

MINUTES

Electric Services in an Annexed Area



Senator Alan Solano, Chair

Representative Thomas Brunner, Vice Chair

**Second Meeting, 2019 Interim
Wednesday, August 28, 2019**

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

The second interim meeting of the 2019 Electric Services in an Annexed Area Committee was called to order by Senator Alan Solano, Chair, at 10:07 a.m. (CDT) on Wednesday, August 28, 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 explained the information that would be available online and unavailable to the private sector. He also discussed his plans for the future of the committee, stating this second meeting would be the last to include the back and forth testimonies. The third meeting will be focused on legislative drafts.

Municipally Owned Utilities

Mr. Matt McCaulley, Lobbyist, Heartland Consumers Power District, said the goal and the scope of the summer study is laid out, but the specific problem to be addressed with drafted legislation is not. Mr. McCaulley emphasized the rural electric cooperatives provide a necessary service in electrifying rural South Dakota and cities should be permitted to grow under a system that has provided stability over the last forty years.

Mr. McCaulley acknowledged it is easy to focus on the fight between the Rural Electric Cooperatives (RECs) and the cities and ignore other important aspects such as the principle of opportunity, keeping the state's business climate friendly, and focusing on the property owners. He stated the importance of focusing on the property owners, the decisions they're making, and that every situation across the state is unique.

Mr. McCaulley also touched on terms commonly used concerning annexation and offered information to suggest the terms are being misused to portray a different image of the situation. He asked the committee to think about what is driving the desire to freeze customers in territories. Mr. McCaulley then spoke briefly on the South Dakota Rural Electric Association's (SDREA) partnership with Basin Electric and how the SDREA is feeling pressure to help fund the North Dakota Basin Bailout.

Senator Solano reminded everyone the committee needs to stay focused on what will impact South Dakota electrification.

Representative Brunner referred to the language of proponent and opponents being used in testimony and suggested the language was premature as nothing presented would make anyone an opponent or a proponent as the committee is a summer study to gather information on the topic.

Mr. Casey Crabtree, Director of Economic Development, Heartland Consumers Power District, spoke on the economic development projects Heartland has been, and is currently, involved with and placed strong emphasis on the importance shovel ready sites play in economic development and the opportunities for growth.

Mr. Crabtree showed examples of areas classified under cherry picking at the last meeting and explained the reasoning behind why certain areas were annexed and others were not. By using the situations to draw attention to the property owners Mr. Crabtree reiterated that annexation occurs when property owners ask to be part of the city utilities.

Mr. John Prescott, City Manager, Vermillion, outlined a wheeling agreement between Vermillion and East River Electric and informed the committee of what has occurred with that agreement since its inception. He also referred to examples presented at the last meeting regarding Vermillion and explained the purpose of the annexations and how they benefitted the customers and property owners involved. Mr. Prescott stated economic development is not about building another meter, it is about building communities.

Mr. Adam Karst, Director of Administration and Finance, Watertown Utilities, gave a brief summary of the loan to the Watertown Development Company discussed at the last meeting. Mr. Karst spoke briefly on the importance of shovel ready sites and how the recent investments made in Watertown tie to electric revenue and reinvestment in economic growth.

Mr. Steve Meyer, General Manager, Brookings Municipal Utilities, shared a different perspective on the \$21.5 million dollars of lost revenue quoted by Sioux Valley Energy. He reminded the committee the number is an estimate of lost gross revenue with no operating or other expenses applied against it. Mr. Meyer stated a lot of subjectivity exists in creating estimates of this kind and the biggest assumption is that the customer would have been attracted to the different properties if the city had not been serving them.

Mr. Larry Nelson, Lawyer, Canton, gave a brief synopsis of what was happening in the electric industry from 1963-1975, and the Territorial Integrity Act of 1975. Mr. Nelson said the law protects the public interest, there is no right of the RECs for service area, and cities should have the right to serve their residents and not be prevented from growing.

Remarks

Senator Solano noted the ability to choose service provider was a topic discussed during the testimonies, but clarification was needed on if a customer within an annexed area could choose to stay with a rural electric and not go with the municipal electric service. He also asked for clarification on operating expenses per meter and why Vermillion was lower than other municipal electrics, and percentages over the last ten years of annexation and how it relates to the estimated percentage of bare ground in annexed areas.

Rural Electric Cooperatives

Mr. Edward Anderson, General Manager, SDREA, said the issue is not about annexation as the SDREA supports annexation. Annexation and the taking of an incumbent utility are not tied together. He stated that a number of successful growing communities continue to thrive without the benefit of a municipal utility system and electric cooperatives are more than capable of serving loads within expanding municipal boundaries.

Referring to the data requests made by the committee, Mr. Anderson listed the four focus areas of the study scope and said reconciling these topics with the majority of the questions raised and submitted as data requests is a struggle for the cooperatives as most of the questions were structured in a way that makes meaningful comparisons difficult to obtain. In those cases where reasonable comparisons are possible, the cooperatives still do not perceive any valid contribution to the work of the committee on the framework of Senate Bill 66.

Mr. Andy Buntrock, Director of Strategic Planning and Communications, Basin Electric Power Cooperative, responded to the statement made about the SDREA feeling pressure to help fund the North Dakota Basin Bailout and provided the committee with information concerning accusations made against Basin Electric and electric cooperatives ([Handout 1](#)). Mr. Buntrock said South Dakota cooperatives are not looking to change the law to subsidize Basin Electric and Dakota Gas. Basin Electric is in stable financial condition and any financial information taken out of context to indicate that seeking fairness in electric utility service territories is about subsidizing Dakota Gas is false.

Mr. Ted Smith, Director of Engineering and Operations, Sioux Valley Energy, explained the System Average Interruption Duration Index (SAIDI), the System Average Interruption Frequency Index (SAIFI), and the reliability of service cooperative members experience. Sioux Valley's members have power 99.9% of the time. When comparing standards, the density and number of consumers can make a big difference in the reliability numbers. The service territories of the electrical cooperatives are expansive compared to the service territories of the cities and comparing reliability numbers without context can be misleading.

Mr. Smith explained examples of cooperative facilities near larger cities with municipal electric systems, pointing out that as territory is continuously lost, the ability for cooperatives to plan a successful urban system is virtually impossible. Mr. Smith also spoke in detail about the miles of distribution line and the percentage of overhead and underground infrastructure for the Codington-Clark, Clay-Union, and Sioux Valley Cooperatives.

Mr. Richard Macke, Vice President, Power System Engineering, discussed the rates cooperative members experience and rate-setting process of cooperatives.

Electric cooperatives across the country serve both rural areas and areas with towns. In South Dakota, the cooperatives serve only three customers per mile of line installed which affects rates and rate designs. Cooperatives have a high fixed investment required to serve relatively few customers, which is why cooperatives often have relatively high monthly fixed charges. Being allowed to continue to serve areas of higher population density is of significant economic value to cooperatives and their memberships. Benefit exists in spreading investment and fixed costs over a larger customer base and more sales volume as it dilutes the cost to everyone. Cooperatives plan their systems to serve their entire service territory and they review their policies and rates to ensure they are serving growth that is beneficial to the entire membership.

Every customer presents a unique situation when it comes to rates. Usage levels, seasonality, added equipment such as space and water heaters, multiple rate options and other adjustments make the comparison of rates a difficult topic of discussion and will always create rate disparities between different utilities, and even customers within the same utility.

Mr. Macke also shared statistics showing cooperative rates compared to municipal rates. On average, cooperative residential rates are within 1.6%, or \$1.60 per month, of municipal rates. The cooperative rates for industrial customers were, on average, within 2.5% of municipal rates.

Mr. Bob Sahr, General Counsel, East River Electric Power Cooperative, spoke on the taxes paid by electric cooperatives. Although most cooperatives are non-profits and typically do not pay federal corporate income tax, they do pay significant state and local taxes that benefit the state. The major tax paid by the electric cooperatives is the kilowatt hour tax. In 2019, South Dakota's electric cooperatives remitted \$13.4 million in kilowatt hour taxes. Cooperatives also pay property and wind energy taxes, as well as other taxes and fees most business in South Dakota pay. Combining the three major taxes – kilowatt, property, and wind energy – South Dakota's electric cooperatives paid more than \$18 million in the last year.

Ms. Darla Pollman-Rogers, SDREA, referred to the previous statement regarding Basin Electric and told the committee that Basin Electric has invested over \$500 million worth of infrastructure in South Dakota.

Ms. Pollman-Rogers asked the committee to remember the distinction previously made between annexations and the option of a municipal electric to serve in an annexed area. Once annexation occurs, the option is triggered if there is a municipal electric. A city is not obligated to extend service after annexation, leaving the decision of service to the municipal electric and not the customer. Ms. Rogers stated the problem the electric cooperatives are trying to address is, under the current law, one side has the ability to take service territory and customers from other providers creating a large advantage over the other providers. There should be cooperation among providers to determine the best way to provide services to South Dakota's customers which does not occur under current law in annexed areas, and that is what the cooperatives are asking the committee to fix.

Remarks

Senator Wismer voiced concern over burdening South Dakota customers with the duplication of infrastructure and asked what happens when an area served by a rural electric is taken over by a municipal utility.

Mr. Smith responded the city sends the rural electric notice that an area has been annexed and either makes an offer to purchase the electric facilities in the area or not. If the municipality offers to purchase the electric facilities, they are given a statement of appreciated costs. When a mutual agreement is made, a date for the transfer of service is decided upon. Once the customers are transferred over, the 11-7-year window for compensation begins. Mr. Smith said the municipals may or may not use the facilities purchased from the rural electric.

Investor-Owned Utilities

Mr. Steve Willard, SD Electric Utility Companies, presented the committee with the Investor-Owned Utilities' responses to the data requests ([Handout 2](#)). The handout provided in-depth information regarding the taxes paid by the Investor-Owned utility companies in South Dakota including property, sales, wind, and gross receipts tax.

Mr. Willard discussed the Federal Tax Cuts and Jobs Act passed in 2017, the approved settlements with the Public Utilities Commission, the money refunded, and the ongoing benefits of each company under the Federal Tax Cuts and Jobs Act.

Mr. Willard praised the investor-owned utility companies in South Dakota and their contributions to the volunteer efforts in their communities, their level of dedication to their employees and their safety, and the ways they encourage their employees to volunteer and give back to the communities. Reiterating what was said many times during the meeting, he extolled the utility companies for collectively doing a sensational job of taking care of their customers.

Electric Service Maps

Senator Solano informed the committee they would look at the maps from the Brookings and Vermillion communities. The municipal utility and rural cooperative representatives from each area shared their maps and described their service in the area.

Mr. Russell Halgerson, Electric Department Manager, City of Brookings, gave an overview of the BMU system and broached the topics of stranded investments and duplicate facilities.

Mr. Halgerson highlighted that most municipals own their transmission lines and most rural cooperatives do not. The benefit of owning the transmission lines is the crews are in town and able to respond quickly to get customers back on power if an outage occurs.

If service territory lines were frozen, Brookings would experience significant stranded investment and duplicate facilities. Cities have always had the right to grow which allows the cities a chance for long term planning and proactive investment to build infrastructure. Feeders and substations are installed in preparation of growing in any and all directions. Stranded investment occurs in the form of fully stranded infrastructure, which refers to the feeders and substations installed in the preparation of growth, and future size stranded investment, which occurs when equipment is oversized in preparation for growth and the needed capacity that comes with that growth. If growth never happens, the equipment and facilities are stranded.

Mr. Ted Smith spoke on behalf of the rural cooperatives and gave an overview of the services surrounding the Brookings area. Mr. Smith commented the cooperative has similar urban design as the city of Brookings in some areas where they have the certainty of keeping their territories. The arrangement the cooperatives have of not owning their own substations, as Mr. Halgerson pointed out, works well for the cooperatives. With the arrangement they are able to remain experts in distribution while their supply company is able to remain experts in transmission and substations.

Senator Schoenbeck asked if Mr. Smith would agree with what Mr. Halgerson said regarding stranded costs. Mr. Smith said there would be significant stranded costs on both ends.

Mr. John Prescott and **Mr. Shane Griese, Utilities Manager, Vermillion**, gave a brief overview of the municipal systems in Vermillion.

Mr. Chris Larson, General Manager, Clay-Union Electric, spoke on behalf of the rural cooperatives regarding the Vermillion area.

Public Testimony

Mr. Amel Redfish, Mayor, Arlington, said Arlington owns all of the city's utilities except natural gas. Mr. Redfish provided history on the efforts made and the money spent in order to bring economic development to his town. His community has invested \$2.5 million dollars into a shovel ready industrial park because it needs the revenue to continue to thrive. More land will need to be annexed to entice more people to Arlington and Mr. Redfish said Arlington needs to be able to continue providing their municipal electrical services in order to keep the town growing and surviving.

Mr. Paul Briseno, City Manager, Brookings, stressed the city of Brookings supports the Coalition to Preserve Consumer Choice, and prides itself on providing efficient and effective services. Choice and local control ensures a resilient future for his community. Mr. Briseno said no other entity knows the situation in Brookings like BMU and they rely on the partnership with BMU and their knowledge to grow the community. He asked for continued support for the protection of consumer choice.

Mr. Chris Schilken, Executive Director, Watertown Development Company, briefly discussed economic development in Watertown.

Mr. Brad Lawrence, Utility Director, Madison, commented the issue is not about one load serving entity taking over another load serving entity's granted territory. Municipal government is the embodiment of the public's will. The public has been very conscious of the private property rights of the individuals and generally very protective of those rights. Mr. Lawrence asked what valid reason existed to grant a corporation the ability to thwart the will of the people and stated the flaw in current law is that cooperatives do not own the property being annexed, yet the property owners still have to compensate them for the right to choose their utility provider.

Mr. Fred Weekes, Mayor, Aurora, asked the committee not to forget about the small communities like Aurora that would be affected by changes in existing law and would be stopped from growing entirely.

Mr. Bill Truman, Facility Director, Avera Heart Hospital, Sioux Falls, provided history on the Avera Heart Hospital and spoke favorably about how well the hospital has been served over the years by Southeast Cooperative.

Ms. Kelsey Collier-Wise, President, Vermillion City Council, testified in favor of the Vermillion Municipal Electric Utility. Vermillion citizens and taxpayers benefit from the services and revenue the municipal electric utility provides. Changes to the existing law will limit the growth and result in the loss of citizen benefits, rights provided by municipal government law, and inconsistent and inequitable treatment of some citizens. The current system provides for a balance of interests in the transfer of service territory.

Final Remarks

Senator Solano pointed out that while this is a contentious topic, the one thing everyone agrees on is the high quality of service the citizens of South Dakota experience, regardless of who is providing the service. Citizens of South Dakota are fortunate to have the quality of electric service existing in a state with such a rural and frontier area. When disaster strikes, it was made apparent in the meeting that everyone pulls together to resolve the issues quickly and efficiently and it is important to recognize that. It was also made apparent how much the utility companies care deeply about the safety of their employees and their communities.

When it comes to the disagreements and the issue of locking down territories, Senator Solano commented that locking down territories may not be possible. When territories are up against one another, it is possible to work through a lot of things and he is interested in looking at how communication, understanding, and planning together can be ensured.

Representative Brunner agreed with Senator Solano and said the committee needs to focus on what will make things work better for everyone involved. He emphasized there will need to be give and take from everyone involved. It is hard to vote and solve a problem that can be solved within the industry. Representative Brunner urged everyone to look at how much they have in common and the opportunities that exist in the state to cooperate and work together and encouraged the free flow of ideas that could help move the issue forward.

Senator Schoenbeck mentioned the cooperation already happening presents an interesting dynamic compared to everything heard in the meetings so far. Everyone has pointed out where the divergences are but most of the time those divergences do not occur. Senator Schoenbeck said if the committee was starting from scratch things may be done differently, but they should start from what exists currently and focus on working together as a lot of business cooperation is missed when the focus rests solely on differences.

Representative Chaffee remarked that after being a part of the meetings he has a good feeling about South Dakota and the efforts being made towards economic development.

Adjournment

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

The committee adjourned at 3:42 p.m.