyzing the potential costs and benefits of electric industry restructuring for consumers, the economy and the environment. This information brief describes what is meant by "restructuring" and summarizes some of the more important points of contention in this debate.¹

The electric industry in Minnesota, as well as the rest of the country, is experiencing fundamental change. New federal regulations encourage a significant increase in competition at the wholesale level of this industry by forcing utilities to open their transmission lines to competitors at non-discriminatory rates. In addition, due to technological advances and pressure from large industrial and commercial customers, nearly every state in America, as well as the United States Congress, is considering "restructuring" the industry to allow the implementation of competition at the retail level. Some states have authorized retail competition, either by legislative action or by regulatory order.² In Minnesota, legislative action would be required before retail competition could be implemented in this state.³

¹ Readers interested in more detail should refer to the January 1997 version of the House Research report entitled "Restructuring the Electric Industry." This report includes much more information about the restructuring debate, the Minnesota electric utility industry, and the history of electric utility regulation.

² States that have passed final legislation ordering retail competition to be implemented are California, Illinois, Maine, Massachusetts, Montana, Nevada, New Hampshire, Pennsylvania and Rhode Island. In addition, the state regulatory commissions in Arizona, Michigan and New York have issued final orders ordering retail competition to be implemented in those states. Other states, such as New Jersey, Oklahoma and Vermont, have either passed legislation or issued regulatory orders, but require final legislative approval.

³ It should be noted that there is some threat of federal preemption on this issue. As noted above, Congress is currently considering restructuring legislation. Several of the bills under consideration include preemption provisions, which would require states to implement retail competition. It is as yet unclear as to when such legislation might pass

There is broad agreement in the debate over restructuring that, where it is appropriate to do so, competition and the marketplace should replace regulation as the primary means of setting electricity prices and selecting electricity suppliers. However, there is a great deal of debate over the question of where it is appropriate to implement competition.

Specifically, the restructuring debate centers around whether it is appropriate to implement competition at the retail level of the industry. Retail competition⁴ would allow consumers to purchase electricity from a supplier of their choice, at prices set by market forces, as opposed to purchasing electricity from the utility in whose exclusive service territory the customer is located, at rates established by a regulatory authority.

Restructuring = Rate Unbundling + Deregulation of Generation

Although the term "restructuring" initially referred to a much broader universe of electric industry reforms, it is now commonly used as a synonym for: 1) "unbundling" the generation component of the electricity rate from other components and pricing generation separately; and 2) deregulating the choice of electricity supply.

Rate Unbundling

The retail rate for electricity sold by utilities in Minnesota is regulated or established by a regulatory authority charged with oversight of the utility. This is the case regardless of whether the power was sold by:

- 1) an investor-owned utility like Minnesota Power or Northern States Power ("IOUs");
- 2) a municipal utility like Rochester Public Utilities or Willmar Municipal Utility ("Munis"); or
- 3) a rural electric association like Federated or Kandiyohi ("Co-ops").⁵

The regulatory authority reviews the costs incurred by the utility and establishes or approves a rate sufficient to allow the utility an opportunity to recoup those costs.

the Congress. It is instructive that the landmark Telecommunications Act of 1996 took 10 years of legislative attention to pass. However, few observers expect federal restructuring legislation to take that long to pass. It is equally unclear as to whether the federal legislation that does eventually pass will contain language preempting states from regulating electric utilities. While certain members of Congress believe preemption to be the most efficient method of implementing retail competition nationally, others disagree, preferring a less prescriptive approach, allowing individual states to decide whether deregulation is in the interest of the state.

⁴ Also referred to as "customer choice," "retail wheeling," or "direct access."

⁵ The Public Utilities Commission ("PUC") has primary authority over the regulation of IOUs, whereas Munis are regulated by the relevant municipal authority and Co-ops are overseen by a board comprised of Co-op members.

Currently, this rate is a "bundled" rate. Included in this bundle are the costs of generating (producing), transmitting (transporting in bulk) and distributing (providing to a final consumer) the electricity to the consumer.

In addition to these costs, this rate also includes costs relating to:

- 1) oversight of utilities by regulatory authorities;
- 2) maintenance and operation of the infrastructure to transport and distribute electricity;
- 3) environmental protection;
- 4) universal service and other consumer protections;
- 5) research and development;
- 6) a return on shareholder's investment (IOUs only); and
- 7) the construction of additional facilities.

"Unbundling" refers to the separation of those costs specifically related to the generation of electricity from the other costs "bundled" within the current rate for electricity. This separation allows for the pricing of "generation," or electricity production and supply, independently from the other costs of providing electricity.

The process of unbundling the rate can be both procedurally contentious and technically difficult. Because a large portion of the rate for electric service would continue to be set by a regulatory authority after restructuring, potential competitors fear that utilities providing both regulated and unregulated services will attempt to shift costs that should be recovered through the market price into the regulated rate. This cost-shifting would allow utilities to "cross-subsidize" their competitive services, and reduce the market price for these services. Obviously, competitors, regulators and consumer advocates want to ensure that the unbundled price for generation includes all of the appropriate costs, allowing for no cross-subsidization. In addition, because generation and transmission are so closely entwined, it can be quite difficult from a technical perspective to separate them. The argument over what costs are attributable to generation is important to the development of a competitive electricity market.

Deregulation of Generation

In Minnesota, each electric utility with distribution responsibilities has been granted an exclusive service territory. Each utility may serve only those retail customers located within its service territory. In turn, no other entity or electricity supplier may serve those retail customers.

Thus, a retail customer must take electric service from the utility in whose service territory the customer is located, and, except in certain limited circumstances, at the rate established or approved by the applicable regulatory authority. This obligation goes both ways; the customer has to purchase service from the utility and the utility has to provide it.⁶

⁶ The reciprocal nature of this relationship may be important in states like Minnesota, where electricity rates are low compared to the national average. Under a restructured industry, producers of low-cost power that currently sell their power to Minnesota customers may sell their power on the retail market to the highest bidder. Absent adequate

As part of its obligation to provide electric service, the utility is responsible for generating sufficient electricity, or must arrange for the generation of sufficient electricity, to meet its customers' power needs.

Most parties involved in the debate over restructuring agree that deregulation of generation would mean that:

- 1) these reciprocal obligations would be terminated;
- 2) a utility's exclusive service territory would be abolished with respect to electricity production and supply, allowing other entities to compete to provide generation services to the utility's former customers;
- 3) the responsibility for selecting an electricity supplier and arranging for sufficient generation to meet a customer's needs would shift from the utility to the customer; and
- 4) the price for electricity generation would be unbundled from the cost of other components of electric service, and would be set by market forces, not by a regulatory authority.

Essentially, deregulation of generation is the unbundling of electric services, while rate unbundling is the unbundling of the cost of electric services.

Note: Nearly all participants in this discussion agree that restructuring does not mean that the electric industry would be entirely deregulated. Under most restructuring proposals, generation is deregulated, but distribution and transmission remain subject to comprehensive regulation. Thus, deregulation of generation does not necessarily mean that other entities would be allowed to compete to provide distribution services and other electric services to retail customers in a utility's exclusive service territory. In general, these other services would continue to be provided by the customer's current utility, at rates set by a regulatory authority.

For example, if a residential customer in utility A's service territory decides to purchase electricity from utility B, the customer would continue to be served by utility A for those services that are necessary to get the electricity generated by utility B into the customer's home. The customer may then receive two bills, one from A and one from B.

Presumably, if competition is effective in reducing energy prices and the customer has sufficient information to make an informed choice, the customer's bill under competition (market price for generation, plus regulated price for all other electric services, or A + B) should be less than the customer's bill under regulation (regulated price for all electric services provided exclusively by A).

In addition, the industry would remain subject to other forms of regulation, such as environmental standards, reliability requirements and anti-trust restrictions.

competitive pressures, this could result in higher prices for consumers in this state, as Minnesotans may have to pay more for the same electricity, or purchase higher priced electricity elsewhere.

Important Issues in the Restructuring Debate⁷

While many pro-restructuring advocates maintain there are significant non-price benefits to allowing customers to choose their electricity supplier, the primary argument advanced for deregulating generation is the potential for cost savings from expected efficiencies caused by competition. It is no accident that the restructuring debate began, is most contentious, and is furthest along, in areas of the country that have the highest electricity rates.⁸

However, while the debate may begin and end with the issue of price*, it makes several stops along the way. Other important issues in this debate include:

- reliability and safety of the electricity grid*
- innovation in technology and services due to competition
- the magnitude of transition costs, and who should bear them
- level playing field issues, such as the effect of the personal property tax
- consumer protection & universal service*
- environmental protection, renewable energy development, and conservation*

Price

Restructuring proponents assert that restructuring may reduce the cost of electricity to consumers. These parties expect that implementing retail competition will drive utilities and other energy providers to operate with greater efficiency and economy.

As evidence of the potential for deregulation and competition to result in savings to consumers, deregulation advocates point to a study done by Robert Crandall of The Brookings Institution and Jerry Ellig of the Center for Market Process entitled, "Economic Deregulation and Customer Choice: Lessons for the Electric Industry." This study analyzed and described the benefits of deregulation nationally in several other industries, finding that deregulation has caused price reductions in the five industries listed in the following table:

⁷ The issues marked with an asterisk (*) are the issues the Minnesota Legislative Electric Energy Task Force found to be of particular concern. See Appendix A.

⁸ Minnesota, and the Midwest region generally, is considered to have fairly low rates for electricity. For example, the New England region has an average electricity rate of over twice that of the Midwest (10.88 cents per kilowatt hour versus 5.32 cents per kilowatt hour). Source: POWERdat Market Indicators, Public Utilities Fortnightly, July 15, 1997, page 17. As noted previously, several states in New England have already passed restructuring legislation.

Summary of Trends Following Regulatory Change

Industry	% Real Price Reduction After 2 Years	% Real Price Reduction After 5 Years	% Real Price Reduction After 10 Years	Annual Value of Consumer Benefits Due to Deregulation ⁹
Natural Gas	10-38% (1984-86)	23-45% (1984-89)	27-57% (1984-94)	N.A.
Long Distance Telecommunication	5-16% (1984-86)	23-41% (1984-89)	40-47% (1984-94)	\$5 billion
Airlines	13% (1977-79)	12% (1977-82)	29% (1977-87)	\$19.4 billion
Trucking	N.A.	3-17% (1980-85)	28-58% (1977-87)	\$19.6 billion
Railroads	4% (1980-82)	20% (1980-85)	44% (1980-90)	\$9.1 billion

Source: Crandall and Ellig, 1997

Pro-restructuring analysts expect electric industry restructuring to prove similarly beneficial, both nationally and in Minnesota, and insist that any delay in implementing retail competition would result in Minnesota electricity consumers paying more than necessary for longer than necessary.

However, other industry analysts are more cautious about the potential benefits of deregulating generation, especially in low-cost states like Minnesota. These analysts point to a recent analysis conducted by the Office of Integrated Analysis and Forecasting of the federal Energy Information Administration (EIA),¹⁰ entitled "Electricity Prices in a Competitive Environment: Marginal Cost Pricing of Generation Services and Financial Status of Electric Utilities."

The EIA found that, assuming a nationwide implementation of retail competition by January 1, 1998, retail competition could provide significant savings nationally. However, the EIA also found that two regions of the United States, the Pacific Northwest and the Upper Midwest,¹¹ would likely experience price increases.

⁹ The Crandall/Ellig report includes the following note with this table: "All figures are real, in \$1995. Consumer benefits in the last column measure *total* consumer benefits, including both price reductions and changes in service quality."

¹⁰ The EIA is administratively part of the federal Department of Energy, but according to the EIA, "the analyses offered in this report are based on an objective, independent examination and do not purport to represent the policy positions of the United States Department of Energy or the [Clinton] Administration. The EIA does not take positions on policy questions."

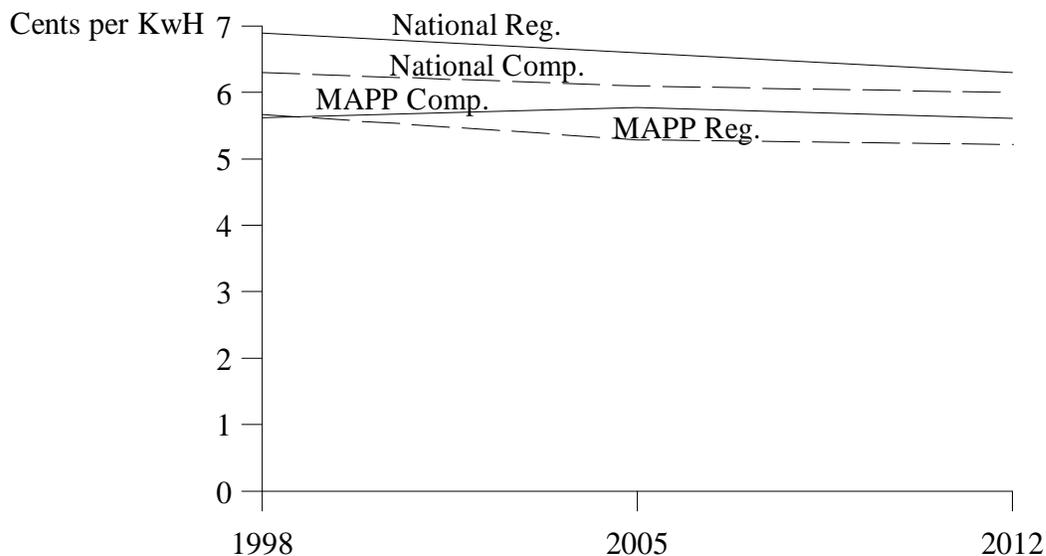
¹¹ More specifically, the "Mid-Continent Area Power Pool" (MAPP) which is made up of Minnesota, the Dakotas, eastern Montana, western Wisconsin, Nebraska, Iowa, Saskatchewan, and Manitoba.

As can be seen from the following graph, the EIA analysis estimates that the regulated rate for electricity in the Upper Midwest would be lower than the deregulated market price for electricity in the region through the year 2012.¹² The bottom line of the graph is the EIA's estimate of the average regulated rate in the Upper Midwest through the year 2012. The line above it is the EIA's estimate of the potential market price for electricity in the region for that time period.

As also can be seen from this graph, the national average competitive price (2nd line from the top) may be significantly below the national average regulated rate (top line) through 2012.

Comparison of Electricity Prices

Regulated Rates and Competitive Prices in the MAPP Region and Nationally



Source: EIA, 1997

Thus, while retail competition could result in significant savings nationally similar to those experienced under deregulation of other industries as documented by the Crandall/Ellig study, the EIA analysis indicates that consumers in our region of the country may be hurt by restructuring.¹³ As a result of this analysis and other studies, many industry participants and analysts in Minnesota are urging policy makers to move cautiously and carefully in evaluating the implementation of retail competition in this state.

¹² The EIA analysis is comprised of a number of scenarios, reflecting ranges in regulatory efficiency and consumer response to competition; the one depicted here is the EIA's "moderate consumer response" scenario.

¹³ A basic assumption of the EIA analysis is that no entity in the market place would be able to exert "market power." Market power is a term referring to the ability of a market participant to increase prices above competitive levels, thus to increase profits. Market power can result from any number of conditions, including a lack of true competitors or control over an essential bottleneck facility. If, as many economists predict, utilities in the MAPP region would enjoy some level of market power, the price increases caused by retail competition could be exacerbated.

The EIA study was not meant to be a definitive analysis of electricity prices in a fully competitive market, nor is it such a analysis. Instead, it gives policy makers an indication of what prices might be, or the direction prices might trend, upon implementation of retail competition.

Also, the EIA analysis dealt only with average rates and retail prices, and only on a region-wide basis. Neither it nor the Crandall/Ellig study attempted to provide a Minnesota-specific analysis.¹⁴ Nor did either study evaluate how various classes and types of consumers may be affected by implementing retail competition. Many advocates, analysts, industry participants and policy makers have expressed the concern that small business, residential, low-income and rural consumers may not receive an appropriate share of any cost savings from restructuring, and may bear a disproportionate burden of cost increases due to restructuring.

Reliability and Safety of the Electricity Grid

Perhaps co-equal with the issue of price, the reliability and safety of the electricity grid is a critical issue in the restructuring debate. The current infrastructure used to transport and distribute electricity was designed and constructed to be operated in a regulated environment, to serve customers located in within a utility's exclusive service territories. Already, with the onset of increased wholesale competition brought on by recent Federal Energy Regulatory Commission orders, the electricity grid has been taxed by the increase in the number and complexity of power transactions. Retail competition would result in another (and potentially greater) explosion in the number of such transactions. There is a substantial question as to whether the current technology and practices of those charged with maintaining system reliability and safety will be able to handle a load of that magnitude at current reliability levels. Engineers and reliability experts are working diligently to solve this very important problem, but some have expressed grave concerns that the pace of change in the industry may well outstrip their efforts.

Innovation in Technology and Services

The implementation of customer choice may result in an explosion in the development of new technologies and new services, similar to that which has occurred in the years since the monopoly on long distance telecommunications was broken up. Driven by consumer demand and the desire for market share and market niches, electricity suppliers and utilities will inundate the market with new services and technologies that may increase productivity and efficiency. It is unknown what the magnitude of these productivity and efficiency benefits might be, but is possible that these benefits could mitigate, to some extent, the potential price increases indicated by the EIA analysis, should those increases occur.

¹⁴ No Minnesota-specific analysis has been done regarding the expected price of electricity in a deregulated Minnesota electricity market.

Transition Costs and Who Should Bear Them

Producers, consumers, regulators, taxpayers and others likely will incur large costs caused by the transformation of the electric industry into a competitive market, such as:

- the development of new operating guidelines and codes of conduct;
- the possible divestiture of utility assets or other forms of corporate restructuring;
- additional consumer protection and anti-fraud restrictions; and
- consumer education programs.

It will be important for policy makers to identify the need for such additional costs, and allocate responsibility for them in a fair and equitable manner.

A subset of transition costs, commonly referred to as "stranded costs" has caused a great deal of controversy in the restructuring debate in other states. Stranded costs are those costs incurred by a utility to meet its obligations to serve customers in a regulated environment, but which the utility will not be able to recover in a competitive market. The largest portion of these costs relate to power generating facilities that produce power at above-market prices -- decreasing the value of the facility and rendering it "uneconomic" to operate.

Utilities argue that they made those investments with the expectation of a regulated environment, and that government has the responsibility to allow them to recover those costs as part of a transition to retail competition. Others argue that government has no such obligation, and that to allow utilities to recover stranded costs would frustrate the primary purpose of deregulating generation -- to lower electricity prices.

At present, it appears that Minnesota utilities may not incur large numbers of stranded costs, due to the fact that most Minnesota generation facilities produce electricity at quite a low cost. In fact, some analysts predict that Minnesota facilities actually will increase in value in a competitive environment, and that the Minnesota electric industry would have "negative stranded costs." A conclusive analysis of stranded costs in Minnesota has not yet been conducted, however.

Level Playing Field Issues

When creating a competitive market from scratch, it might be a simple thing to design rules and conditions that do not give one competitor an advantage over another. However, that is much more difficult to when transforming a regulated industry into a competitive market. The debate over equalizing out the advantages and disadvantages each incumbent may have over other market participants is complex.

In Minnesota, there are nearly 200 incumbent utilities, each with its own corporate structure and history. As for-profit entities, IOUs are taxed differently from Munis and Co-ops, which are both not-for-profit utilities. In addition, Munis, as governmental entities are treated differently by the federal, state and local tax codes and bond requirements than the Co-ops and IOUs, which are private entities.

One of the other "level playing field" issues in Minnesota concerns the personal property tax levied on utilities. This tax is levied, for the most part, only on utilities (both gas and electric). IOU's, which by far have the largest number of personal property assets in the state among utilities, pay the greatest amount of tax. Munis are exempt from the personal property tax, for the most part, but most Munis make some monetary contribution to their municipal government in lieu of property tax. Co-ops are subject to the personal property tax in most situations, but in large part have decided to locate their generation assets outside the state, thus escaping the tax. The personal property tax on attached machinery at generation facilities is, in essence, a tax on production, which increases the total cost of generating electricity at those facilities. Any differential in this tax burden can create a competitive differential between competitors. In addition, most states do not impose a personal property tax on generation facilities. Thus, competitors from outside the state may have an advantage relative to in-state providers. This will be an important issue as the restructuring debate progresses in Minnesota.

Consumer Protection and Universal Service

Minnesota's current regulatory structure provides two important functions for consumers. First, it provides regulatory oversight over the activities of utilities, to guard against actions that could harm consumers. Second, it requires utilities to provide service at just and reasonable rates to any consumer that requests service. Policy makers considering a shift to a competitive retail electricity market should consider whether and how to provide such protections in the absence of comprehensive regulatory oversight over electricity supply. In addition, it will be important to impose these obligations on all market participants (such as power marketers and independent power producers), not only utilities, so that utilities are not placed at a competitive disadvantage relative to other suppliers.

Environmental Protection, Renewable Energy & Conservation

Environmentalists in Minnesota are concerned that a shift to a competitive retail electricity market will harm the environment. Environmentalists are concerned that utilities will increase the output of low-cost coal and nuclear plants in the Midwest, thus increasing air emissions and the generation of high-level nuclear waste. Environmentalists and others also are concerned that the development and implementation of renewable energy generating technologies will be severely curtailed or eliminated, because these technologies are not currently competitive with other forms of generating technologies, such as natural gas combustion. Finally, environmentalists are concerned that conservation improvements will not be considered cost-effective under retail competition, with an increased emphasis on short-term cost savings.

Restructuring advocates believe that restructuring will not harm the environment. They maintain that, due to transmission constraints and other infrastructure concerns, coal plants in the Midwest will not be able to increase capacity much beyond current levels, and even if such constraints did not exist, generation facilities still will be subject to emissions regulation by the Minnesota Pollution Control Agency. As for renewable energy, these advocates suggest that a retail market for electricity could increase the development and implementation of renewable energy technologies, because many consumers may be willing to pay a premium for renewable energy. Finally, restructuring advocates point out that consumers will continue to invest in conservation improvements that are cost-effective.

The Threshold Question

The threshold question in the restructuring debate may be whether or not electric industry restructuring is likely to lower energy costs for all consumers. Policy makers faced with this question will undergo a cost-benefit and risk assessment of restructuring -- what is the likelihood costs will go down versus the risk of costs increasing? In high-cost states, that cost-benefit and risk assessment is quite clear. Costs may be so high that the risk of any further increase is minimal, whereas the potential for cost savings is large.

However, this assessment is much more difficult for policy makers in low-cost states. Studies such as the Crandall/Ellig study are instructive as to the potential benefits of deregulation, but these studies are counterbalanced by analyses such as that conducted and published by the EIA, indicating that prices in this region may rise.

The Minnesota Legislative Electric Energy Task Force (LEETF) has been charged by the legislature to review and analyze these and many other issues related to electric industry restructuring. The task force's initial recommendations were issued on December 15, 1997, and are set forth in Appendix A. In these recommendations, the LEETF recommends that no legislation resulting in comprehensive policy changes to the electric industry be acted on the 1998 legislative session, and that the LEETF continue to study these issues and work to develop a Minnesota approach to restructuring. The LEETF found 4 issues to be of particular concern (price, reliability and safety, environmental protection, and universal service and consumer protection), and that strategies, standards and practices to address these concerns must be developed before the task force can recommend that the state move forward on restructuring.

In addition to the LEETF, the energy committees of both the House and Senate have created subcommittees that have met throughout the interim to review and familiarize themselves with restructuring issues, in anticipation of future legislative activity on restructuring. The legislative debate over restructuring the Minnesota electric industry has only begun.

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Appendix A

Recommendations of the
Minnesota Legislative Electric Energy Task Force
on Electric Industry Restructuring
and Utility Taxation

Issued December 15, 1997

Legislative Electric Energy Task Force

Initial Recommendations Pursuant to Laws of Minnesota, 1997 Chapter 191, Article 1, Sections 11 & 12

The 1997 Minnesota Legislature directed the Legislative Electric Energy Task Force (LEETF) to review and analyze issues relating to electric industry restructuring, and to present the 1998 Legislature with the task force's initial recommendations by January 15, 1998.

Specifically, the LEETF was to review the impacts of restructuring on:

- various types of electricity customers
- the state's economy
- the reliability and safety of the electric grid
- the state's environment and
- the various types of electricity suppliers in the state.

In addition, the task force was required to establish an interim subcommittee on utility taxation to analyze issues relating to the imposition of personal property taxes on the state's gas and electric utilities.

Beginning in early summer, and throughout the fall and winter of 1997, the LEETF held a series of public meetings to solicit opinions and information from interested parties on these issues. As the task force members' familiarity with and understanding of the complex issues of electric industry restructuring developed, many members expressed the concern that the benefits of deregulating the electric industry supply in Minnesota may not outweigh the risks associated with deregulation. Issues of specific concern to the members of the LEETF include the effect of restructuring on: the price of electricity in the state; the reliability and safety of the regional electric grid; the state's environment; and the provision of universal access and affordability of electric service.

Price. Minnesota consumers currently enjoy electric rates well below the national average.

Although one of the primary reasons advanced by proponents of electric industry restructuring is that deregulation and competition should reduce the cost of electricity to consumers, the LEETF heard testimony indicating that electricity prices in the state could actually increase under competition. While it is by no means certain that prices will rise under deregulation, the effect of restructuring on prices in Minnesota will have to be better understood, and strategies developed to minimize the risk of price increases (such as guarantees of price stability or price decreases), before the LEETF can recommend that the state move forward on deregulation.

Reliability. The current regulatory system provides for safe and reliable generation, transmission and distribution of electricity to Minnesota consumers. The LEETF heard testimony indicating that authorizing retail competition in the state may threaten the provision of safe and reliable electricity, with the technology and practices that are currently being deployed in the region. These issues are currently being addressed, at the national, regional, state and utility levels. It is critical that parties work together to address these concerns prior to the introduction of retail competition in Minnesota. Our current level of reliability and safety cannot be compromised.

Environment. Testimony provided to the LEETF indicated that competition could have both positive and negative effects on the state's environment. Strategies must be developed to ensure that a move to retail competition does not degrade the Minnesota environment.

Universal service and consumer protection. Minnesota has a long and proud tradition of providing universal access to affordable electric service. In addition, Minnesota consumers have come to expect protection from consumer fraud, negligent or deceptive business practices and

anti-trust violations. Proponents of restructuring will have to demonstrate to the LEETF that the rural electricity consumers in our state, as well as the state's low-income consumers, will continue to have affordable access to electric service. Furthermore, standards and practices will need to be developed to provide Minnesota consumers with the protections they expect.

On the basis of the testimony presented to the LEETF during the 1997 interim, the LEETF finds that it does not have the information necessary to recommend that the state move forward with electric industry restructuring at this time. Thus, the initial recommendations of the LEETF are that:

1. no legislation related to comprehensive policy change with respect to electric industry restructuring be acted on in the 1998 legislative session
2. the legislature and the LEETF continue to study and analyze the issues relating to electric industry restructuring, and that the LEETF provide an update on these issues to the legislature by January 15, 1999
3. the LEETF monitor restructuring activities in the many states that have enacted restructuring legislation, in order to learn from their experiences as these states implement their legislation
4. the LEETF monitor the activities of the United States Congress regarding electric industry restructuring, in order to be prepared to implement deregulation of electric supply should states be ordered to do so by the federal government
5. the LEETF continue to provide leadership on developing a Minnesota approach to restructuring
6. parties interested in the electric industry restructuring issues continue to meet and work on these issues, in an effort to develop a broad consensus on restructuring the state's electric utility industry, and that the state's Public Utilities Commission, Department of Public Service and the Office of Attorney General continue to play an important role in this effort
7. LEETF members and staff continue to be briefed, included and consulted at all stages of efforts undertaken to develop this broad consensus
8. the recommendation of the interim subcommittee on utility taxation be adopted and incorporated by reference

Legislative Electric Energy Task Force

Interim Subcommittee on Utility Taxation

The 1997 Minnesota Legislature required the Legislative Electric Energy Task Force to establish an interim subcommittee to conduct an analysis of certain issues relating to the imposition of personal property taxes (PPT) on the state's gas and electric utilities. Specifically, the interim subcommittee was required to analyze and develop a recommendation regarding:

- the effects of the PPT on the ability of the state's utilities to compete in a less regulated energy industry;
- the impacts that eliminating the PPT would have on local units of governments (including school districts), state revenues and rate payers; and
- alternatives to the current utility taxation structure.

The task force established the interim subcommittee, which held a number of public hearings in the fall/winter of 1997. In addition to those public hearings, members and staff of the subcommittee met with interested parties to collect information and to solicit opinions. During the course of these proceedings, the subcommittee found that the issues it was charged with exploring are exceedingly intricate and complex, and that several analytic, policy and political questions remain to be considered and answered before the subcommittee can make a recommendation as to whether and how to address the issue of the PPT.

These questions include:

1. what significance the PPT holds in the context of all of the federal, state and local taxes and tax benefits available to the various types of utilities operating in the state
2. whether restructuring would result in such sharp price reductions or market share losses that the economic viability of utilities subject to the PPT would be threatened

3. whether the PPT should be replaced with a different tax, fee or surcharge; how that replacement fee should be structured; and how replacement revenues should be distributed to local government units
4. whether PPT reform or elimination would have to be revenue neutral for local government units, including the question of whether those local government units that are heavily dependent on PPT revenues and providing above-average government services to its citizens should be expected to:
 - a) reduce overall expenditures and services; or
 - b) increase local tax levies on other local property.
5. whether PPT reform should be tied to the implementation of retail competition for electric supply, or whether the state should proceed with utility tax reform prior to or independent of restructuring the electric industry
6. whether and how technical issues, such as how property owned by different types of utilities should be valued by local assessors or the Minnesota Department of Revenue, should be reformed or more fully analyzed

Due to the importance of these issues, the interim subcommittee on utility taxation of the Legislative Electric Energy Task Force recommends that:

1. the task force spend additional time and resources in fully understanding the answers to these and other related questions;
2. the interim subcommittee be continued to allow for uninterrupted, in-depth study of these complexities; and
3. parties affected by these issues are encouraged to continue to meet and work, in an effort to develop a broad consensus, and are invited to periodically update the task force as to their efforts and progress.

At this time, the interim subcommittee makes no further recommendation regarding legislative activity on these issues during the 1998 session.