

MINUTES

Electric Services in an Annexed Area

Senator Alan Solano, Chair

Representative Thomas Brunner, Vice Chair



**First Meeting, 2019 Interim
Thursday, July 25, 2019**

**Room 414 – State Capitol
Pierre, South Dakota**

The first interim meeting of the 2019 Electric Services in an Annexed Area Committee was called to order by Senator Alan Solano, Chair, at 10:01 a.m. (CDT) on Thursday, July 25, 2019.

A quorum was determined with the following members answering roll call: Senators Lee Schoenbeck, Alan Solano (Chair), Susan Wismer, and Jordan Youngberg; and Representatives Shawn Bordeaux, Thomas Brunner (Vice Chair), Kirk Chaffee, Spencer Gosch, and Tim Reed.

Staff members present included Alex Timperley, Legislative Attorney; and Rachael Person, Senior Legislative Secretary.

NOTE: For purpose of continuity, the following minutes are not necessarily in chronological order. Also, all referenced documents distributed at the meeting are attached to the original minutes on file in the Legislative Research Council office. This meeting was web cast live. The archived web cast is available on the LRC website at sdlegislature.gov.

Opening Remarks

Senator Solano welcomed everyone to the meeting and commented on the number of people in attendance, stating it was a tremendous occurrence for an interim summer study. He highlighted the four areas of focus for the committee designated in statute: (1) the option of a municipal electric utility to provide electric service in an annexed area and associated process; (2) economic development practices of electric utilities as it relates to the first area of focus; (3) the history of assigned service territories; and (4) the process by which electric utilities set rates. He reminded everyone in the room the meeting was centered on creating a foundation as to the different areas of electric services in South Dakota and a grounding as to how processes have evolved through history so the committee can look at what is taking place now, what could be done in the future, and what other states might be doing. Senator Solano also encouraged everyone to remember this may be a highly debatable topic, but the ultimate goal is to ensure the residents of South Dakota have access to reliable and quality services.

Review of Statutory History and the Laws in Surrounding States

Mr. Alex Timperley, Legislative Attorney, Legislative Research Council, gave an overview of the three types of electric utilities present in South Dakota. Investor-owned, municipal-owned, and cooperative utilities have all been around for a number of years and the specific issue in front of the committee now is what happens when a municipality annexes a new area and the area has been receiving services from a cooperative or investor-owned utility.

The general process for newly annexed areas and how they would be allocated was decided in 1975. Prior to 1975 some overlap existed, and consumers still had a choice as to who provided their electricity. However, in 1975 a law was passed that gave electric utilities their own service territories with exclusive rights to provide

service. Once the boundaries were laid out, the law allowed for a change in those boundaries if a municipality annexed a new area. Changes to statute were made in 1992 and 2009 which were illustrated by a hand out Mr. Timperley provided. The most notable change throughout the years is the portion of statute detailing how the purchase price would be calculated.

Mr. Timperley then discussed the different methods surrounding states employ with annexations. The first method is that the annexation does not affect the rights of the utility previously serving the annexed area. The second, a municipality adding territory would be required to provide just compensation under their general eminent domain law using a more general calculation to determine the payment made to the former utility. And third, is a method similar to South Dakota, where a municipality can add territory in a newly annexed area under a calculation specifically provided by statute which can be reviewed by the local Public Utilities Commission or a similar board.

The Role of the Public Utilities Commission

Mr. Chris Nelson, Public Utilities Commissioner, Pierre, spoke about the Public Utilities Commission's (PUC) involvement with the territory law, and started by emphasizing the exceptional quality of the electric service provided by all three types of utility providers in the state and that South Dakota citizens are well taken care of.

The basis of the territory law states where the utilities were providing service on March 21, 1975, that is where their territories would be established. By July 1, 1976, the PUC created the official territory maps for the state and in 2008 they initiated the process of digitizing those maps and providing precise legal descriptions for the territory boundaries. Utilities are given exclusive rights to serve within those territories with some exceptions provided for in law. Routinely, in situations where a new customer is building a house in the lines of Utility A but the electric lines of utility B may be in closer proximity to the new house and it is cheaper for the customer to use utility B, the utilities and the customer will ask the PUC for an exception to provide cheaper service to the customer. Commissioner Nelson said the incumbents are very willing to allow these exceptions to happen for the benefit of the customer. Another exception is the large load exception. If a new customer projects in excess of a 2-megawatt contracted minimum demand load, they are not required to take service from the incumbent. If they find a provider other than the incumbent provider, they will bring the exception to the PUC.

Commissioner Nelson touched on the rate-setting portion designated in statute and said the PUC is involved with setting the rates for customers of investor-owned utilities but is not involved with setting the rates for co-ops or municipal electrics.

Representative Bordeaux asked what the implications would be if one of the tribes started its own utility and how that would affect the regions with trust lands in several counties where another utility is providing services to that tribe.

Commissioner Nelson said electric areas are very static and there is nothing, other than statutes currently in place, that would give the incumbent the right to exclusively serve that territory or the ability for a new utility to form and take over the territory.

Representative Brunner asked for clarification in the case of the customer choosing one utility over the other stating the utility who has the territory where the new house is built still has the first right to serve the customer.

Commissioner Nelson replied that is correct; however, the utilities are phenomenal at working together to provide the cheapest utility for the customer.

Senator Solano asked if Commissioner Nelson has heard any of the same concerns from other public commissions across the nation and if they are tackling the same issues or if this issue is more isolated to South Dakota. Commissioner Nelson responded this topic has not come up in any of the presentations or discussions he has been a part of at national or regional meetings.

Electric Cooperatives

Ms. Darla Pollman-Rogers, SD Rural Electric Association (SDREA), stated the legislature properly determined that assigning exclusive territory to each utility was in the public interest because it avoided duplication of facilities, unnecessary encumbrance of the landscape, and permitted utilities to plan a system to serve all their assigned territories. SDREA introduced Senate Bill 66 (SB66) in an effort to level what is seen by some as an uneven playing field. Ms. Pollman-Rogers pointed out as the current process stands, once a city annexes a territory its municipal electric has one year to give notice to the incumbent utility provider that it will be furnishing electric service in the newly annexed area and no negotiations, recourse, or right to appeal the process exists for the incumbent utility. Another issue that arises often is what is known as “cherry picking.” This can be seen as a flaw in the process, which allows municipal electrics to annex areas to include preferred, larger customers and leave behind smaller customers. Acknowledging the compensation formula set in statute, Ms. Pollman-Rogers stated the formula does not adequately compensate the utilities for lost territory or the opportunity to provide electric service to present and future members. While a municipal electric utility has the ability to expand their territorial lines, private providers are not allowed to expand in the same fashion causing permanent detriment to the private electric service providers.

Mr. Tim McCarthy, CEO and General Manager, Sioux Valley Energy, echoed Ms. Pollman-Rogers’ statements and added the private electric providers do not want to take customers or territory outside of their limits, they want to sell electricity to the areas defined as their service territories. Mr. McCarthy said because the private electric service providers do not have the ability to negotiate terms they lose potential revenue forever. Over the last 20 years, Sioux Valley Energy has been compensated 2.1 million dollars for lost territory under the current compensation formula; however, they have lost an estimated 21.5 million dollars of revenue. Mr. McCarthy illustrated some examples of “cherry picking” in his area and asked that all utilities be given a level playing field.

Mr. Dave Eide, General Manager, Coddington-Clark Electric Cooperative, Inc., added many believe that enacting SB66 will restrict a municipality’s ability to grow. Mr. Eide alluded to the city of Watertown and the 5,000 acres of bare ground currently within the service territory. He expressed the only time territory is taken away from Coddington-Clark Electric is when a housing development is about to go in. Mr. Eide also illustrated some examples of “cherry picking” and pointed out a loss of electric service territory causes lost revenue for the company creating higher electric rates for the remaining customers.

Mr. Chris Larson, General Manager, Clay Union Electric, touched heavily on the compensation side of the current statute. He referred to the 11-year compensation window provided for in statute and said this does not work when the land annexed is bare ground at the time of the annexation. If that ground is not developed within the 11-year window, the cooperatives do not receive compensation for the lost ground. If compensation is received, the compensation pales in comparison to the revenue lost every year due to lost territory. This loss in revenue

can be detrimental to cooperatives because it shifts a burden onto the members of the cooperative causing them to pick up more of the cost to pay for reliable infrastructure.

Senator Youngberg asked if the loss of compensation, going forward, would be an issue of compensation rate or boundary lines. Mr. Larson responded a compensation rate doesn't really exist, the process is straight forward about the amount that will be received and what is being recuperated is the depreciated cost. Low compensation amounts can be caused by annexations involving bare ground where no facilities exist.

Ms. Linda Salmonson, Economic Development Manager, East River Electric Power Cooperative, spoke to the committee about economic development in general, what drives it, and how electric cooperatives support it. Ms. Salmonson said electricity is essential when it comes to economic development, but it is not the primary driver in the site selection or decision-making process. Ms. Salmonson stated the cooperatives established the REED fund which allows them to play a role in economic development by lending money to the areas of business, agribusiness, community projects, and housing developments. She explained the REED fund in depth and said the changes proposed in SB66 would have no adverse effect on the economic development in South Dakota.

Municipal Electric Utilities

Mr. Matt McCaulley, Lobbyist, Heartland Consumers Power District, spoke on behalf of the Coalition to Preserve Consumer Choice. He suggested the committee resolve the issue not by picking winners and losers but by picking a working system. Rural electric cooperatives serve a necessary service in electrifying rural South Dakota and they should be proud of fulfilling the vision set out in front of them in terms of electrifying rural South Dakota, but cities should be permitted to continue to grow under a system that has provided remarkable stability for the past forty years. Mr. McCaulley said the proposed territory freeze would eliminate what little consumer power choice exists in the law today and would lock customers into paying the higher rates usually experienced with rural electric power.

Mr. McCaulley stated it is difficult when you hear the term "cherry picking" because the person who is not involved in the conversation is the property owner who may have asked to be part of the city or may have wanted only a portion of their property annexed into the city; and it is important to remember the property owners and what they want in a situation such as this. Rural property owners should have the opportunity to decide if they want to be a part of the city and take advantage of not only the electric service but water, sewer, emergency, drainage, and pest control services, among many others.

Mr. McCaulley stressed that if SB66 had passed, adopting that freeze would have been the first time in South Dakota history that cities would have been frozen from expanding the services they provide their citizens. When looking at a proposed solution, it is important to look at the Constitution and ask if the proposed solution is actually going to work, if rate payers are going to be locked into higher prices, and what will the impact be.

Mr. Steve Lehner, General Manager, Watertown Municipal Utilities, clarified some points made earlier regarding his territory. He stated Watertown has a larger territory than the city limits, so they have option to grow. Mr. Lehner also stated the annexations that have occurred have been voluntary annexations where the developer and business owners asked to be annexed into the city.

Mr. Steve Myer, General Manager, Brookings Municipal Utilities, added the annexations do not occur on a whim, but involve a property owner or developer asking to be a part of the city. Knowing when and where these

occurrences are going to happen is almost unpredictable and is one of the biggest challenges to all cities and those providing service.

Investor-Owned Electric Utilities

Mr. Steve Willard, SD Electric Utility Companies, highlighted customers in his testimony and stated the customers had not been a highly discussed topic in the day's proceedings. He reminded everyone that they are called customers because the utilities do not exist without them. Mr. Willard commented the Investor-Owned utilities are essentially on both sides; a freeze is good for them because it is predictable, but it is also a fact that there is no "one-size-fits-all" solution. More importantly, at the end of the day, everyone should be working towards what is best for the customers of South Dakota.

Mr. Brett Koenecke, SD Electric Utility Companies, represents utility and energy companies in front of the PUC. He pointed out that service territory is important to all three different methods of delivering electricity, but it's important to keep in mind that whatever is done has a broad reaching impact and will have to be put into effect by a lot of people, including customers, businesses, courts, investors, the PUC, and customers who are customers of multiple entities. He said the state has enjoyed a long run of regulatory stability in this area in contrast to how things were working prior to 1975.

Ms. Pam Bonrud, Director of Government and Regulatory Affairs, Northwestern Energy, spoke about the economic development projects Northwestern Energy is a part of and provided a handout showing their community service activities.

Mr. Justin Dever, MDU Resources Group, spoke on behalf of Montana Dakota Utilities, their services, and their economic development practices.

Mr. Steve Kolbeck, Principal Manager, Excel Energy, spoke on behalf of Excel Energy, describing their services and various economic development projects.

Public Testimony

Mr. Al Heutan, Director of Economic Development Corporation, Brookings, touched on economic development and stated every community is different. In regard to economic development, shovel ready sites are extremely important in being able to compete in national or statewide competitions to recruit businesses to communities. Many people in both rural and city environments benefit from economic development. Brookings Municipal Utilities, because of the way the law has worked in South Dakota, has been able to generate revenue from sales of electricity to its consumers which they, in turn, provide back to the city to pay for economic development. If SB66, as it was introduced, was in place twenty or thirty years ago, Brookings would not have some of the economic developments they have today which have produced massive benefits for everyone involved.

Mr. Jared Knock, customer, Coddington-Clark Electric, asked that the co-op format be strengthened. He voiced his concerns with the current process and said as a farmer at the end of the territory line in Coddington-Clark's territory, he personally feels the weight of annexation as more and more land is being annexed into the city and the members of the co-ops who are the farthest away from, and the least desirable for, the municipalities are forced to pay more, have less access, and become the most vulnerable for continued service.

Ms. Sarah Caron, Mayor, City of Watertown, urged the committee to consider the public welfare in the deliberations. Ms. Caron said SB66 is bad for towns and the state of South Dakota because companies come to the town requesting annexation because of the total package of services that can be provided. Having the ability to offer services is an important economic tool and removing it weakens the power of negotiation when towns are trying to attract new businesses.

Mr. Bob Pesall, City Alderman, Flandreau, explained how the profits generated from the municipal utility in Flandreau are put into other public works and the residents of the city get to vote on how that money is used. He then explained what would happen in a community like Flandreau if the city was prevented from expanding.

Mr. Jameson Berreth, City Administrator, Volga, pointed out people have spent a lot of time talking about the bigger cities in the state, but the issue will have a negative impact on the smaller communities trying to provide the best, most reliable services for their citizens as well. Mr. Berreth explained if territories were frozen, and the customers did not have the ability to choose where they received service, Volga would not have been able to attract the Prairie Aquatech facility which has been a great advantage for his town. He asked the legislature to allow towns such as his to continue providing all electric and municipal utilities as a package to potential customers.

Closing Remarks

Senator Solano touched base on the list of the requested information created during the course of the meeting. He then asked the committee to scrutinize the questions to make sure the questions being asked will allow for information that can be used in the decision-making process going forward.

The next Electric Services in an Annexed Area meeting will be August 28 in Pierre starting at 10:00 a.m. (CDT).

A motion to adjourn was made by Representative Brunner, seconded by Representative Chaffee. The motion prevailed on a voice vote.

The Committee adjourned at 3:55 p.m.