



Taxation and Regulation of Public Utilities

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Introduction

This paper provides information on the taxation of regulated public utility corporations in Wisconsin. The focus is on the separate state taxation of utilities on the basis of gross receipts or property value (*ad valorem*), in lieu of local property taxation. In addition, information is provided on the regulatory treatment of the utility sector and on other relevant tax provisions.

Several factors combine to make the economics and taxation of the public utility sector different than that of most other corporations. The public services provided are relatively exclusive in nature and the component industries are dominated by relatively few, large corporations. One consequence of these characteristics is that each industry is subject to a regulatory system that, in turn, has significant implications for their tax treatment. In addition, rapid economic, technological, and regulatory changes, alterations in the energy use mix due to price changes and conservation efforts, and changes in company ownership or company structure all have major effects on the taxation of different types of utilities.

In recent years, significant changes have occurred with respect to the regulation of telecommunication and electric utilities. While the 1984 U. S. District Court-ordered break-up of AT&T was responsible for dramatic changes in the telecommunications sector, the decision can be characterized as a response to major technological changes that were impacting this utility sector and were affecting competition. By the mid-1990s, Wisconsin had adopted legislation authorizing telecommunications utilities to elect lesser levels of state regulation in exchange for a certain level of service commitments. Legislation also required

such utilities to disaggregate the costs of providing various basic network services as an essential step in pricing these services in a competitive environment.

Change has also occurred in the electric industry. The federal Energy Policy Act of 1992 and subsequent orders by the Federal Energy Regulatory Commission paved the way for the development of a competitive interstate wholesale power market. A number of states have since taken steps to implement restructuring at wholesale and even retail levels. However, in the wake of the California energy crisis of 2000 and 2001 and concerns about the possible manipulation of power markets under deregulation, some state governments have opted away from deregulation.

Nonetheless, Wisconsin has directed electric utilities based in the state to transfer control over their electric transmission facilities to an independent operator, and the state has assumed responsibility for the operation of certain energy conservation, research and development, and low-income assistance programs previously operated by the utilities. In recent years, changes have also been enacted relating to financing the costs of construction or renovation of electric generating facilities.

Amidst a growing demand for energy, public officials and policy makers are concerned about the adequacy of investment in electric generation and transmission facilities. As a result, further legislative or administrative decisions at both the federal and state levels are possible regarding the treatment of different types of utility companies and the classification of taxable revenues. To the extent that the power industry remains in flux, projections of utility company taxable revenues

and resulting tax collections will contain an element of uncertainty.

State Utility Taxes

Historical Development

Public utilities in Wisconsin are subject to state taxation in lieu of local general property taxation. The state tax takes one of two general forms, depending on the type of company: (a) an "ad valorem" tax based on the state-assessed value of company property, which is generally multiplied by the statewide average property tax rate; or (b) a tax or license fee based on a percentage of gross revenues or receipts of the company. The history of these tax provisions is varied for each type of company, but generally represents a movement from local to state assessment and taxation to take advantage of the state's greater ability to assess and tax utilities operating across municipal boundaries.

State ad valorem taxation began with the taxation of railroads in 1905; they had previously been subject to a local license fee based on gross earnings. Light, heat, and power companies connected to street railway companies came under state assessment in 1908; most other power companies were brought under the system in 1917. Beginning with the 1985 assessment, light, heat, and power companies were subject to a license fee based on gross revenues. Rural electric cooperatives were subject to local property taxation until 1939, when state gross revenues taxation was imposed. Most power companies that are located and operating in a single municipality are subject to local taxation. However, 1995 Wisconsin Act 27 included a provision that imposed the state gross revenues license fee for light, heat, and power companies on all qualified wholesale electric companies.

Conservation and regulation companies (owners of dams and reservoirs used for

hydroelectric power generation) were brought under state ad valorem taxation in 1915. Commercial airlines became subject to state taxation in 1946. Gas and oil pipeline companies have been subject to state assessment and taxation since they began operating in Wisconsin in 1950.

Car line companies (lessors of passenger and freight railroad cars) were brought under state gross receipts taxation in 1931; they were previously subject to state property assessment. In 1990, the Department of Revenue (DOR) stopped administering the utility tax on car line companies on advice of the Attorney General, who indicated that the tax probably violated the federal Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act). The federal act contains a broad prohibition against taxes that discriminate against railroads. However, in a U.S. Supreme Court case (*Department of Revenue of Oregon v. ACF Industries, Inc.*, January, 1994) the Court ruled that the State of Oregon did not violate the provisions of the federal 4R Act by imposing an ad valorem tax upon all railroad property while exempting various other, but not all, classes of industrial and commercial property. Subsequently, 1995 Wisconsin Act 237 was enacted, which imposed a 3% gross earnings utility tax on car line companies beginning with earnings generated in 1996.

Gross revenues license fees had been imposed on telephone companies starting in 1883. The initial graduated tax rates on total revenues were separated into toll and local exchange rates in 1931. Specialized common carriers (such as microwave telecommunications firms) were explicitly brought under this tax in 1981. In 1986, telegraph companies were shifted from ad valorem to gross revenues taxation as a telecommunications service. In addition, all other companies providing telecommunications services to the public (such as resellers) were made subject to the gross revenues license fee. Since 1998, however, all telephone companies are taxed on an ad valorem basis. Unlike the ad valorem tax imposed on other types of utilities, which is based on the statewide average

Table 1: Summary of Utility Tax by Type of Utility

Utilities Subject to Ad Valorem Taxes	Tax Base*	Tax Rate
Pipelines Municipal Electric Associations Conservation & Regulation Companies Railroad Companies Air Carrier Companies	Real Property, Tangible & Intangible Personal Property	Average Net Property Tax Rate in State
Telephone Companies	Real Property, Tangible Personal Property	Net Property Tax Rate in Jurisdiction Where Property is Located

*With the exception of telephone companies, utilities taxed on an ad valorem basis are generally assessed under a unit assessment process (under which the property is assessed at full market value if the property were sold as a unit). Telephone companies are assessed using methods used to assess manufacturing property, which do not require unit assessment. For all ad valorem taxpayers, if a general structure is used for non-utility purposes, that portion of the structure is assessed locally.

Utilities Subject to Gross Revenues License Fee	Tax Base	Tax Rate
Car Line Companies	Gross Revenues	3.00%
Electric Cooperative Associations	Gross Revenues Less Certain Deductions	3.19**
Municipal Light, Heat, and Power Companies	Gross Revenues from Outside the Municipality	3.19
Private Light, Heat, and Power Companies*		
Gas Revenues	Gross Revenues from Gas Sales	0.97
All Other Revenues	Gross Revenues from All Other Sales Less Certain Deductions	3.19**

*With certain exceptions, a private light, heat, and power company that is located entirely within a single town, village, or city is subject to local assessment and taxation.

**For gross revenues from 2004 through 2009, the tax rate on wholesale electricity sales is reduced to 1.59%.

property tax rate, the ad valorem tax on telephone companies is based on the prior year's net property tax rate of the local taxing jurisdiction.

Table 1 summarizes the type of utility tax, the tax base, and the tax rate that currently apply to each type of Wisconsin utility company.

Ad Valorem Group

Utilities subject to ad valorem taxation include municipal electric associations and the following types of companies: (a) pipeline; (b) conservation

and regulation; (c) telephone; (d) railroad; and (e) airline.

Determination of Assessment. The ad valorem assessment is generally determined by deriving a unit value, equivalent to full market value if the utility were sold as a unit; allocating a portion of that value to Wisconsin where appropriate; and applying the statewide average property tax rate to the resulting value. State law excludes from ad valorem taxation the value of certain property that is also excludable from general property taxes: (a) certain motor vehicles; (b) treatment plant and

pollution abatement equipment; and (c) computers. As provided under 2001 Wisconsin Act 16 (the 2001-03 biennial budget act), cash registers and fax machines are also exempt from both ad valorem and property taxes, effective with tax assessments as of January 1, 2003.

A fairly comprehensive valuation process is necessary to determine market value of the utility companies described above, since actual sales price data do not generally exist. This process utilizes three distinct indicators of value--the cost, capitalized income, and stock and debt indicators--which attempt to take account of earning potential and are weighted differently according to the most appropriate indicator for a given type of utility.

In determining the cost indicator, the Department may consider four different types of costs: historical, original, reproduction, and replacement. To these costs, allowances are made for loss of value due to depreciation, functional and economic obsolescence, regulatory required write-offs, and utility plant acquisition adjustments. The capitalized income indicator is based on a company's operating income (before subtracting depreciation), capitalized at a rate based on market rates for equity, debt, and other factors. The premise behind this method is that the company is worth what it can earn--the purchase price of the company can be determined by estimating expected future earnings and a required rate of return for investors. However, determining the expected earnings and appropriate rate of return can be difficult and is the subject of some controversy. The third indicator, the stock and debt indicator, uses the market value of these two items and other current liabilities, which together are assumed to equal the market value of property and assets. As companies diversify or form conglomerates, the stock and debt method of valuation becomes more difficult. Other indicators are also considered, including company and independent appraisals, prior year assessments, shareholders reports, and, where available, comparable sales. Given these indicators, the

Department uses its judgment to arrive at an estimate of fair market value.

As noted, telephone companies are subject to ad valorem taxation starting with taxes due for 1998. The Department of Revenue is required to assess telephone company property using the same methods the Department uses to assess manufacturing property. As a result, the value of intangible property is excluded from the company's value established by DOR. (Under the unit value methods of valuing property, used with other ad valorem taxpayers, the value of intangible property is generally included in the utility company's property value.) As with other utilities subject to ad valorem taxation, the value of certain motor vehicles, treatment plant and pollution abatement equipment, computers, and, effective with tax assessments as of January 1, 2003, cash registers and fax machines is specifically excluded from the company's property value.

In general, DOR uses a sales-based approach to assess manufacturing real property and the cost-based approach in assessing manufacturing personal property. The Department conducts a field review of the property once every five years. For real property, DOR makes annual adjustments to reflect the economic change in value and new construction. The method for determining the value of personal property is to establish the original cost of the equipment and multiply the cost by a conversion factor that adjusts the cost for the change in prices over time and for depreciation.

For companies subject to ad valorem taxation, if a structure is used in part for utility operations and in part for nonoperating purposes, the structure is generally assessed for taxation by the state at the percentage of its full market value that represents its operating purposes. The balance is subject to local assessment and taxation.

However, Act 16 modified this general approach for telephone companies. Under Act 16, the following approach applies for telephone

companies having a structure used in part for operations and in part for nonoperating purposes, effective with tax assessments as of January 1, 2003: (a) if real or tangible personal property is used more than 50% (as determined by DOR) in its operation as a telephone company, then DOR assesses the property and the property is exempt from the general property tax; and (b) if real or tangible personal property is used less than 50% in the business's operation as a telephone company, then the property is assessed and taxed locally.

Payment of Tax. Ad valorem taxpayers make semiannual payments on May 10 and November 10. Under this payment schedule, the utility company must pay either 50% of its previous year's net utility tax liability or 40% of its estimated current year's liability on May 10. The utilities are notified of their tax liability for the current year on either August 10 (railroads and municipal electrics), October 1 (pipelines, airlines, and conservation and regulation companies), or November 1 (telecommunications companies). The remainder of the current year's assessment is due on November 10.

Utilities Subject to Ad Valorem Tax. The following section provides a description of the utilities subject to the ad valorem tax.

Pipeline Companies. A pipeline company is defined as any person that is not a light, heat, and power utility and that is engaged in the business of transporting or transmitting gas, gasoline, oils, motor fuels, or other fuels by means of pipelines. Of the group of utilities subject to ad valorem taxes prior to 1998, pipeline companies generated the most general fund utility taxes. However, revenue from the ad valorem tax on telephone companies now exceeds collections from pipeline companies. There were nine pipeline utility companies operating in Wisconsin in 2003. The largest carriers in Wisconsin, in terms of the allocated assessed value of their property, are the ANR Pipeline and Great Lakes Gas Transmission Companies, which transport natural gas, and Enbridge Energy, which

transports natural gas and oil products.

Conservation and Regulation Companies. A conservation and regulation utility is any person organized under the laws of the state for the conservation and regulation of the height and flow of water in public reservoirs in the state. This is done by impounding the rivers' headwaters into various reservoirs during times of heavy rainfall and then releasing the stored water during subsequent periods. These companies normalize river flow and the stored water is used for hydraulic power generation by various light, heat, and power companies. There are two such companies in Wisconsin, which have been established to conserve runoff waters in the Chippewa River and Wisconsin River watersheds: the Chippewa & Flambeau Improvement Company and the Wisconsin Valley Improvement Company.

Municipal Electric Associations. Under the state statutes, any combination of municipalities may contract to create a public corporation for the joint development of electric energy resources or for production, distribution, and transmission of electric power or energy, wholly or partially, for the benefit of the municipalities. Three municipal electric associations were subject to ad valorem utility taxes in 2003 -- Badger Power Marketing Authority of Wisconsin, Western Wisconsin Municipal Power Group, and Wisconsin Public Power, Inc.

Telephone Companies. A telephone company is any person that provides telecommunications services to another, including the resale of services provided by another telephone company. "Telecommunications services" means the transmission of voice, video, facsimile, or data messages. Telegraph messages are specifically included in this definition, while cable television, radio, one-way radio paging, and transmitting messages incidental to hotel occupancy are specifically excluded. A telephone company does not include a person who operates a private shared communications system and who is otherwise not

a telephone company. As described above, the Department of Revenue is required to assess telephone company property using the same methods the Department uses to assess manufacturing property (which differs from how other utilities in the ad valorem group are assessed).

Prior to the imposition of the ad valorem tax on telephone companies with taxes due for 1998, telephone companies were subject to a 5.77% gross revenues license fee. As part of the shift to an ad valorem tax, a transitional adjustment fee was imposed for 1999 and 2000 on licensed providers of commercial mobile services and companies that provide basic local exchange services. The fee was the difference between the taxpayer's ad valorem utility tax payment and the amount that the taxpayer would have paid if subject to a gross revenues tax of 5.77%. For telephone companies licensed to provide commercial mobile (wireless) services, the transitional adjustment fee applied only to the company's activities as a provider of such services. 1999 Wisconsin Act 9 provided that a credit could be taken against the transitional adjustment fee under certain circumstances.

In 2003, there were over 200 telephone companies with a Wisconsin public utility tax assessment. Some of these companies operate local exchanges. Others offer interstate service or intrastate service between local access and transport areas (LATAs). A third group consists of firms that resell long distance services. [Resellers purchase and resell bulk services from another telephone company; they own and operate switching facilities but do not have separate transmission lines.] Finally, commercial mobile telephone companies provide wireless services (cellular and personal communications services).

Even with the divestiture of AT&T, the telecommunications industry in Wisconsin is characterized by the dominance of a relatively few large companies. Three telephone companies were assessed approximately 45% of the total 2003 ad

valorem tax assessment on telephone companies. These companies include Ameritech Wisconsin and Verizon North, Inc., which provide local exchange services, and the long-distance company AT&T Communications, Inc.

Railroad Companies. A railroad company is any person (except a local unit of government) owning and/or operating a railroad in the state or owning or operating any station, depot, track, terminal, or bridge for railroad purposes. There are 11 railroad companies in Wisconsin. The major carriers are: the Burlington Northern and Santa Fe Railroad Company; Soo Line Railroad Company; Union Pacific Railroad; and Wisconsin Central Ltd. Railroad utility taxes are treated as segregated funds and are deposited in the transportation fund.

Air Carrier Companies. The statutes define an air carrier company to be any person engaged in the business of transportation in aircraft of persons or property for hire on regularly scheduled flights. The major air carriers operating in the state are Midwest Airlines, Air Wisconsin, Express Jet Airlines, Northwest Airlines, American Eagle Airlines, and Federal Express. Airline company utility taxes are also treated as segregated revenue and placed in the transportation fund.

Wisconsin 2001 Act 16 created an exemption, beginning in 2001, from ad valorem taxes for any air carrier that operates a hub facility in Wisconsin. For the purposes of this provision, a hub facility is defined as either one of the following: (a) a facility from which an air carrier company operated at least 45 common carrier departing flights each weekday in the prior year and from which it transported passengers to at least 15 nonstop destinations or transported cargo to nonstop destinations; or (b) an airport or any combination of airports in Wisconsin from which an air carrier company cumulatively operated at least 20 common carrier departing flights each weekday in the prior year, if the air carrier company's headquarters is in Wisconsin. Currently, Midwest Airlines and Air Wisconsin are the only two

carriers that qualify for this exemption. In November, 2003, however, the hub airline tax exemption was ruled unconstitutional in Dane County Circuit Court on the grounds that it violates the commerce clause of the United States Constitution. This decision is currently on appeal.

Gross Revenues Group

Utilities subject to the license fee on gross revenues include the following: private light, heat, and power companies; municipal light, heat, and power companies; electric cooperatives; and car line companies.

Determination of Assessment. Gross revenues utilities submit annual reports to the Department of Revenue on the amount of taxable gross revenues for the preceding year. The gross revenue amount is multiplied by the applicable tax rate to determine the amount of taxes due. The Department later audits the reports for compliance.

Payment of Tax. The Department makes a tax assessment based on taxable revenues earned in the previous calendar year. Installment payments are made toward the tax in the year that the revenue is earned. A final payment is generally made in the following year, the assessment year, to reconcile the two installment payments with the final assessment. For light, heat, and power companies and electric cooperatives, semiannual installment payments of either 55% of the previous assessment or 50% of the estimated assessment are due on May 10 and November 10 of the year in which the revenue is earned. These utilities are notified of their actual license fee the following May 1. On May 10 of the year following the year in which the revenue was earned, the assessment year, either a final adjustment payment is made or a refund is issued to reconcile the two prior installment payments with the actual assessment.

For car line companies, at least 50% of the current or 50% of the subsequent year's liability is due on September 10 and the remaining liability is due on April 15. No final reconciliation is required, as

the full assessment is known at the time the final payment is made.

Utilities Subject to the Gross Revenues Tax.

The following section briefly describes each utility that is subject to the gross revenues tax.

Private Light, Heat, and Power Companies. In general, a light, heat, and power company is defined as a business enterprise engaged in the following businesses: (1) generating and furnishing gas for lighting or fuel or both; (2) supplying water for domestic or public use or for power or manufacturing purposes; (3) generating, transforming, transmitting, or furnishing electric current for light, heat, or power; or (4) generating and furnishing steam or supplying hot water for heat, power, or manufacturing purposes. The tax on light, heat, and power companies was converted from an ad valorem to a gross revenues tax by 1983 Wisconsin Act 27, beginning with the 1985 assessment.

Beginning in 1996, the definition of a light, heat, and power company was expanded to include qualified wholesale electric companies (also called independent power producers). A qualified wholesale electric company is defined as any person that: (1) owns or operates facilities for the generation and sale of electricity to a public utility or to any other entity that sells electricity directly to the public; (2) sells at least 95% of its net production of electricity; and (3) owns, operates, or controls electric generating facilities that have a total power production capacity of at least 50 megawatts.

As part of a broader effort to enhance electric reliability in the state, 1997 Wisconsin Act 204 authorized the construction and operation of a type of electric generating facility referred to as a wholesale merchant plant. Act 204 defined a wholesale merchant plant to be electric generating equipment and associated facilities in this state that do not provide service to any retail customer and that are owned or operated by: (1) either a person

that is not a public utility; or (2) subject to PSC approval, an affiliated interest of a public utility. Act 16 clarified that a wholesale merchant plant with a total power production capacity of at least 50 MW is considered a qualified wholesale electric company for purposes of state utility taxes.

Under 1999 Wisconsin Act 9, transmission companies were added to the definition of light, heat, and power companies subject to the gross revenues license fee. The expansion of the definition was part of the Reliability 2000 Initiative, a series of law changes included in Act 9 that are described in this paper in the section on "Federal and State Regulation." Act 9 specified that a transmission company's revenues for transmission services to certain public utilities and electric cooperation associations are excluded from the definition of gross revenues subject to the license fee, and specified other provisions related to the formation and operation of a transmission company. The tax provisions first applied to taxable years beginning January 1, 2000, which covered taxable gross receipts during calendar year 2000.

The assessment for a light, heat, and power company for each year is based on taxable gross revenues earned during the previous year. Gross revenues for a company other than a qualified wholesale electric company and a transmission company are defined as total operating revenues reported to the PSC, less interdepartmental sales and rents and the retailers' discount from the sales tax. Effective March 30, 2004, as provided under 2003 Wisconsin Act 152, such gross revenues also include receipts from total environmental control charges to finance certain environmental activities authorized by the Public Service Commission. A private light, heat, and power company may deduct from its gross revenue either: (1) the actual cost of power purchased for resale if that company purchases more than 50% of its electric power from a nonaffiliated utility that reports to the PSC; or (2) 50% of the actual cost of power purchased for resale if that company purchases more than 90% of

its power and has less than \$50 million in gross revenues. Certain grants and public benefit fees created under 1999 Act 9 are also excluded from the gross revenues of light, heat, and power companies.

For a qualified wholesale electric company, "gross revenues" means total business revenues from other businesses that are engaged in providing services as a light, heat, and power company. For a transmission company, revenues from transmission services to a Wisconsin public utility or electric cooperative are excluded from gross revenues for the purpose of determining the license fee.

Revenues from the sale of gas services are subject to tax at the rate of 0.97%. The tax rate on all other taxable revenues is 3.19%. However, as provided under 2001 Act 16, the tax rate on wholesale sales of electricity is temporarily reduced to 1.59% for a specified period. The reduced rate applies starting with the May 1, 2005, assessment, and ending with the assessment on May 1, 2010 (based on gross revenues from calendar years 2004 through 2009). The tax reduction for wholesale electricity sales was provided with the intention of encouraging the addition of generation capacity in the state.

An apportionment factor is applied to a company's gross revenues (less certain deductions, as described above) to determine Wisconsin taxable revenues, based on the shares of a company's total payroll, property, and sales that are in Wisconsin. Under 2001 Act 16, the payroll factor for a light, heat, and power company was modified. Act 16 provided that management and services fees paid by a light, heat, and power company to an affiliated public utility holding company are included as part of the light, heat, and power company's payroll factor. Correspondingly, Act 16 also provided an exemption from local property taxes for that portion of a public utility holding company's property (other than land) that is used to provide services to a light, heat, and power

company affiliated with the holding company. These modifications first applied with the May 1, 2002 assessment, which was based on gross revenues from calendar year 2001.

Of the 25 private light, heat, and power utilities operating in Wisconsin in 2003, including six qualified wholesale electric companies and one transmission company, 21 had Wisconsin taxable gross revenues from electric operations totaling approximately \$4,301.1 million. The largest electric utility is Wisconsin Electric Power Company, serving most of southeastern Wisconsin, whose taxable gross revenues for electric services in 2003 of \$1,868.2 comprised 43.4% of all electric service taxable gross revenues apportioned to the state. A total of five firms (Wisconsin Electric Power Company, Wisconsin Power and Light, Wisconsin Public Service Corporation, Excel Energy, and Madison Gas and Electric) generated 94.3% of taxable electric operating gross revenues in the state. Eleven private companies had taxable gross revenues of \$2,116.2 million from natural gas operations; the two largest, Wisconsin Gas and Wisconsin Electric Power, made up 56.2% (\$1,188.7 million) of taxable revenues from natural gas operations. Eight private light, heat, and power utilities provided both electric and natural gas services.

Municipal Light, Heat, and Power Companies. A municipal light, heat, and power company is subject to state tax on its gross revenues for services provided outside of the municipality that owns the utility. In 2003, 77 municipal light, heat, and power utilities had operating revenues subject to the state tax. These local government-operated firms had approximately \$55.2 million in taxable gross revenues from electric and other non-gas operations. Of this amount, 78.7% (\$43.4 million) is attributable to the 12 firms with at least \$1 million in taxable revenues. Only one municipal utility provides natural gas service (Florence Utility Commission), with taxable gross revenues from gas operations of \$122,100 in 2003.

Electric Cooperative Associations. An electric cooperative association is an entity organized under state law that carries on the business of generating, transmitting, or distributing electric energy to its members at wholesale or retail. Electric cooperatives are taxed at a flat 3.19% rate on gross revenues. However, as with private light, heat, and power companies, Act 16 provided that the tax rate on wholesale sales of electricity is temporarily reduced to 1.59%, starting with the May 1, 2005, assessment, and ending with the assessment on May 1, 2010 (based on gross revenues from calendar years 2004 through 2009).

Similar to the treatment afforded light, heat, and power companies, gross revenues are defined as total operating revenues, less interdepartmental sales and rents and the retailers' discount from the sales tax. As for a light, heat, and power company, certain grants and public benefits fees associated with the Reliability 2000 Initiative under 1999 Act 9 are excluded from gross revenues. In addition, a deduction is allowed for the cost of power bought for resale if the cooperative buys more than 50% of the power it sells, or if the electric cooperative purchased more than 50% of the power it sold in 1987 from an out-of-state seller. For multistate associations, a share of total cooperative revenues are apportioned to Wisconsin using a three-factor formula based on the proportion of property, payroll, and sales in-state to the respective total of each factor.

The major electric cooperative association is Dairyland Power Cooperative, which supplies wholesale electricity to 25 rural electric distribution cooperatives in the Midwest, 18 of which are in Wisconsin. In 2003, Dairyland accounted for approximately 56.8% (\$170.6 million) of total electric cooperative taxable gross revenues (\$300.3 million).

Car Line Companies. A car line company is defined as any person, not operating a railroad, that is engaged in the business of furnishing or leasing car line equipment to a railroad. As noted,

beginning with earnings generated in 1996, car line companies are subject to a 3% utility tax on gross earnings. Gross earnings are defined as all receipts by a car line company from the operation of equipment in the state. Earnings from interstate businesses are allocated to Wisconsin based on the ratio of Wisconsin car miles to total car miles. In 2003, eight car line companies had a total of \$13.9 million in gross revenues subject to the state utility tax.

Tax Collections

Utility tax revenues are deposited in the state's general fund, except for those collected from railroad and airline companies, which are segregated transportation fund revenues. General fund utility tax collections in fiscal year 2003-04 were \$269.8 million, constituting about 2.5% of total general fund tax revenues. Transportation fund utility tax collections totaled \$20.1 million, making up 1.5% of total transportation fund collections for 2003-04.

Table 2 shows the change in general fund utility tax collections over the last seven fiscal years. The table indicates a change in the utility tax on telecommunications companies from a tax on gross revenues to an ad valorem tax, starting with collections during the 1997-98 fiscal year. The decrease in collections from 1997-98 through 2000-01 reflects the full transition to the ad valorem tax. The 1997-98 tax collections for telecommunications companies, shown as the gross revenues tax, include some collections for 1998 under the ad valorem taxation system. For 1998-99 and 1999-00, telecommunications tax collections include the transition fees imposed on local exchange carriers and commercial mobile telephone companies. As the final payment of such fees was due in May, 2000, telecommunications tax collections for subsequent years are entirely from ad valorem taxes.

Table 3 shows historical collections for the two transportation fund utilities. A lawsuit by the railroads challenged extra assessments that had

Table 2: General Fund Utility Tax Collections (In Millions)

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
Ad Valorem Tax							
Telephone/Special Common Carrier	---	\$149.4*	\$114.7*	\$80.4	\$86.6	\$106.3**	\$81.6
Pipeline	\$7.6	9.5	11.9	10.4	10.3	10.5	10.6
Municipal Electric	1.9	1.3	1.4	1.4	1.3	1.2	1.3
Conservation & Regulation	<u>0.1</u>	<u>0.0</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>
Total Ad Valorem Tax	\$9.6	\$160.2	\$128.1	\$92.3	\$98.3	\$118.2	\$93.6
Gross Revenues Tax							
Telephone/Special Common Carrier	\$158.5***	---	---	---	---	---	---
Electric Cooperative	7.5	\$7.5	\$7.8	\$8.2	\$8.6	\$9.4	\$8.5
Private Light, Heat & Power	110.4	117.1	121.1	136.4	143.1	147.0	165.4
Municipal Light, Heat & Power	1.4	1.5	1.5	1.6	1.6	1.7	1.8
Car Line Companies	<u>0.6</u>	<u>0.6</u>	<u>0.6</u>	<u>0.5</u>	<u>0.5</u>	<u>0.5</u>	<u>0.4</u>
Total Gross Revenues Tax	\$278.4	\$126.7	\$131.0	\$146.7	\$153.8	\$158.6	\$176.1
Refunds of Interest & Penalty	0.4	0.1	0.9	0.2	0.1	0.0	0.1
General Fund Total Collections	\$288.4	\$287.0	\$260.0	\$239.2	\$252.2	\$276.8	\$269.8

*Includes transitional adjustment fees assessed during the transition from gross revenues taxes to ad valorem-based taxation.

**Includes approximately \$10.0 million in one-time revenues from an audit and a property value dispute settlement.

***Includes some collections of ad valorem tax and transitional adjustment fees during 1998.

Table 3: Transportation Fund Utility Tax Collections (in Millions)

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
Ad Valorem Tax							
Railroad	\$10.0	\$12.1	\$11.5	\$1.3	\$12.0	\$12.5	\$11.9
Airline	<u>6.3</u>	<u>8.6</u>	<u>9.0</u>	<u>9.3</u>	<u>5.7</u>	<u>5.4</u>	<u>8.2</u>
Transportation Fund							
Total Ad Valorem Taxes	\$16.3	\$20.7	\$20.5	\$10.6	\$17.7	\$17.9	\$20.1

been included in prior years. In settlement of this lawsuit, the Department of Revenue refunded \$10.8 million to nine railroads in November, 2000. The railroad utility tax figure shown in Table 3 for 2000-01 is net of the \$10.8 million refund.

As noted, 2001 Act 16 created an exemption for air carriers with a hub facility in Wisconsin beginning in 2001. The first installment of taxes for 2001 was paid in fiscal year 2000-01, prior to the enactment of Act 16. The installment payments made by Midwest Airlines and Air Wisconsin did not reflect the tax decrease under Act 16. The two carriers were, therefore, refunded \$1,265,200 in 2001-02, associated with the overpayment during 2000-01. The 2001-02 airline utility tax figure shown in Table 3 is net of this refund for the previous year. The 2002-03 figure also reflects refund and litigation settlements from prior years.

Other State Taxes on Utilities

Corporate Income and Franchise Tax

In addition to the ad valorem and gross revenues taxes described above, Wisconsin public utilities are generally subject to the state corporate income and franchise tax on the same basis as other corporations. However, certain types of utility companies are exempt from this tax. Municipal light, heat, and power companies are exempt due to their status as agencies of local government. Electric cooperatives are exempt from the corporate income tax based on the general exemption for all

cooperatives organized under Chapter 185 of the Wisconsin Statutes.

Taxable utility companies determine net corporate income tax liability in the same manner as most corporations. State corporate income tax provisions are generally referenced to federal law. Thus, the starting point for determining state income tax liability, net taxable income, is determined by subtracting allowable federal deductions from federal gross income. However, there are certain state adjustments that must be made in arriving at net taxable income for state purposes. (These specific adjustments are described in the informational paper on the state corporate income tax.) The state utility tax is specified as an allowable deduction in these adjustments. The state corporate income tax is imposed at a flat 7.9% rate on taxable income. If applicable, state tax credits are used to offset gross tax liability to arrive at net tax liability. More detailed information about the state corporate income tax may be found in the Legislative Fiscal Bureau's informational paper entitled, "Corporate Income/Franchise Tax."

Sales Tax

Several sales tax provisions have a direct impact on utility companies. These provisions primarily affect the energy and telecommunications industries and are discussed below.

Energy-Related Provisions

Power companies are exempt from the sales tax on their purchases of fuel used to produce

electricity, steam, or other power. However, for tax years beginning prior to January 1, 2006, manufacturing businesses pay sales tax on fuel used in the manufacturing process, but are allowed a credit against state income tax liability for the amount of tax paid. As provided under 2003 Wisconsin Act 99, effective for tax years starting after December 31, 2005, the tax credit is eliminated; fuel and electricity consumed in manufacturing tangible personal property is exempt from the state sales tax, effective January 1, 2006. Act 99 also includes provisions that allow manufacturers meeting certain investment and employment criteria to claim unused sales tax credits from prior years.

State law provides a sales tax exemption for residential purchases of electricity and natural gas from November through April. Most other fuels purchased for residential use (such as coal, fuel oil, propane, steam, and peat) are totally exempt. Purchases of electricity and fuel, including natural gas, used in farming are exempt from the sales tax year-round. These sales tax exemptions have an indirect impact on utilities, since the tax is imposed on consumer, rather than utility, purchases.

As described above, 1999 Wisconsin Act 9 included the Reliability 2000 Initiative related to the creation of an electric transmission company. As part of this initiative, sales tax exemptions were provided for certain transfers of transmissions facilities to a transmission company and for the gross receipts of electric utilities and retail electric cooperatives from collections of public benefits fees.

Telecommunications-Related Provisions

Equipment. Prior to September 1, 1995, the sale and use of equipment and electrical instruments, other than station equipment, used by a telephone company in its central office for transmitting and operating signals generally were exempt from sales tax. 1995 Wisconsin Act 27 repealed this exemption, effective September 1, 1995. Thus, the

above-identified items are now taxable. Further, as a result of the repeal, services (repair, alteration, fitting, cleaning, and the like) to such property also are now subject to the sales tax.

Services. Generally, sales of telecommunications services to consumers are subject to the sales tax. Conventional, wire-based telecommunications services that originate or terminate in Wisconsin and are charged to a service address in this state, including the rights to purchase telecommunications services (pre-paid calling cards and authorization numbers) as well as internet-access fees are taxable services in Wisconsin.

2001 Act 109 modified the sales tax treatment of mobile telecommunications services in Wisconsin, effective for bills issued after August 1, 2002, by bringing state law into conformance with the Federal Mobile Telecommunications Sourcing Act (PL 106-252). Under the new law, the Wisconsin sales tax applies to cell phone calls and other mobile telecommunications services if the individual's or business' primary street address is in this state, regardless of where the services originate, terminate, or pass through. The great majority of other states have adopted the same change. Prior to the change, mobile telecommunications services were taxed in the same manner as conventional, wire-based services -- that is, if the service originated or terminated in Wisconsin and was charged to a service address in this state, it was subject to Wisconsin tax.

The new mobile telecommunications sourcing policy was intended to clarify, particularly in light of substantially expanded cell phone usage in recent years, which jurisdiction has the right to tax services that may originate and terminate in different jurisdictions (as well as potentially pass through still other jurisdictions en route to completion). The change in federal law by itself effectively precluded Wisconsin from collecting sales tax on services provided in-state to roamers from out of state, regardless of whether the state

would opt to incorporate the new sourcing guidelines into state law. By bringing its statutes into conformance with the federal law, however, Wisconsin gained the ability to tax cell phone calls that do not originate or terminate in Wisconsin yet that are billed to a Wisconsin address (for example, a phone call placed by a Wisconsin resident to San Diego from Chicago).

Finally, state law provides sales tax exemptions for county-wide "911" emergency phone systems and toll-free calls that originate outside this state and terminate in Wisconsin.

More information about the sales tax treatment of internet-access fees and other utility services may be found in the Legislative Fiscal Bureau's informational paper entitled "Sales and Use Tax."

State Regulation

In 1907, Wisconsin became the first state to regulate essential utility services provided to the public by entities that generally operated as noncompetitive natural monopolies. Initially, state regulation of public utilities was the responsibility of the Railroad Commission. The Railroad Commission's duties were subsequently revised and expanded in 1931 into the current Public Service Commission (PSC). Currently, the PSC regulates telecommunications (other than wireless telecommunications), electric, gas distribution, heating, water, and combined water and sewer utilities.

The PSC's regulatory authority is vested in three full-time commissioners, appointed by the Governor, with the advice and consent of the Senate, to staggered, six-year terms. The Governor designates the Commission chairperson, who in turn may appoint division administrators from outside the classified service. The agency's professional and support staff are all in the

classified civil service.

While PSC regulation may vary based on such factors as type of utility, utility size, the number of customers served, and whether the utility owns and operates its own communications or transmission lines, the Commission is generally responsible for the following:

- Regulation of the construction, use, modification and financing of utility operating property, including regulation of the use of depreciation accounts for new construction;
- Valuation of such operating property;
- Oversight, including examination and audit, of utility accounts and record keeping;
- Approval of utility mergers;
- Determination of levels of adequate and safe service and response to consumer complaints about utility operations and prices; and
- Setting the level and structure of rates for utility service based on authorized rates of return on investment.

For most consumers, the PSC's rate-setting responsibility is the most visible aspect of the agency's regulation of utilities. The rate-setting process attempts to establish prices in what has traditionally been a monopoly market at levels that would approximate such prices if competitive market forces operated. While a utility company's natural interest is to have these prices set at a level that will maximize profits, the regulatory process acts to provide a counterbalance so that utility services are provided to customers at prices that are reasonable both to ratepayers and to utility owners.

Rate-setting typically involves three related determinations. First, the amount of revenue necessary for the utility to operate, pay debt, and

meet the allowable rate of return on investment must be determined. Second, prices must be set that will generate the company's revenue requirement, allocated across categories of service according to relative costs and other factors for each category. Most directly relevant for utility tax purposes is the fact that all taxes paid, including corporate income, utility (ad valorem or gross revenues), and sales taxes, are treated as expenses, and are generally fully recovered through the rates allowed by regulatory authorities. Finally, an appropriate distribution of the rate increase across the various categories of service must be developed and approved.

For utilities subject to such rate regulation, the rate-setting process has three basic procedural phases: pre-hearing, public hearing, and decision-making. The process begins with a utility company's request for a rate increase. Prior to any formal hearing on the request, the PSC staff analyzes the request and its impact and conducts a company audit. Also at this time, interested parties wishing to participate at the public hearing on the rate request prepare their materials. The public hearing phase of the rate-setting process is an investigative and fact-finding process, rather than a decision-making forum. The utility makes a formal presentation of its proposal. The public, authorized intervenors, or the PSC staff may challenge the rate request or suggest alternatives at this stage of the rate-setting process. Following the public hearing, an open meeting is held by the commissioners on each rate case. The commissioners make their decision, based on the information presented in the initial formal filings and on the subsequent record developed at the public hearing.

While PSC decisions are generally final, they may be appealed by the utility or by other parties with an interest in the matter, first at a PSC rehearing, and then to state Circuit Court.

The PSC's authority extends to intrastate utilities and the intrastate operations of multi-state utilities. At the federal level, regulatory

responsibilities over interstate utility operations are divided between the Federal Communications Commission, for interstate services of telecommunications companies, and the Federal Energy Regulatory Commission, for interstate operations and wholesale sales by energy service companies. The line between state and federal regulatory authority is not always clear and, particularly in the telecommunications field and increasingly in the electric industry, relations between the two levels of regulations are in a state of flux.

The statutes grant the PSC broad jurisdiction to do all things necessary and convenient in the exercise of its regulatory authority over public utilities. The Commission has traditionally used a flexible approach in exercising its jurisdiction. Under this approach, the PSC has had discretionary authority to adjust, as needed, the degree of regulation of classes of public utilities.

In recent years, however, the statutes have been revised to lessen the scope of the Commission's regulatory authority over certain types of public utilities. Provisions of 1993 Wisconsin Act 496 authorized substantially reduced regulatory review of telecommunications utilities by imposing specific and detailed statutory limitations governing the extent of PSC regulatory authority over such utilities. Provisions of 1997 Wisconsin Act 204 made a number of changes to the Commission's regulation of electric generation and transmission. These changes are described in the following section.

Recent Changes in State Regulatory Oversight of Utilities

Telecommunications

Under 1993 Wisconsin Act 496, the PSC is required to regulate telecommunications utilities

with the goal of developing forms of regulation other than the traditional rate of return approach generally used for public utilities rate-setting. This legislation authorized local exchange telecommunications utilities to become "price-regulated" (a form of incentive regulation), under which the PSC regulates the utility based only on the prices of basic services offered, instead of regulating the total earnings of the utility.

Once a telecommunications utility elects to become price-regulated, its basic rates must be frozen for three years. Thereafter, the telecommunications utility may change its rates for price-regulated services only as follows: the change in the revenue-weighted price indices for all services subject to price regulation may not exceed the most recent annual change in the gross domestic price index, less a productivity offset of 2% or 3%, depending on the size of the utility. After six years, and every three years thereafter, the PSC must revise the productivity offset percentages based on a statewide productivity study. In addition, depending upon the size of the utility, a penalty of up to 1% or 2% may be added to increase the productivity offset (due to inadequate service provided by the utility), and an incentive of up to 1% or 2% may be subtracted to decrease the productivity offset (to encourage infrastructure development).

A price-regulated telecommunications utility may reduce the charges for any service subject to price regulation upon one day's notice to the PSC. The telecommunications utility may change its rate structure upon ten days notice, provided the previous rate structure continues to be offered to customers.

Once a telecommunications utility has operated as a price-regulated utility for three years, it may alter its rate structure or increase rates for price-regulated services upon 120 days' notice to the PSC. The notice must be accompanied by documentation that the change is just and reasonable. The PSC is authorized to investigate

the proposed rate change and may suspend the proposed change pending the conclusion of the Commission's investigation. During its investigation, the Commission may consider only the following factors before approving, modifying or rejecting the change: cost allocations by the utility for costs to price-regulated services that are beyond the control of the utility; competition; network and service quality, improvements and maintenance; changes in the costs of providing the service that are beyond the control of the utility; and the impact of the change on the public interest.

Telecommunications utilities that do not elect to become price-regulated as authorized by statute may petition the PSC to become subject to alternative regulation. Under an alternative regulation plan, the PSC may approve a regulatory mechanism that imposes lesser rate or earnings limitations on a company in exchange for the utility's commitment and obligation to maintain service quality, reduce long distance access prices, maintain and improve the service network, limit price changes to specific levels, and open markets to competition. Small telecommunications utilities (generally, telecommunications utilities with fewer than 150,000 lines) that are not subject to either price-regulation or alternative regulation may change prices without PSC approval pursuant to procedures established under ss. 196.213 and 196.215 of the statutes. These provisions specify maximum allowable rate increases and establish customer notification procedures when rates increases are made.

In addition to regulation of incumbent local exchange companies, the PSC regulates the entry of alternative telecommunications utilities (such as, reseller and facility-based providers) and telecommunications carriers into intrastate local and toll telecommunications markets. These entities are generally referred to as competitive local exchange carriers. Most provide a wide range of services including local, long distance and internet access. The level of regulation for the competitive local exchange carriers is typically lower than for the

incumbent local exchange companies and is specifically set forth in statute, administrative code, or PSC order. For example, the PSC does not regulate the rates of competitive local exchange carriers as it does for the incumbent local exchange companies.

The federal Telecommunications Act of 1996 sets forth the interconnection rights and obligations of both the incumbent local exchange companies and the competitive local exchange carriers. Under the federal Act, disputes over interconnection agreements are mediated and arbitrated by the PSC. The PSC must also approve interconnection agreements reached through voluntary negotiations between the parties. In addition, the federal Act authorizes the PSC to regulate the terms and conditions of competitive entry into rural telephone company exchanges.

Finally, the federal Act stipulates that before any company may enter the long distance market within its own region, it must first meet several requirements designed to foster competition. The Federal Communications Commission, the U. S. Department of Justice, and the PSC share responsibility to make certain that these requirements are met.

The PSC receives and seeks to resolve complaints against telecommunications providers from retail customers. These consumer complaints often involve billing disputes, quality of service, out-of-service problems, and disconnections. The PSC also receives and resolves complaints between providers. These complaints center on the terms and conditions of interconnection at the wholesale level that, if left unresolved, can adversely affect retail customers.

The PSC administers a variety of universal service programs that relate to the accessibility and affordability of telecommunications service. All of these programs are funded by telecommunication providers through assessments imposed by the PSC.

Universal Service Fund (USF). The USF was established under 1993 Wisconsin Act 496 to ensure that all state residents receive essential telecommunications services and have access to advanced telecommunication capabilities such as the internet. The Act requires the PSC, with the advice of the Universal Service Fund Council, to establish programs funded from the USF that ensure the delivery of essential services and advanced service capabilities anywhere in the state. Essential service includes: (1) single party service with touch tone capability; (2) line quality capable of carrying facsimile and data transmissions; (3) equal access; (4) emergency services number capability; (5) a statewide telecommunications relay service for the hearing impaired; and (6) blocking of long distance toll services. To implement this general statutory directive, the PSC was authorized to promulgate administrative rules establishing the various USF-funded programs.

USF programs are funded by PSC assessments of telecommunications utilities with gross intrastate telecommunication revenues exceeding \$200,000. Act 496 initially authorized these assessments to fund only those programs developed by the Commission. These initial programs were to ensure telecommunications access for low-income residents, provide assistance to disabled residents, provide safeguards against fluctuations in price, and provide grants to medical organizations or non-profit groups for advanced telecommunication services.

Subsequent to the creation of the USF by Act 496, 1997 Wisconsin Act 27 established two additional programs funded from the USF. First, as part of the Technology for Educational Achievement in Wisconsin (TEACH) Board initiative, a USF-funded telecommunications access program was created. This program provides funding to eligible entities for access to new data lines and video links. Examples of eligible entities include school districts, technical college districts, private schools, cooperative educational service

agencies, juvenile correctional facilities, and public library boards.

Second, Act 27 established a USF-funded program under the UW System to reimburse the Department of Administration (DOA) for BadgerNet telecommunications services provided to UW campuses at River Falls, Stout, Superior, and Whitewater. BadgerNet is the state's telecommunications network that transports voice, data video, and broadcast formats, statewide.

Under 2003 Wisconsin Act 33, the TEACH Board was eliminated and its duties, including administration of the telecommunications access program, were transferred to DOA. Act 33 also expanded the list of eligible entities under this program to include public museums.

Wireless 911 Services. Provisions of 2003 Wisconsin Act 48 created a three-year grant program to reimburse local units of government and wireless telecommunications providers for costs related to tracking the telephone number and the location of callers using wireless telephones to make emergency calls. The grant program is funded through surcharges on consumers' wireless telecommunication bills. The PSC must promulgate rules requiring wireless telecommunications providers to impose a surcharge on their customers' bills based on the Commission's estimate of the costs of providing grants to local governments and wireless telecommunications providers. The surcharge must be uniform for all customers.

These surcharges are intended to cover local governments' costs for the following: (1) necessary network equipment, including database equipment, computer hardware and software, and radio and telephone equipment used within a wireless public safety answering point; (2) training operators of a wireless public safety answering point; (3) network costs; (4) collection and maintenance of data used to identify callers and their location; and (5) relaying messages to

emergency call centers.

To encourage countywide and regional cooperation, no more than one grant may be awarded per county. In addition, the PSC may provide supplemental grants to local units of government to encourage multi-jurisdictional grant applications. Wireless telecommunications providers may be reimbursed for costs related to enhancing the systems necessary to operate the wireless public safety answering point.

Electric Utilities

Partial Deregulation and Restructuring. In late 1994, the PSC opened a docket to consider approaches to restructuring electric utility transmission, generation and distribution operations. In October, 1995, an advisory committee issued a report detailing the various restructuring options that appeared to be feasible and described the types of legislative and policy changes required to implement each option. Then, in February, 1996, the PSC submitted a report to the Legislature advising that any conversion from regulated to competitive markets must be contingent on a series of electric industry and regulatory reforms. The PSC indicated that it intended to proceed incrementally through the restructuring process. The Commission's view at that time was that full retail competition would occur only if reforms in the industry's generation, transmission, and retail sectors were first implemented.

Disruptions to the state's electric power supply during the summer of 1997 subsequently led to the Legislature's involvement in the discussion of electric utility restructuring and deregulation. During the following spring, legislation designed to increase electric power reliability in the state was considered and approved as 1997 Wisconsin Act 204. While this legislation ostensibly addressed electric power reliability issues, it also impacted electric industry restructuring.

Act 204 required electric utilities with a transmission infrastructure to follow procedures to transfer control of such facilities either to an independent system operator or to divest the ownership of such facilities to an independent transmission owner. The Act authorized the operation of independently constructed wholesale merchant plants and limited the circumstances under which an affiliate of a utility could own such merchant plants. The Act also required the PSC to study existing transmission line capacity and order additional construction, if necessary. Finally, effective January 1, 1999, the Act repealed the biennial advance planning process for power plant siting and construction and replaced that process with a strategic energy assessment, to be prepared biennially by PSC staff.

Provisions of 1999 Wisconsin Act 9 significantly advanced the electric utility restructuring effort begun by 1997 Wisconsin Act 204. The principal electric utility restructuring provisions of Act 9 created a new corporate entity to control the high-voltage transmission lines that move bulk electricity across the state. Act 9 also included new requirements concerning the use of renewable energy resources, encouragement of conservation efforts, and the provision of financial assistance to low-income energy customers.

Act 9 authorized the transfer of ownership and control of the high-voltage transmission lines held by Wisconsin-based public utility companies operating principally in the eastern part of the state to a transmission company now called the American Transmission Company (ATC). Public utilities could make this transfer before September 30, 2000, while electric cooperatives and municipal utilities had until September 30, 2001, to make the transfer. The public utility companies, electric cooperatives, and municipal electric utilities received stock in the ATC to compensate them for their divested assets. In turn, the ATC provides these entities with equitable access to the transmission grid at fair rates. In addition, the ATC is responsible for constantly monitoring the flow of

electricity across the transmission grid as well as the planning, construction, operation, maintenance, and expansion of the grid.

In exchange for surrendering ownership and control of transmission lines, Act 9 exempted holdings by Wisconsin-based utility companies in associated energy, environmental or water businesses; customer metering and billing; and telecommunications investments from then-existing statutory provisions limiting these types of non-utility assets to not more than 25% of total holdings.

Earlier, provisions of 1997 Wisconsin Act 204 had required eastern Wisconsin public utilities to develop new generating capacity to produce 50 megawatts of electricity from renewable energy sources (wind, water, solar or biomass) by December 31, 2000. Additional modifications under Act 9 required any electric utility or cooperative to generate an escalating percentage of its retail electricity sales through renewable resources, increasing to 2.2% by the end of 2011.

Act 9 also created two public benefits programs to: (1) provide assistance to low-income households for weatherization and other energy conservation services, payment of energy bills, and the early identification and prevention of energy crises; and (2) award grants for energy conservation and efficiency services and for renewable resource programs. These programs are administered statewide by DOA for most utility customers. Municipal utilities and retail electric cooperatives have the option of implementing either or both of these public benefits programs for their own customers or members, or participating in the DOA-managed statewide effort.

The development of state-run public benefits programs has been an outgrowth of the restructuring of the electric utility industry in the state into separate generation, transmission, and distribution entities. It has been viewed by some in the industry as desirable from a competitive

standpoint to shift responsibility for utility-operated low-income programs and energy conservation public benefits programs from the utilities to another entity. Under the Act 9 provisions, the state and the utilities agreed that these public benefits functions should be transferred to DOA and that much of the funding being collected and used by utilities for these public benefits programs would be paid instead to the state.

Funding to support these public benefits programs derives from all of the following sources: (1) a new flat fee (yielding an aggregate \$40.8 million in 2003-04) assessed on customers' electric service bills that through June 30, 2008, may not exceed the lesser of 3% of the monthly electric service bill or \$750; (2) public benefits revenues currently collected by electric and natural gas utilities in customer rates and transferred to DOA (an annual amount of \$67.2 million); and (3) federal funds received by the state for low-income home energy assistance and weatherization programs (approximately \$56.8 million for FFY 2004). [For further information on the public benefits program, see the Legislative Fiscal Bureau's informational paper entitled, "Utility Public Benefits."]

Leased Generation. Provisions of 2001 Wisconsin Act 16 authorized public utilities and the affiliated interests of those utilities to enter into long-term leased generation contracts with one another. Act 16 also authorized a public utility to transfer, at book value, real estate used for providing utility service to an affiliated interest in order to implement an approved leased generation contract.

Under a leased generation contract, a utility's affiliated interest agrees to construct or improve electric generating equipment and associated facilities. The public utility then leases the land, equipment and facilities and operates the facility. The lease must be at least 20 years in length for gas-fired facilities and 25 years for coal burning facilities. After this initial lease, the public utility has the right to renew the lease or purchase the

facility at fair market value. Commission approval of either action is required. The cost of the project must be at least a \$10,000,000 improvement in order to qualify as a leased generation contract.

Act 16 prohibits the PSC from increasing or decreasing the retail revenue requirements of a utility on the basis of any income, expense, gain, or loss incurred or received by the utility's affiliated interest due to its ownership of equipment and facilities under a leased generation contract. The PSC must allow a utility to recover in rates all costs related to a leased generation contract.

Electric cooperatives or municipal electric utilities may acquire an interest in equipment, facilities, or land under a leased generation contract. Nuclear powered and wholesale merchant plants are not subject to leased generation contracts.

The initial effect of these provisions is to authorize the Wisconsin Energy Corporation, the parent company of Wisconsin Electric Power Company, to form a nonutility affiliate to be an electric power generating company. This nonutility affiliate may then build and own electric power generating facilities, which may be leased, in turn, back to Wisconsin Electric, which is the public utility affiliate in the same holding company system. Wisconsin Electric could then operate the new facilities to produce electric power for its customers, much as it operates its current stock of generating facilities. This ownership and lease arrangement is intended to allow the Wisconsin Energy Corporation to build generating facilities outside of its public utility affiliate (Wisconsin Electric), thereby taking advantage of less regulated financing and contracting options than would have been the case if the public utility constructed the facility.

Commencement of Utility Construction. 2001 Act 16 also required an electric utility that has received a certificate of public convenience and necessity from the PSC for constructing facilities rated at a

capacity of 100 megawatts or more to begin construction within one year of the latest of: (1) the date the Commission issues the certificate; (2) the date on which the electric utility has been issued every required federal and state permit, approval, or license; (3) the date on which every deadline has expired for requesting administrative review of such permits and licenses; and (4) the date on which the electric utility has received the final decision, after exhausting every proceeding for judicial review. Act 16, authorized the PSC to grant an extension of this deadline upon a showing of good cause by the electric utility.

If the electric utility did not begin construction within this one-year period, unless extended, the original certificate would be void.

Environmental Trust Financing. Provisions of 2003 Wisconsin Act 152 established an alternative means for public utilities to finance certain capital costs related to undertaking an environmental control activity. This new mechanism (referred to as environmental trust financing) provides additional flexibility to utilities seeking to fund the construction, installation, or placement of equipment or technology that reduces or prevents environmental pollution. The concept includes financing used to retire an existing plant or facility in an effort to reduce, control, or eliminate environmental pollution but does not include financing for the payment of monetary penalties, fines, or forfeitures assessed against a public utility.

Under Act 152, once a public utility applies to the PSC for an environmental trust fund financing order, the Commission has 120 days to determine whether to accept or deny the application. The Commission must do all of the following when issuing an environmental trust financing order: (1) specify the amounts that may be recovered by the utility through environmental control charges and indicate the time period over which customers may be assessed those costs; (2) require customers

residing in the utility's service territory to pay the environmental control charges for the entire length of the order, regardless of whether the customers subsequently obtain service from a different utility during that period; (3) identify the revenue stream under the proposal that may be used to retire or secure environmental control equipment bonds; and (4) include a formula for making adjustments to the environmental control charges to prevent over- and under-collections of the charges and to ensure the timely recovery of relevant costs (referred to as a "true-up" mechanism). The PSC must review this true-up mechanism at least annually.

A financing order remains in effect until the environmental trust bonds are paid in full, including all financing costs, even in the case of bankruptcy by the utility. If the PSC deems it appropriate, the public utility may reissue the debt, if lower rates can be achieved.

A utility that issues bonds pursuant to an environmental trust financing order must deposit the bond proceeds into an account that is used solely for paying the environmental control and financing costs. On an annual basis, the utility must provide customers with an explanation of the environmental control charges.

The PSC may not consider environmental control charges as costs or revenue of the utility. The utility's right to collect environmental control charges continues until all environmental control costs and related financing costs have been fully recovered.

The state is not financially liable in any way for utility-issued environmental trust bonds. Under Act 152, the state may not engage in any action that would reduce the value of the environmental control property or alter the environmental control charges, other than to ensure that collections are sufficient to cover the regular bond repayments.