some states, tension has increased between consumer advocates and the PUC, as both attempt to figure out how they fit into a new industry structure. For example, in Ohio there has been a good deal of tension between the PUC and the Office of Consumers’ Counsel (OCC), as the PUC attempts to determine what role it will play in consumer protection and consumer education in a restructured utility marketplace. Rob Tongren, the Consumers’ Counsel, describes the source of the tension: “There is a question of who should handle residential consumer complaints. The PUC has been moving more into that area, but its charge is to protect the public interest (that is, to act as the judge). OCC’s enabling statute gives it the authority to take ‘appropriate action with respect to residential consumer complaints’ whereas the PUC lacks similar specific statutory authority.”

Maine has taken a more cooperative approach toward ensuring that the PUC and the Public Advocate are not duplicating their efforts. Under the direction of the State Planning Office, the PUC and the Public Advocate have worked together to redefine the roles of both organizations. Under this new structure, which has yet to receive legislative approval, the PUC would focus on regulation of utilities and the market and would no longer perform an advocacy function. The Public Advocate would be primarily responsible for serving as a watchdog over emerging markets, seeking to protect competition, giving consumers tools to make informed choices, and protecting consumers from market abuses.

In redefining the role of consumer advocacy organizations, it is important to recognize the inter-relationships and synergies that exist between organizations. For example, smaller consumer organizations may be dependent on the large state consumer agency to provide certain information, expertise, and other support in complex cases. If the state consumer agency reorganizes, care is needed to ensure reorganization does not have an adverse effect on smaller organizations. Ellis Jacobs, from the Legal Aid Society of Dayton, Ohio, discussed this concern: “My effectiveness will depend on the availability of OCC and other groups. We need to share the work and have the ability to bounce ideas off of others. OCC seems to be moving more into the consumer education function and away from litigation. If that happens, we will have to beef up our litigation ability (we may need as many as five people, rather than our current 1½ doing utility-related work).”

Finally, consumer advocacy organizations need to better coordinate their efforts on a national level. Several organizations work on a national level to represent the interests of utility consumers, including the National Association of State Utility Consumer Advocates (NASUCA), the National Association of Attorneys General (NAAG), the Consumer Federation
of America (CFA), AARP, the National Association of Consumer Agency Administrators, Consumers Union, and the National Consumer Law Center. These and other organizations have worked together on some issues, but they do not always take advantage of opportunities to work together when their interests converge. Fred Schmidt, the director of the consumer protection bureau for the Nevada Attorney General, readily acknowledges that “there has not been good communication between NAAG and NASUCA.” With a restructured utility industry, however, that communication will be more important than ever. Mr. Schmidt explains, “NASUCA members tend to view the PUC as the way to solve problems. In a restructured world, that won’t necessarily be the case.”

As an example, one of the most pernicious problems that has been created by utility industry competition is “slamming,” the unauthorized change of a customer’s utility service provider. Within the telecommunications industry, there are thousands of complaints each year regarding slamming. In Nevada and Oregon, slamming complaints are being handled by prosecutors in the attorneys general offices as consumer fraud cases, which has proven to be effective in combating the problem. Utility consumer advocates, also trying to find ways to deal with this problem, may not be aware of the efforts that have been undertaken by attorneys general.

In summary, as the structure of the utility industry changes, traditional relationships among consumer advocacy organizations will need to change as well. It will be increasingly important to keep open the lines of communication and to develop coalitions and working groups to ensure that scarce resources are being used in the most effective way possible.

**Funding**

Consumer advocacy organizations are funded in several different ways. Most state agencies that perform a utility consumer advocacy function are funded through an assessment on each utility operating in the state, though some receive funding from the state’s general fund. Legal services organizations receive funding from the federal government, state governments, the United Way, or from Interest on Lawyer Trust Accounts (IOLTA) programs. Nonprofit consumer organizations receive most of their funding from the contributions of individual consumers, though foundations and other private charities may provide grants. The restructuring of the utility industry could have a major impact on funding for all three types of consumer advocacy organizations.

Most organizations will need additional resources to make the transition from a fully regulated utility industry to a partially deregulated industry. The number and complexity of proceedings that are necessary to do the job
properly means that additional staff and/or outside consultants will need to be hired. As an example, the Maine Public Advocate received a 50 percent increase in its budget for fiscal year 1998-1999, primarily for consulting costs associated with electric industry restructuring. This additional funding is being provided during the transition period to a competitive utility industry. It remains to be seen whether the Public Advocate receives additional responsibilities as a result of changes in the utility industry, which might lead to increased funding requirements in the future.

Historically, utility consumer advocates have relied on their success in saving money for consumers to justify their budget requests or to encourage consumers to join their organizations. During the 1970s and 1980s, when utilities were filing for unprecedented, multi-million dollar rate increases, the need to fund a consumer advocate was clear. However, the issues involved in utility industry restructuring are much less concrete than the dollars and cents involved in a rate case. For example, restructuring involves questions about market power, rules for corporate affiliates dealing fairly with each other, guidelines for communicating with consumers, requirements for utility bill formats, and numerous other consumer-protection issues that do not have an immediate effect on the amount of the monthly utility bill. How does an organization explain the benefit of participating in a proceeding to determine the rules for participating in a competitive market? Will consumers readily contribute to an organization if they cannot discern the effect on their utility bill? Will legislators be as understanding of budget requests when the state consumer agency can no longer quantify the savings on utility bills from their advocacy efforts?

The answers to these questions are far from clear. It remains to be seen whether legislatures, foundations, and individual consumers will be willing to contribute to consumer advocacy organizations when the issues move from the pocketbook to public policy and market structure.

For those organizations funded through an assessment on utility companies, there is a serious question of the fairness and adequacy of that funding method. If consumer advocates are spending more of their time dealing with competitive-market issues, then a portion of their funding arguably should come from companies that are participating in that market. It would not seem fair to require regulated utility companies to bear the entire burden of supporting these organizations, while relieving competitors of that same responsibility.

Moreover, if funding remains tied to utilities' regulated revenues, then the level of funding can be expected to decline as more of the utilities' activities take place in the unregulated market. For example, if the only portion of an electric bill that is regulated are the transmission and distribution charges, that
Strategies for Changing and Adapting

would remove about one-half of the utility’s revenues from the regulated side of the business. If the consumer advocate’s funding is based on the utility’s regulated revenues, then the funding could decrease by 50 percent or more.

Many consumer advocates are actively transforming their organizations to deal with the new structure of the utility industry. The following case studies provide examples of some of the changes taking place.

Case Study 1: Building a Network

Consumers in Maine will not be able to buy electricity on the open market until March 2000. By that time, a statewide coalition of consumer groups expects to be in its fifth year.

Legislation to restructure the electric industry in Maine was negotiated during countless meetings involving utilities, consumers, legislators, and the PUC. Early in the process, the various consumer interests (large industries, low-income consumers, small businesses, and residential consumers) recognized that they needed to find a way to put aside their differences and work toward a common, consumer-oriented position.

Steve Ward, Maine’s Public Advocate, started the effort to organize the Maine Electric Consumers Coalition but did not expect it to last very long. Past efforts to get various consumer groups together had not been very successful.

This time, however, the group had a clearly defined mission to counteract the lobbying clout of the utilities in the debate over restructuring the electric industry. Members of the coalition recognized the need to find common ground and develop a consumer alternative to utility–industry restructuring proposals. The coalition developed a common set of consumer principles and met frequently to compare notes and discuss strategy. Mr. Ward thinks that the coalition will continue through the implementation phase of the electric restructuring legislation and may work on other utility issues as well. “Above all, form a consumer coalition,” he advises. “The coalition provides us with information from real consumers speaking from various perspectives.”

Case Study 2: Educating the Consumer

The District of Columbia Office of the People’s Counsel (OPC) has placed a great emphasis on consumer education. Betty Noël, the People’s Counsel, has taken a number of actions to help ensure that utility consumers are informed about the benefits and drawbacks of competition. For example, prompted by the public’s concern with a lessening of service quality, OPC filed a request for a quality-of-service investigation, covering all three utilities that serve the District.

Subsequently, OPC held a public hearing focusing on quality of service, creating a public record of consumer concerns and allowing utilities to hear those concerns.
OPC also is actively involved in a Washington Gas Company working group that is evaluating educational materials about customer choice. Recently, OPC convened a consumer focus group to review and comment on these educational materials. The group provided valuable input and recommendations that the utility incorporated into its revised materials.

**Case Study 3: Helping the Consumer**

From its community outreach efforts and work with other consumer organizations, the Ohio Office of Consumers' Counsel (OCC) recognized the need to provide better service to Ohio's residential utility consumers. OCC is one of the largest state agencies in the nation that represents utility consumers, with more than 60 employees and an annual budget in excess of $6 million.

In 1996, OCC responded to about 1,300 inquiries from utility consumers. During the next year, OCC increased its complaint-handling staff and began to publicize its toll-free number. The level of inquiries received by OCC increased more than forty-fold. OCC received 35,635 inquiries from consumers and expects that number to be eclipsed in 1998. Through July 1998, OCC received 35,251 customer contacts and anticipates total inquiries for 1998 to exceed 72,000. Today, as a result of OCC's negotiations with companies, many utility bills in Ohio list OCC's toll-free number for consumers to discuss any questions or complaints with their utility service.

Rob Tongren, the Consumer's Counsel, explains that with the possibility of competition in the utility industry, "the demands on OCC are increasing dramatically, particularly in the area of complaint handling and consumer protection." In order to meet the demand for these services from all consumers, Mr. Tongren is devoting more resources to these activities and "making an effort to hire people with skills in other languages."

**Case Study 4: Reorganization**

The Nevada Office of Consumer Advocate (OCA) is one of about 20 in the country that is part of the state attorney general's office. In 1997, the attorney general's office was reorganized, making the OCA part of the Public Protection Bureau. Now, the utility consumer advocates work side by side with experts on consumer education, fraud, and antitrust.

Fred Schmidt, Nevada's Consumer Advocate and the new director of the Public Protection Bureau, sees major advantages to this new structure: "We have brought together expertise in telemarketing, consumer fraud,
antitrust, and utility advocacy. Our reorganization is providing the resources and expertise that is needed to deal with changing issues involving utilities.” Mr. Schmidt also noted the benefits of having prosecutors, investigators, and consumer education specialists available for help on utility-related matters.

Case Study 5: Helping Low-Income Consumers

Low-income consumers may have the most to lose when utility industries are restructured. A new program in New York is finding ways to help these consumers without resorting to costly litigation.

Several years ago, the federal government established a “lifeline” program to help low-income consumers afford basic telephone service, but in order for lifeline to work, consumers need to be informed that this program is available, and the local phone company must agree to administer the program and receive the approval of the state PUC. After years of fighting about the lifeline program, the Public Utility Law Project (PULP) in New York reached an agreement with the largest local phone company in the state (NYNEX, now part of Bell Atlantic) and the state Department of Family Assistance. NYNEX now has access to state social service records so that it can automatically enroll eligible consumers in the lifeline program. The result: enrollment has increased by more than 250,000 people in two years, and more than 100,000 people who are no longer eligible have been dropped from the program. Gerry Norlander, a senior attorney at PULP, explains that they now have about 750,000 people statewide on the lifeline program which is “probably 60-70 percent of the eligible population, compared to most states where less than 25 percent of the eligible households participate in lifeline.”

Case Study 6: Finding New Ways to Protect Consumers

Consumer advocates’ focus on litigation is changing. As utilities file fewer rate cases, consumer advocacy organizations have realized that they need to find new ways to protect consumers and enhance the quality, affordability, and availability of utility services. In California, The Utility Reform Network (TURN) participated in a statewide ballot initiative on electric restructuring. TURN’s network of volunteers gathered more than 720,000 signatures to place the initiative on the ballot. In addition, while TURN contin-
ues to be actively involved in litigation, it is looking for ways to provide information to consumers, such as becoming a resource for cities and towns that want to buy electricity for their residents. Nettie Hoge, TURN's executive director, explains: "We want to help local governments understand their options and become educated about electric restructuring."
Chapter 5: Conclusions / Implications

The utility industry is changing, and utility consumer advocacy organizations must change along with it. The issues are changing, the work load is increasing, and responsibilities are being redefined. Old funding sources may no longer be available, and new sources may be difficult to find. Organizations that used to share the same points of view may become adversaries but old enemies may become allies.

When other industries were deregulated, the transition often resulted in a loss of important protection for the consumer. Large consumers received better service and lower prices but often at the expense of small or low-income consumers. Deregulation in other industries also has raised concerns about the safety, reliability, and overall quality of service. It is still early enough in the restructuring of the utility industries to learn from these experiences.

Utility consumer advocates must increase their effectiveness. A theme that recurred in discussions with consumer advocates throughout the country was the need to form coalitions and networks of consumer organizations on the local, state, regional, and national levels. Utility companies are getting much bigger, and consumer advocates need to increase their impact as well. This does not necessarily mean that an individual organization needs to grow; rather, growth can come by sharing resources and expertise across many organizations. Each consumer organization has a different core competency and a different constituency. Bringing these groups together not only increases resources but also makes each organization more sensitive to the particular interests of the others.

Consumer education and consumer protection will be increasingly important functions for consumer advocates. If utility services are purchased in a competitive market, then consumers will need to be educated about how to make wise decisions. As utilities are deregulated, consumer advocacy organizations must be vigilant about consumer fraud and other marketing abuses.

Consumer organizations need to take a hard look at their structure and function. They need to explore and understand the relationship between their organization and others, both within state government and in the private sector. They need to forge ties with organizations in other states and perhaps even other countries as utility companies expand their operations throughout the world. With competition and restructuring come mergers and acquisitions. The telecommunications industry now has just a handful of companies that control local telecommunications services and three companies that control the long-distance market. The
energy industry has seen an unprecedented number of proposed mergers during the past year, and more are likely to occur as restructuring spreads throughout the country. More issues will be decided on a regional or national—or even international—level rather than in an individual state. Consumer advocacy organizations need to have structures in place to deal with these much larger, regional utilities.

In doing this, consumer advocacy organizations cannot just rely on what might have worked in another state or for another organization. While those experiences may provide some useful insight into strategies that should be explored, one state’s experience is not always directly transferable to another. Each state, each organization, and each national association may need to reexamine its role, form new networks, and evaluate issues as they emerge.

Consumer advocacy organizations cannot rely solely on experiences from other deregulated industries. One factor that separates the utility industry from other previously regulated industries is that the utility industry has a number of highly skilled, institutionalized consumer advocacy organizations. Restructuring the utility industry provides a unique opportunity for consumer advocacy institutions to make a transition to dealing with competitive businesses in less-regulated markets. Their experience in making this transition may help show the need for similar types of consumer advocacy organizations to protect consumers in other competitive markets.

It is possible that over time, at least in some states, the functions of utility consumer advocates will be a routine part of a larger consumer protection and consumer education organization, but the transition from the current, regulated utility industry to a less-regulated industry structure will be complex and difficult. Consumer advocates are needed to ensure that the new industry structure contains protections for consumers and that educational programs promote smart shopping in the new market. The work load will be enormous, the issues will be complex, funding sources will change, and coalitions will shift. Strong consumer advocates can help assure that the new utility industry provides safe and reliable service to all consumers at affordable prices.
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Private and Public Utilities Agree...

Federal “Private Use” Tax Rules Prevent Community-Owned Utilities From Fully Participating in the Competitive Electricity Marketplace

Problem
Community-owned utilities currently face outdated federal tax law barriers which prevent their full participation in the rapidly-changing electricity marketplace. Existing Federal tax rules (“private use” rules) will limit the ability of public power systems to continue to provide electricity to consumers in a restructured electricity market, where flexibility is the key to survival. Attempting something as basic as retaining their existing customers could cause the tax-exempt bonds that public power systems used to finance their infrastructure to become retroactively taxable, resulting in a very costly and problematic situation for both the cities and their bondholders. Current private use rules inhibit community-owned utilities from joining Regional Transmission Organizations (RTOs), which will hamper critical transmission grid and system reliability.

Solution
In order to allow community-owned utilities the ability to fully participate in the emerging deregulated electricity marketplace, industry stakeholders, both public and private systems, have agreed that the following modest modifications to the private use rules are warranted:

- **Election and Grandfather for Generation** — Public power systems, as entities of state and local governments, will have the ability to make a local choice on future generation operations. If relief from private use restrictions is needed, these utilities can gain the necessary relief from private use restrictions on outstanding tax-exempt debt, but must agree to refrain from issuing tax-exempt bonds to build most new
generation facilities. If no relief is needed, these systems can continue operating under a clarified version of the existing private use tax rules.

- **Transmission and Distribution Facility Limitations** — New tax-exempt bonds may be issued to finance transmission facilities if those facilities are, or will be, necessary to serve wholesale or retail native load. The use of new tax-exempt debt for transmission is also permitted where the utility is ordered or permitted by a regional transmission organization or state agency to build such facilities. The agreement includes a straight prohibition on using tax-exempt bonds to build "merchant" transmission facilities.

- **No New Restrictions on Distribution Facilities** — No new limitations are imposed on the use of tax exempt-bonds by existing community-owned utilities to finance construction of distribution facilities. As a transition mechanism, newly formed public systems; however, are subject to a 10-year moratorium on the use of tax-exempt bonds to acquire or construct such facilities.

These changes, in conjunction with necessary tax code changes for shareholder-owned electric utilities, form the basis of a reasonable compromise that retains important concepts included in bipartisan legislation (H.R. 721 and S. 386), which has been cosponsored by more than 30 Senators and 130 Representatives. Important concepts retained from these bills are:

- Clarification — of how the existing private use rules will work in a competitive marketplace;
- Choice — provide a statutory mechanism by which public power systems can make an election on whether (a) to lift the private use test on existing generation facilities financed with tax-exempt bonds, or (b) remain subject to private use rules.
- Open Access — encouragement and incentives for community owned utilities to open up their transmission and distribution facilities, thereby providing more electricity choices to consumers.
Background

Community-owned utilities, as entities of state and local governments, have used tax-exempt debt to finance their utility infrastructure in much the same way any city would to finance schools, roads and bridges. Public power systems cannot issue stock to raise capital and have no other real source of financing these large capital projects other than municipal bonds. In exchange for the use of tax-exempt debt, public power systems are required to adhere to a strict set of federal tax rules and regulations designed to limit the amount of power that they can sell to private entities. These rules limit a community-owned utility’s ability to negotiate contracts with existing customers, resell excess power resulting from competition (“lost load”), and discourage the opening of transmission lines — which were financed with tax-exempt debt.

Like many rules and regulations currently in effect, yesterday’s private use rules are not suitable for today’s competitive environment. What might have been manageable and appropriate in an era of strict regulation is proving to be wholly unworkable in a restructured marketplace. In fact, as more and more states implement their own electricity restructuring plans independent of federal legislation, the private use rules have begun to hamstring community-owned systems’ ability to adapt to the changing business environment. Equally important is the problem that these rules present for community-owned utilities to participate in progressive energy policy developments that are necessary to provide continued high levels of reliable and affordable electric service for all electricity consumers.

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September 2000
Private and Public Utilities Agree . . .

Tax Law Changes Are Urgently Needed to Smooth the Transition to Electric Competition and Protect Reliability

Problem
Action is needed now to bring the Internal Revenue Code (Code) into line with changes in the electricity industry so that electric competition can grow and the reliability of the electric system will be maintained. Action is urgently needed because of two approaching deadlines: October 15, 2000, for the formation of regional transmission organizations (RTOs) under an order issued by the Federal Energy Regulatory Commission (FERC), and January 23, 2001, when temporary Treasury Department regulations expire. These regulations are intended to enhance electric competition by allowing competitive power suppliers to use the distribution and transmission facilities of community-owned utilities. Tax law changes are needed now as a result of these government directives, and to allow efficient markets to develop in the 24 states and the District of Columbia that have adopted electric competition. Resolution of these issues will also help additional states to adopt competition in the near future.

A fully competitive electricity market will include a variety of electricity suppliers. Among those suppliers will be for-profit, taxable entities; public power providers (that are not-for-profit); and local agencies. Each type of market participant faces tax barriers to participate in competitive markets. Congress should enact "The Electric Power Industry Tax Modernization Act" (H.R. 4971, S. 2967), legislation which offers a balanced approach to a fair and open marketplace. This legislation, which needs the urgent attention of the 106th Congress, addresses four major issues.
Solution

Private Use Relief: Tax-exempt financed generation, transmission, and distribution facilities of community-owned electric utilities are subject to "private use" limitations. These limitations make it difficult or impossible for such utilities to permit open access to transmission and distribution facilities as required or encouraged by state and federal laws and regulations. This inability to provide open access to transmission inhibits competition and poses significant reliability problems for the electricity grid, because it limits the amount of electricity reserves that can be transferred to areas with high demand. The U.S. Treasury Department issued temporary and proposed regulations to address these problems. However, the regulations provide insufficient relief, and they expire on January 23, 2001. Only Congress can provide a complete and permanent solution.

Transmission Tax Relief: Under FERC Order No. 2000, issued in December 1999, all transmission-owning electric companies are required by October 15, 2000, to articulate their plans to join an RTO or to explain why they cannot, and set forth a plan for further action. Under current tax laws, transmission-owning utilities that sell or spin-off their transmission assets to form RTOs would incur a substantial federal income tax liability.

The solution to this dilemma, which arose from a government mandate, is to amend Section 1033 of the tax code to permit sales of transmission assets on a tax-deferred basis if these sales occur in conformance with FERC Order No. 2000 (or related state mandates), and the proceeds of the sales are reinvested in certain utility assets. Similarly, Code Section 355(e) should be amended as an alternative to permit a non-taxable spin-off of transmission assets, even if the assets are to be combined with neighboring transmission assets in conformance with Order No. 2000. These tax law changes will further diminish tax barriers to wholesale and retail competition by creating truly independent transmission organizations.

Contributions in Aid of Construction (CIAC): Under current federal tax law, the costs of building new transmission and distribution facilities for homes, commercial properties, and
industrial sites — indeed, any kind of property where connection costs are paid by a developer or interconnecting third party to a utility — are treated as “contributions in aid of construction” ("CIACs") and are considered as taxable income to the utility. CIACs typically involve reimbursing a utility for those expenses related to expanding or upgrading utility services, such as distribution and transmission lines, to serve new development. The result is that a developer or interconnecting third party must reimburse a utility for construction costs plus a federal income tax of about 31 percent.

By treating the reimbursement of costs of interconnections to transmission and distribution facilities as non-taxable, policymakers would remove a barrier to competition by making it less costly to provide services. This would help increase the supply of power and improve electric reliability. It would also help to eliminate any barriers to the construction of new distribution facilities on behalf of third parties, such as developers of housing and commercial and industrial projects.

**Nuclear Decommissioning Funds:** Owners of nuclear power plants make contributions to external trust funds to ensure that monies are available to decommission plants when they are retired. Congress added Section 468A to the Code in 1984 to permit owners of nuclear plants to currently deduct a portion of the contributions that are made to the external funds. Section 468A, when enacted, was designed to operate within the structure of regulated rates. It depends on public service commissions authorizing specifically identified costs (such as decommissioning expenses) that an electric utility can charge its customers.

Congress should adapt Section 468A of the Code to the structure of competitive markets. “The Nuclear Decommissioning Restructuring Act” (H.R. 2038 and S. 1308), contained in “The Electric Power Industry Tax Modernization Act” (H.R. 4971 and S. 2967), will adapt Section 468A of the Code to competitive markets, while preserving the original intent. Moreover, this legislation would also facilitate the transfer of nuclear facilities to new owners in compliance with state and federal directives.
Background

Over the last four years, Congress has considered comprehensive electric utility restructuring legislation. This is a complex and controversial issue, and no federal legislation has been enacted to date. Nevertheless, 24 states have adopted competition, and FERC is moving ahead with the formation of RTOs to facilitate the formation of competitive markets. The problems under the federal tax code facing electric utilities are immediate, and they are the direct result of restructuring activities that have already occurred. They must be addressed now, so that the effects of the tax code will help — not hinder — the development of electric competition and the maintenance of a reliable electric system.

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September 2000
Private and Public Utilities Agree . . .

Remove the Tax on “Contributions In Aid of Construction” to Facilitate Electric Reliability, Increased Electric Supply, and Competition in Electricity Markets

Problem
Federal tax law currently raises the cost of connecting new electric generation systems and other types of facilities, when they are connected to an electric utility’s transmission or distribution system, by treating the reimbursement of costs of interconnections as taxable income to the utility.

Solution
Treat the reimbursement of interconnections for transmission and distribution facilities as non-taxable contributions to capital. With this tax law treatment, a barrier to competition would be removed by making it less costly to provide electric services. This would help increase the supply of power and improve electric reliability. It also would help to eliminate any barriers to the construction of new distribution facilities on behalf of third parties, such as developers of housing and commercial and industrial projects.

Background
Under current federal tax law, the costs of building new transmission and distribution facilities for homes, commercial properties, and industrial sites — indeed, any kind of property where connection costs are paid by a developer to a utility — are treated as “contributions in aid of construction” (“CIACs”) and are considered as taxable income to the utility. CIACs typically involve reimbursing a utility for those expenses related to expanding or upgrading utility services, such as distribution and transmission lines, to serve new development. The result is
that a developer must reimburse a utility for construction costs plus an additional tax cost of about 31 percent.

In addition, third parties seeking to interconnect new generation facilities to a utility’s transmission or distribution system may be required to reimburse utilities for the construction fees associated with the interconnection. The tax law should be clarified that such a reimbursement does not result in an additional 31 percent in taxes. Eliminating the tax on CIACs helps improve reliability by lowering the costs of enhancing distribution and transmission systems through reducing the costs of interconnections.

In an effort to find new sources of revenue, the Tax Reform Act of 1986 changed tax law to treat CIACs as taxable income to the utility that receives the contribution. In many states, the state regulatory commission requires that developers reimburse the utility for the construction costs (i.e., the CIAC) and the tax costs imposed on the CIAC. It is appropriate to remove the income tax on CIACs because, under the principles of utility ratemaking, the utility is not entitled to earn any return on the property that was constructed. Thus, a CIAC really has more in common with a contribution to capital than with revenue resulting from providing utility services.

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September 2000
Private and Public Utilities Agree . . .

Remove the Tax Penalty for Compliance with Federal Regulations to Facilitate Formation of Competitive Electricity Markets

Problem
Under Order No. 2000 (Order), issued by the Federal Energy Regulatory Commission (FERC) in December 1999, all transmission-owning electric companies, subject to FERC jurisdiction, are required by October 15, 2000, to articulate their plans to join a regional transmission organization (RTO), or to explain why they cannot and set forth a plan for further action. RTOs must be operating by December 15, 2001, and would operate the combined transmission systems of most or all of the electric utilities in a region. The Order also provides that an RTO must not be controlled by any of the companies that comprise the RTO or use its transmission facilities. Companies that comprise RTOs and other market participants may initially own up to 5 percent of an RTO, but ownership by a class of participants is limited to 15 percent. Companies that comprise RTOs and other market participants may have unlimited passive ownership.

Under current tax laws, transmission-owning utilities that sell or spin-off their transmission assets to form RTOs would incur a substantial federal income tax liability. Utilities can avoid the tax consequences if they become passive owners of transmission facilities by relinquishing control of their facilities to others. However, passively separating ownership from control undermines efficient transmission operations and provides no incentive for owners to invest in new facilities. Passive ownership is a poor substitute for true independence. It requires complex and inefficient corporate structures. Recent experience shows that the value of assets will decline, and operating costs will increase under such structures. In addition, because companies
would have little incentive to upgrade transmission facilities, reliability could be harmed. Thus, resorting to passive control does not really solve the problems of utilities that must form an RTO.

Solution
Amend Internal Revenue Code (Code) Section 1033 to permit sales of transmission assets on a tax-deferred basis if these sales occur in conformance with FERC Order No. 2000, providing that the proceeds of the sales are reinvested in certain utility assets. Similarly, Code Section 355(e) should be amended to allow for a tax-free spin-off of transmission assets, even if they are to be combined with neighboring transmission assets in conformance with the Order.

Background
FERC believes that RTOs will facilitate competition by expanding and simplifying markets for electricity. Thus, in December 1999, FERC issued Order No. 2000 to encourage formation of RTOs. Under an RTO, transmission-owning utilities in a given geographic area that can do so would place their transmission facilities under the control of the RTO. If utilities sell or spin-off their transmission facilities to form an RTO, the transaction would be taxable. A company should not incur a tax liability for complying with government policies seeking to restructure an industry. Public policy should ensure that neither the utilities which comply with FERC’s Order, nor the customers, who do business with new RTOs, suffer economically from imposition of federal income taxes on compliance transactions.

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Private and Public Utilities Agree . . .

Amend the Nuclear Decommissioning Tax Law to Adapt It to the Competitive Electricity Industry

Problem
Current tax law allows for the accumulation of funds in external trusts that are needed to pay for the decommissioning and safe retirement of nuclear power plants. Section 468A of the Internal Revenue Code (Code), which was designed to operate within the structure of a regulated electric utility industry, allows owners of nuclear power plants to make tax deductible contributions to the external trusts. However, the federal government is encouraging the movement of the industry to competition, and half of the states have adopted or endorsed such competition, which uses market-based prices to pay for power rather than regulated rates.

Solution
Congress should adapt Section 468A of the Code to the structure of competitive markets. “The Nuclear Decommissioning Restructuring Act” (H.R. 2038 and S. 1308), contained in “The Electric Power Industry Tax Modernization Act” (H.R. 4971 and S. 2967), would adapt Section 468A of the Code to competitive markets while preserving the original intent. Moreover, this legislation would also facilitate the transfer of nuclear power facilities to new owners in compliance with state and federal directives. The Act would:

- operate independently of cost of service ratemaking to permit taxpayers to continue to receive tax deductions for accumulating properly identified nuclear decommissioning costs in external trusts;
- provide flexibility to taxpayers to allow accelerated funding of nuclear decommissioning costs to these external trust funds where allowed by regulators, in order to accommodate a wide variety of state restructuring initiatives;

1651

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• allow accelerated funding of nuclear decommissioning costs, where required, in connection with the transfer of a nuclear power plant;
• eliminate a discriminatory feature of current law so taxpayers can accumulate additional funds needed for decommissioning on a tax-deductible basis irrespective of the age of their plants;
• define “nuclear decommissioning costs” and acknowledge that they are currently deductible when they are paid or incurred; and
• discontinue the requirement that taxpayers obtain a ruling from the IRS before making deductible contributions to the external trust funds.

Collectively, these changes should preserve the ability of taxpayers, in today's competitive electricity industry, to accumulate funds necessary for decommissioning the country's nuclear power plants.

Background
Owners of nuclear power plants make contributions to external trust funds to ensure that monies are available to decommission plants when they are retired. Congress added Section 468A of the Code in 1984 to permit owners of nuclear power plants to currently deduct contributions that are made to the external funds. Section 468A, when enacted, was designed to operate within the structure of regulated rates. It depends on public service commissions authorizing specifically identified costs (such as decommissioning expenses) that an electric utility can charge its customers. The annual contributions to the external trust funds typically extend over the period of years that the public service commission authorizes the utility to recover its capital investment and operating costs (including decommissioning costs) of a nuclear power plant from its customers.

As a result of the Energy Policy Act of 1992, restructuring laws in almost half of the states, and Federal Energy Regulatory Commission policies, the electric utility industry is in the process of deregulating. In the future, an electric utility may not be in a situation where decommissioning costs are included in its regulated and recoverable costs of service. Rather, such costs could be left to the plant owner to provide through revenues from market-based, or competitive prices.
As now structured, Section 468A requires that deductible contributions be determined by the amount of decommissioning costs included in a company’s cost of service. If the law is not changed, taxpayers who sell power based on market rates may be unable to deduct amounts identified for future decommissioning costs. Therefore, funds collected for decommissioning may be depleted needlessly by income taxes that would be incurred under current tax law because of the failure to meet the connection required by Section 468A to traditional cost of service ratemaking.

More Information?
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