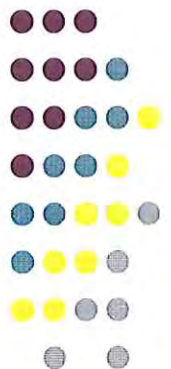




# Taxation and Regulation of Public Utilities

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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.

Since the 1980s, significant changes have occurred with respect to the regulation of telecommunications and electric utilities. In response to increased competition in the telecommunications industry, the U.S. government brought an antitrust lawsuit against AT&T, which was settled in 1982. As part of the settlement, AT&T continued to provide long distance service, but agreed to divest itself of its companies providing local exchange service on January 1, 1984. 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 the 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. 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.

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## State Utility Taxes

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### 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 assessed value of company property within the state; or (b) a tax or license fee based on the gross revenues or receipts of the company generated in Wisconsin. The history of these tax provisions is varied for each type of company, but generally represents a movement from local to state taxation.

Almost since the state's creation, a recognition has existed that certain public utility property may be difficult to tax locally. An 1854 law exempted railroads from the property tax, and, instead, the state imposed a tax based on the railroads' earnings. In 1904 and 1905, that tax was phased out and replaced with an ad valorem tax based on the statewide average tax rate. The state ad valorem tax was extended to street railway companies with connected light, heat, and power operations in 1908 and to all light, heat, and power companies in 1917, provided they operated in more than one municipality. Previously, the state preempted local taxation of conservation and regulation companies (owners of dams and reservoirs used for hydroelectric power generation), which became subject to the state's ad valorem tax in 1915. Subsequently, the tax was imposed on commercial airlines in 1946 and on gas and oil pipeline companies in 1950.

As evidenced by the state's early taxation of railroad companies, the gross revenues tax has been an alternative to the state's ad valorem tax for most of the state's history. Starting in 1883, gross revenues license fees were imposed on telephone companies at graduated tax rates, and separate toll and exchange rates were extended in 1931. A gross revenues based tax was extended to car line companies (lessors of passenger and freight railroad cars) in 1931 and to rural electric cooperatives in 1939.

Since 1986, the basis of taxation has shifted for a number of utilities, but the two basic forms of taxation continue. The tax basis for light, heat, and

power companies was changed from ad valorem to gross revenues in 1986. In the same year, telegraph companies were recognized as providing telecommunications services and also were shifted from ad valorem to gross revenues taxation. In addition, all other companies providing telecommunications services to the public (such as resellers) were made subject to the gross revenues license fee.

The gross revenues license fee on telecommunications services was subsequently discontinued, and since 1998, all telephone companies have been taxed on an ad valorem basis. As part of the shift to an ad valorem tax, a transitional fee was imposed on certain telecommunications service providers in 1999 and 2000, based on the tax that would have been due under the gross revenues license fee. The ad valorem tax on telephone companies differs from the state ad valorem tax imposed on other public utility property. A separate value of the property of telephone companies is determined within each local taxing jurisdiction where telephone company property is located, and the tax is based on the prior year's net property tax rate of the corresponding local taxing jurisdiction.

Both types of tax are administered by the Department of Revenue (DOR). Table 1 summarizes the type of utility tax, the tax base, and the tax rate that currently applies to each type of Wisconsin utility company.

### **Ad Valorem Group**

Utilities subject to ad valorem taxation include: (a) air carrier companies; (b) conservation and regulation companies; (c) municipal electric companies; (d) pipeline companies; (e) railroad companies; and (f) telephone companies.

***Air Carrier Companies.*** The statutes define an air carrier company as 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 Air Wisconsin Airlines, AirTran Airways, American Eagle Airlines, Atlantic Southeast Airlines, Chau-

**Table 1: Summary of Utility Tax by Type of Utility**

Utilities Subject to Ad Valorem Taxes	Tax Base	Tax Rate
Air Carrier Companies Conservation and Regulation Companies Municipal Electric Companies Pipelines Railroad Companies	All real and personal property, including all franchises, title, and interest of the company used or employed in its operations; value as a unit	Average net property tax rate in state
Telephone Companies	Real property and tangible personal property; value within the local jurisdiction where it is located	Net property tax rate in jurisdiction where property is located
Utilities Subject to Gross Revenues License Fee	Tax Base	Tax Rate
Car Line Companies	Gross receipts from the operation of car line equipment	Average net property tax rate in state
Electric Cooperative Associations	Gross revenues, less certain deductions, from: - the sale of electricity for resale - all other sources	1.59% 3.19
Municipal Light, Heat, and Power Companies	Gross revenues from outside the municipality, less certain deductions, from: - the sale of gas services - the sale of electricity for resale - all other sources	0.97 1.59 3.19
Private Light, Heat, and Power Companies	Gross revenues, less certain deductions, from: - the sale of gas services - the sale of electricity for resale - all other sources	0.97 1.59 3.19

tauqua Airlines, Com Air, Delta Airlines, Express Jet Airlines, Federal Express Corporation, Frontier Airlines, Mesa Air Group, Mesaba Aviation, Pinnacle Airlines, Republic Airline, SkyWest Airlines, Southwest Airlines, Trans State Airlines, U.S. Airways, and United Parcel Service Company. Airline company utility taxes are categorized as segregated revenue and deposited in the transportation fund.

Beginning in 2001, an exemption from ad valorem taxes was extended for any air carrier that operates a hub facility in Wisconsin. For purposes of the exemption, 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 car-

rier 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. After being challenged as unconstitutional, the Wisconsin Supreme Court upheld the exemption. The exemption was extended to Air Wisconsin Airlines from 2001 through 2006 and to Midwest Airlines from 2001 through 2009. In 2009, Republic Airways purchased both Midwest Airlines and Frontier Airlines

and merged the two as Frontier Airlines in 2010. DOR determined that the merged airline qualified for the exemption in 2010.

**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. The Chippewa & Flambeau Improvement Company and the Wisconsin Valley Improvement Company have been established to conserve runoff waters in the Chippewa River and Wisconsin River watersheds.

**Municipal Electric Companies.** 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 companies are subject to ad valorem utility taxes -- Badger Power Marketing Authority of Wisconsin, Western Wisconsin Municipal Power Group, and WPPI Energy.

**Pipeline Companies.** State law defines pipeline company as any person that is engaged in the business of transporting or transmitting gas, gasoline, oils, motor fuels, or other fuels by means of pipelines and that is not a light, heat, and power utility. Of the group of utilities subject to ad valorem taxes, pipeline companies generate the second highest amount of general fund taxes. In 2010, eleven pipeline utility companies operated in Wisconsin. The largest carriers, in terms of their property value allocated to Wisconsin, are Enbridge Energy and Southern Lights Pipeline, which transport oil products, and ANR Pipeline Com-

pany, Great Lakes Transmission, Guardian Pipeline, and Northern Natural Gas, which transport natural gas.

**Railroad Companies.** A railroad company is any person, other than 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 12 railroad companies in Wisconsin. The major carriers are the Burlington Northern and Santa Fe Railway Company, Soo Line Railroad Company, Union Pacific Railroad, and Wisconsin Central Ltd. Railroad utility taxes are categorized as segregated revenue and deposited in the transportation fund.

**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, but 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 below, state law provides a different assessment procedure for telephone companies than for other ad valorem taxpayers.

In 2010, 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. These 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 (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. Four telephone companies bore over half of the total 2010 ad valorem tax assessment on telephone companies. These companies include Ameritech Wisconsin, CenturyTel, U.S. Cellular, and Frontier (formerly Verizon).

**Determination of Tax Assessment.** For all ad valorem utilities, a tax assessment is calculated by determining the full market value of the utility's taxable property and multiplying that value by a tax rate. State law excludes from taxation the value of certain property that is also exempt from general property taxes: (a) motor vehicles; (b) treatment plant and pollution abatement equipment; and (c) computers, cash registers, and fax machines.

For the utilities other than telephone companies, the tax assessment equals the statewide average net property tax rate multiplied by the utility's Wisconsin value. DOR determines that value by deriving a unit value, which is equivalent to the utility's full market value if sold as a unit, and allocating a portion of that value to Wisconsin according to statutorily established formulas. Since actual sales price data do not generally exist, this process utilizes three distinct indicators of value -- cost, capitalized income, and stock and debt -- which attempt to take account of earning potential and are weighted differently according to the most appropriate indicator for a given type of utility.

Under the cost indicator, the Department may consider four types of costs: historical; original; reproduction; and replacement. To these costs, allowances are made for loss of value due to depreciation, 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. That is, the purchase price of the company can be determined by estimating ex-

pected future earnings and a required rate of return for investors. 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 to employ. Other indicators are also considered, including company and independent appraisals, prior year assessments, shareholders reports, and comparable sales, if available. Based on these indicators, the Department uses its judgment to arrive at an estimate of fair market value.

Telephone companies have been subject to a somewhat different assessment process since 1998. First, telephone company values are determined within each local taxing jurisdiction where the company's property is located. Second, the value within each local taxing jurisdiction is multiplied by the net tax rate applied in that jurisdiction in the prior year under the general property tax. This procedure causes the value of intangible property to be excluded from the telephone company's value, which differs from the unit value methods for valuing property, where the value of intangible property is generally included in the utility company's assessed value.

State law requires DOR to value telephone company property using the same methods the Department uses to assess manufacturing property, including a field review of all property once every five years on a rotating basis. Generally, DOR uses a sales-based approach to assess real property and the cost-based approach to assess personal property. For real property, DOR makes annual adjustments to reflect new construction and economic changes to value. Beginning in 2005, DOR changed its procedure for valuing telephone company personal property. The property's value is initially determined on a company-wide basis by multiplying the property's original cost by a conversion factor that reflects price changes and depreciation. The resulting value is allocated to individual local jurisdictions based on the original cost of the personal property in each jurisdiction relative to the

original cost of personal property on a company-wide basis.

If telephone company property is used in part for utility operations and in part for nonoperating purposes, the property's predominant use determines how it is assessed. If real or tangible personal property is used more than 50% in the business's operation as a telephone company, then DOR assesses the property and the property is exempt from the general property tax. 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.

For other 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.

**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 for railroads and municipal electrics, October 1 for pipelines, airlines, and conservation and regulation companies, or November 1 for telecommunications companies. The remainder of the current year's assessment is due on November 10.

### **Gross Revenues Group**

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

**Car Line Companies.** State law defines a car line company as any person, not operating a railroad, that is engaged in the business of furnishing or

leasing car line equipment to a railroad. Car line equipment means railroad cars or other railroad equipment used in railroad transportation provided under a rental agreement. In 2010, six car line companies were subject to the state utility tax.

**Electric Cooperatives.** An electric cooperative is an entity organized under state law as a cooperative association that generates, transmits, or distributes electric energy to its members at wholesale or retail. The major electric cooperative association is Dairyland Power Cooperative. It is headquartered in La Crosse and supplies wholesale electricity to 25 rural electric distribution cooperatives, including 18 in Wisconsin, and 16 municipal utilities, including 10 in Wisconsin. In 2010, Dairyland accounted for over 60% of total electric cooperative gross revenues.

**Light, Heat, and Power Companies.** There are two basic types of light, heat, and power companies. They may be either investor-owned or operated as a municipal utility. State law defines a light, heat, and power company as a person, association, company, or corporation engaged in the following businesses: (a) generating and furnishing gas for lighting or fuel or both; (b) supplying water for domestic or public use or for power or manufacturing purposes; (c) generating, transforming, transmitting, or furnishing electric current for light, heat, or power; (d) generating and furnishing steam or supplying hot water for heat, power, or manufacturing purposes; or (e) transmitting electric current for light, heat, or power. Only municipal public utilities that meet the definition and also provide service outside the boundaries of the municipality owning the utility are subject to the state tax.

Since the tax on light, heat, and power companies was converted from an ad valorem to a gross revenues tax in 1985, the definition of light, heat, and power company has been expanded several times to reflect industry changes. Beginning in 1996, the definition was modified to include qualified wholesale electric companies, defined as any



person that: (a) 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; (b) sells at least 95% of its net production of electricity; and (c) owns, operates, or controls electric generating facilities that have a total power production capacity of at least 50 megawatts. These companies are also called independent power producers.

In 2001, the definition of qualified wholesale electric company was extended to wholesale merchant plants that have a total power production capacity of at least 50 megawatts. As part of a broader effort to enhance electric reliability, state law governing the regulation of public utilities had previously been amended to recognize these plants as electric generating equipment and associated facilities in this state that do not provide service to any retail customer and that are owned or operated either by an affiliated interest of a public utility or by a person that is not a public utility.

In 2010, the state's gross revenues tax on light, heat, and power companies extended to 107 utilities. While the state's 77 municipal light, heat, and power companies outnumber the private light, heat, and power companies, the municipal utilities comprised only 1.3% of 2010 tax assessments. The remaining 98.7% of the tax was attributable to 30 private light, heat, and power companies, which included 18 companies providing primarily retail service, 11 qualified wholesale electric companies, and one transmission company. Six companies comprised over 90% of total tax assessments: Wisconsin Electric Power Company; Wisconsin Power and Light Company; Wisconsin Public Service Corporation; Xcel Energy (the holding company for Northern States Power); Madison Gas and Electric Company; and Wisconsin Gas Company.

**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. For each type of taxpayer, state law specifies a rate and defines the tax base. Because the taxes are characterized as gross revenues or receipts, relatively few types of revenues are excluded from the tax base.

Car line companies' 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. A tax rate equal to the average statewide net property tax rate is applied against the receipts. This is the same rate used for the state's ad valorem tax.

For electric cooperatives, gross revenues are defined as the previous year's total operating revenues, less interdepartmental sales and rents and the retailers' discount from the sales tax. Certain grants, public benefit fees, and low-income assistance fees 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. Electric cooperatives are taxed at a flat 3.19% rate on gross revenues, except that the tax rate on wholesale sales of electricity is reduced to 1.59%.

Annual assessments for light, heat, and power companies are based on their taxable gross revenues earned during the previous year. Except for qualified wholesale electric companies and transmission companies, gross revenues are defined as total operating revenues reported to the state Public Service Commission (PSC), less interdepartmental sales and rents and the retailers' discount from the sales tax. Also, gross revenues include receipts from total environmental control charges paid to

companies under financing orders issued by the PSC. A private light, heat, and power company may deduct from its gross revenue either: (a) 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 (b) 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, public benefit fees, and low-income assistance fees are also excluded from the gross revenues of light, heat, and power companies. Municipal light, heat and power companies are only taxed on that portion of their revenues from outside the boundaries of the municipality operating the utility.

For qualified wholesale electric companies, "gross revenues" means total business revenues from the same services that are provided by light, heat, and power companies. For transmission companies, operating revenues are subject to the license fee, except for revenues from transmission services to a Wisconsin public utility or electric cooperative.

To determine Wisconsin taxable revenues for multi-state companies, an apportionment factor based on the shares of a company's total payroll, property, and sales that are in Wisconsin is applied to a company's gross revenues. The payroll factor includes management and services fees paid by a light, heat, and power company to an affiliated public utility holding company. As a result of this treatment, the portion of a public utility holding company's property that is used to provide services to a light, heat, and power company affiliated with the holding company is exempt from local property taxation.

Revenues from the sale of gas services are subject to tax at the rate of 0.97%, and wholesale sales of electricity are taxed at 1.59%. The tax rate on all other taxable revenues is 3.19%. The 1.59% tax rate on wholesale sales of electricity was enacted as a temporary reduction from the 3.19% tax rate on revenues for calendar years 2004 through 2009, but

2007 Wisconsin Act 20 made the reduction permanent.

**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 made in the assessment year, to reconcile installment payments with final assessments.

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.

For electric cooperatives and light, heat, and power companies, 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 by the following May 1. On May 10 of the year following the year in which the revenue was earned, either a final adjustment payment is made or a refund is issued to reconcile the two prior installment payments with the actual assessment.

## **Tax Collections**

Ad valorem tax collections from airlines and railroads are classified as segregated revenues and deposited in the state's transportation fund, while the general fund receives the remaining utility tax revenues. In 2009-10, general fund utility tax collections totaled \$319.4 million and comprised 2.6% of total general fund tax revenues. Utility tax collections deposited in the transportation fund equaled \$28.6 million in 2009-10 and accounted for 1.7% of the transportation fund's total revenues.

Table 2 shows the change in general fund utility tax collections over the last seven fiscal years. Over the entire period, collections increased by 18.4%, although collections decreased in two of the seven years. In 2003-04 through 2005-06, telephone com-

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

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
<b>Ad Valorem Tax</b>							
Conservation & Regulation	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1
Municipal Electric	1.3	1.6	1.5	2.0	2.2	3.5	4.2
Pipeline	10.6	10.6	10.7	10.7	11.2	16.2	23.1
Telephone/Special Common Carrier	<u>81.6</u>	<u>72.6</u>	<u>63.0</u>	<u>65.3</u>	<u>59.5</u>	<u>63.4</u>	<u>70.0</u>
Total Ad Valorem Tax	\$93.6	\$84.9	\$75.3	\$78.1	\$73.0	\$83.2	\$97.4
<b>Gross Revenues Tax</b>							
Car Line Companies	\$0.4	\$0.4	\$0.3	\$0.2	\$0.2	\$0.2	\$0.1
Electric Cooperatives	8.5	7.2	8.1	8.8	9.4	10.5	10.4
Municipal Light, Heat & Power Cos.	1.8	1.9	2.4	2.3	2.7	2.7	2.9
Private Light, Heat & Power Cos.	<u>165.4</u>	<u>159.6</u>	<u>189.1</u>	<u>195.4</u>	<u>212.1</u>	<u>223.5</u>	<u>208.6</u>
Total Gross Revenues Tax	\$176.1	\$169.1	\$199.9	\$206.7	\$224.4	\$236.9	\$222.0
Refunds and Interest & Penalty Payments	0.1	0.5	0.0	0.1	0.0	0.0	0.0
General Fund Total Collections	\$269.8	\$254.5	\$275.2	\$284.9	\$297.4	\$320.1	\$319.4

pany taxes declined due to reductions in taxable values, caused by equipment depreciation and obsolescence. Decreases in ad valorem tax rates also contributed to these reductions, as well as the reduction in 2007-08. Telephone company taxes have increased in three of the four years since 2005-06. The increases are attributable both to higher property tax rates in the two most recent years and to higher taxable values due to equipment investment. In 2004-05, private light, heat, and power company taxes declined when the reduction in the tax rate on wholesale sales of electricity began. Between 2004-05 and 2008-09, additional revenues related to the construction of new production plants caused private light, heat, and power company taxes to increase by 40.0%. However, private light, heat, and power company taxes decreased in 2009-10, reflecting lower revenues due to the economic

downturn, which reduced commercial and industrial energy consumption.

Table 3 shows historical collections for the two transportation fund utilities. Over the seven-year period, total collections have increased by 42.3%. While airline collections have decreased by 45.1%, railroad collections have increased by 102.5%. The large increase in railroad taxes was caused largely by higher taxable values, which increased by 87.1% between 2004 and 2010. Over 90% of that increase was attributable to the Burlington Northern and Santa Fe, Soo Line, and Wisconsin Central Limited railroads. Airline taxes decreased from \$8.2 million in 2003-04 to \$4.5 million in 2009-10. Between the 2004 and 2009 tax years, the statewide average tax rate decreased 13.3%, while airline values increased by only 8.3%. However, 2009 to 2010 in-

**Table 3: Transportation Fund Utility Tax Collections (In Millions)**

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
<b>Ad Valorem Tax</b>							
Airline	\$8.2	\$5.8	\$4.7	\$6.7	\$6.7	\$5.4	\$4.5
Railroad	<u>11.9</u>	<u>16.0</u>	<u>16.4</u>	<u>18.3</u>	<u>19.9</u>	<u>21.6</u>	<u>24.1</u>
<b>Transportation Fund</b>							
Total Ad Valorem Taxes	\$20.1	\$21.8	\$21.1	\$25.0	\$26.6	\$27.0	\$28.6

creases of 5.4% in the statewide tax rate and 13.0% in taxable values may signal future growth in airline taxes. Since 2000, mergers, acquisitions, bankruptcies, and increased competition have characterized the airline industry. Although the number of airlines operating in Wisconsin equaled 25 in both 2004 and 2010, only 14 of those companies operated in Wisconsin in both years.

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## Other State Taxes on Utilities

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### 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

Current law provides a number of energy-related sales and use tax exemptions to utilities and other businesses, including exemptions for the following: (a) purchases by power companies of fuel used to produce electricity, steam, or other power; (b) transfers of transmission facilities to an electric transmission company; (c) the gross receipts of electric utilities and retail electric cooperatives from collections of public benefit fees; (d) fuel and electricity consumed in manufacturing tangible personal property; and (e) purchases of electricity and fuel, including natural gas, used in farming.

Effective July 1, 2011, a sales tax exemption is provided to power companies, as well as others, for products, other than an interruptible power source for computers, whose power source is wind energy, direct radiant energy received from the sun, or gas generated from anaerobic digestion of animal manure and other agricultural waste, subject to minimum power production requirements. The sale, use, or consumption of electricity or energy produced from such a product is also exempt, beginning July 1, 2011. Finally, 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.

The state sales tax is generally imposed on telecommunications services, mobile telecommunications service, most ancillary services (such as voicemail service and directory assistance), and internet access services if the services are sourced to Wisconsin. These services, other than telecommunication services sold on a call-by-call basis, are subject to the tax if the customer's place of primary use is in Wisconsin. Telecommunications services

that are sold on a call-by-call basis are sourced to this state if the call originates or terminates in Wisconsin and is charged to a service address in this state.

The state's sales tax also applies to sales of prepaid calling services (calling cards) and prepaid wireless calling services (prepaid mobile phones), if the sales are sourced to Wisconsin. Generally, these sales are sourced to Wisconsin if the sale takes place at a retailer's location in this state, if the item that will implement the right to receive telecommunications services (such as a calling card) is shipped to a customer's address in this state, or if no item is shipped to a Wisconsin address but the customer's billing address is located in this state.

State law provides certain exemptions from the tax, such as for the sales price of the countywide "911" emergency phone systems, the police and fire protection fee, detailed telecommunications billing services, and interstate 800 services.

More information about the sales tax may be found in the Legislative Fiscal Bureau's informational paper entitled "Sales and Use Tax."

### **Police and Fire Protection Fee**

State law requires communications providers to impose a police and fire protection fee equal to seventy-five cents per month on each active retail voice communications service connection with an assigned telephone number. In instances where a provider extends multiple service connections to a subscriber, a separate fee is imposed on each of the first ten connections, and one additional fee is imposed for each additional ten connections per billed account. Communications service provided via a voice over Internet protocol connection is also subject to the fee. Prepaid wireless telecommunications plans are subject to a fee that is equal to one-half of the fee imposed on other types of service connections. Such fees are imposed with each retail transaction, and retailers are required to collect the fee from the buyer with respect to each transaction. Providers and retailers are permitted to list the fee

separately on subscribers' bills, or to list the fee in combination with charges for funding countywide 911 systems.

While state law directs the PSC to administer the fee, the Commission has contracted with DOR to collect the fee under a separate statutory provision. Subscribers pay the fee to their communications provider or retailer, who remits the fee to DOR by the end of the calendar month following the month the provider or retailer receives the fee from the subscriber. Fees are not included in calculating state or local sales taxes.

The police and fire protection fee was created in 2009 Wisconsin Act 28 and has been imposed since September 1, 2009. During the first nine months the fee was imposed, collections totaled \$45.4 million in 2009-10. Collections of \$61.2 million are estimated for 2010-11, the first full year of imposition.

Proceeds from the fee are deposited in a segregated fund called the police and fire protection fund. Amounts deposited in the fund are used to make payments under the county and municipal aid program, thereby reducing the amount of general purpose revenue needed for the payments.

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## **Public Service Commission's Regulation of Public Utilities**

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### **History**

Wisconsin's Public Service Commission (PSC) was preceded by a Railroad Commission, which regulated railroad rates. In 1907, the Railroad Commission's responsibilities were expanded when Wisconsin became the first state to regulate essential utility services provided to the public by entities that generally operated as noncompetitive, natural monopolies. The Public Service Commission was established as the successor to the Railroad Commission in 1931. Currently, the PSC regu-

lates electric, natural gas, steam, water, and combined water and sewer utilities and certain aspects of local telephone service.

### **Public Service Commission Overview**

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, and number of customers served, the Commission is generally responsible for:

- Setting the level and structure of rates for utility service based on authorized rates of return on investment;
- Regulating the construction, use, modification, and financing of utility operating property, including the use of depreciation accounts for new construction;
- Valuing operating property;
- Overseeing, examining, and auditing utility accounts and records;
- Approving utility mergers, other than for telecommunications utilities;
- Overseeing transactions between a public utility and an affiliated interest; and
- Determining levels of adequate and safe service and responding to consumer complaints about utility operations and prices.

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. The following material provides greater detail on the PSC's major responsibilities.

### **Traditional Rate Regulation**

Although recent legislation has changed the Commission's responsibilities, rate-setting has historically been the Commission's most visible regulatory function. In what has traditionally been a monopoly market, the rate-setting process attempts to establish prices at levels that would occur naturally under competitive market forces. While a utility's natural interest is to set prices at levels that maximize profits, the regulatory process provides a balance so that services are provided at prices that are reasonable both to ratepayers and to utility owners.

Rate-setting typically involves three basic determinations. First, the Commission sets a rate of return that the utility is allowed to earn on its investment in plant and equipment. Second, the amount of revenue necessary for the utility to operate, pay debt, and meet its allowable rate of return is determined. Third, prices are set at levels that will generate the company's revenue requirement, allocated across categories of service according to relative costs and other factors for each category. All corporate income taxes, ad valorem or gross revenues utility taxes, and sales taxes are treated as expenses, and are generally fully recovered through the rates.

For utilities subject to such rate regulation, the rate-setting process has three basic procedural phases: pre-hearing, public hearing, and decision-making. First, the pre-hearing phase begins when a utility requests a rate increase. Prior to any formal hearing, PSC staff analyze the request and its impact and conduct a company audit. Also at this time, interested parties wishing to participate at the

public hearing on the rate request prepare their materials. Second, 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. Third, the decision-making phase occurs after the public hearing and involves an open meeting held by the commissioners on the 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. Appeals are made, first, at a PSC rehearing and, then, to 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. Primary oversight of the state's two commercial nuclear power reactors that generate electricity is provided by the federal Nuclear Regulatory Commission, which regulates the operation and decommissioning of nuclear power plants and the transportation, storage, and disposal of nuclear waste from the plants. 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 regulation are in a state of flux.

The PSC authority over rates does not extend to all public utilities. In addition to the interstate utilities, some intrastate utilities are also excluded from PSC oversight. These include electric cooperatives,

telephone cooperatives, certain specified providers of telecommunications services, and cable television companies. In recent years, state law has been revised to lessen the scope of the Commission's regulatory authority over other utilities, including telecommunications service providers.

### **Partial Deregulation of Telecommunications Services**

Telecommunications services are provided by a variety of companies. Incumbent local exchange companies (ILECs) are the local telephone service providers that existed both before and following the break-up of the "old AT&T Bell System." Resellers are companies that buy service at wholesale from ILECs and resell that service to consumers. Competitive local exchange carriers provide service independently in areas served by ILECs. Competitive local exchange companies, resellers, and wireless and cellular companies are not subject to traditional PSC rate regulation.

For the traditional telecommunications utilities (the ILECs), many are now subject to forms of regulation other than the traditional rate of return approach generally used for public utilities rate-setting. One regulatory mechanism under the statutes is "price-regulation," which can be characterized as a form of incentive regulation. Instead of regulating the total earnings of the utility, the PSC regulates the utility based only on the prices of basic services offered.

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 if the change in the revenue-weighted price indices for all services subject to price regulation does 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, a penalty due to inadequate service may be added to increase the productivity offset, and an incentive to encourage infrastructure development may be subtracted to decrease the productivity offset. Adjustments to the productivity offset may be set up to 1% or 2%, depending upon the size of the utility.

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, provided the notice is accompanied by documentation that the change is just and reasonable. The PSC may approve, modify, or reject the proposed change based on an investigation and may suspend the proposed change pending the conclusion of its investigation. The Commission's investigation is limited to: cost allocations of price-regulated services that are beyond the control of the utility; competition; network and service quality, improvement, 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. Currently, AT&T and Frontier (formerly Verizon) are price-regulated. Since first coming under price regulation, AT&T has successfully petitioned the PSC to remove from price regulation limits its business services in all exchanges and its residential exchange line services in its 17 largest exchanges.

Telecommunications utilities that do not elect to become price-regulated 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 (telecommunications utilities with fewer than 50,000 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 rate increases are made.

In addition to regulation of incumbent local exchange companies, the PSC regulates the entry of competitive local exchange carriers into intrastate local and toll telecommunications markets. These companies generally 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.

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 Act, the PSC must approve interconnection agreements reached through voluntary negotiations between the parties, as well as mediate and arbitrate disputes over interconnection agreements. In addition, the federal Act authorizes the PSC to regulate the terms and conditions of competitive entry into rural telephone company exchanges.

### **Restructuring of Electric Utilities**

While the telecommunications industry was being deregulated, the Public Service Commission examined whether similar principles could be applied to the electric industry. The Commission's



efforts were prompted, in part, by federal law changes allowing wholesale electric generators to compete with electric utilities in supplying power and requiring owners of electric transmission lines to let any generator transmit power over their lines.

In late 1994, the PSC opened a docket to consider approaches to restructuring electric utility transmission, generation, and distribution operations, and, one year later, an advisory committee issued a report detailing the various restructuring options that appeared to be feasible and describing the types of legislative and policy changes required to implement each option. A PSC report to the Legislature in February, 1996, advised 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. In 1997, disruptions to the state's electric power supply shifted the state's restructuring efforts to focus on reliability, as opposed to deregulation. Electric industry restructuring has caused the PSC to expand its activities beyond traditional rate regulation to include new responsibilities related to electric transmission, affiliated interests, independent power producers, renewable energy portfolios, and strategic energy assessment.

### **Transmission Divestiture**

Previously, individual electric utilities owned and operated electric transmission lines and facilities in their service territory. State law changes in 1997 and 1999 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 ATC to compensate them for their divested assets. In turn, ATC provides these entities with equitable access to the transmission grid at fair rates. In addition, 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. Although the PSC oversaw the transfer of utility infrastructure to ATC, ATC's creation diminished the Commission's authority since the Federal Energy Regulatory Commission regulates the transmission and wholesale sales of electricity. However, the PSC has retained oversight of the construction of transmission facilities. In western Wisconsin, Northern States Power and Dairyland Power Company continue to maintain their own transmission infrastructure.

### **Affiliated Interests and Leased Generation**

State law authorizes public utilities and the affiliated interests of those utilities to enter into long-term, leased generation contracts with one another. Generally, an affiliated interest is a person or company with an ownership interest in a public utility. Also, it can be a company in which a public utility has an ownership interest.

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 facilities. 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 facilities at fair market value. The project must be at least a \$10 million improvement in order to qualify as a leased generation contract.

State law requires PSC approval of leases and lease renewals between public utilities and affli-

ated interests. The Commission must find that the lease will not have a substantial, anticompetitive effect on electricity markets for any class of customers. Also, state law 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.

The initial effect of these provisions was 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. The nonutility affiliate builds and owns electric power generating facilities, which are then leased back to Wisconsin Electric. Wisconsin Electric operates the new facilities to produce electric power for its customers, much as it operates the generating facilities that it directly owns. This ownership and lease arrangement allows 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 exist if the public utility constructed the facility.

### **Siting of Power Plants and Transmission Facilities**

State law prohibits the construction of large electric generating facilities and high-voltage transmission lines unless the PSC has issued a certificate of public convenience and necessity (CPCN). Unlike other PSC regulatory activities, the siting portion of the CPCN requirement also applies to electric cooperatives and merchant companies.

A CPCN is required for any generating facility with a capacity of 100 megawatts or more and transmission facilities of at least one mile in length

that are designed for operation at 100 kilovolts or more. Certificates of public convenience and necessity are not required for transmission lines designed to operate at a nominal voltage of less than 345 kilovolts if an electric cooperative constructs the transmission line entirely within an existing transmission line right-of-way or if a utility constructs the transmission line within 60 feet of the centerline of an existing transmission line operating at a nominal voltage of 69 kilovolts or more. In the latter case, the construction area can exceed the existing right-of-way, subject to certain limitations.

The PSC determines the information to be contained in applications and, within 30 days of an application's submittal, the Commission must determine if the application is complete. A public hearing must be held on each application, and state law requires the Commission to take final action on a completed application within 180 days of its submittal, although the PSC may request a court-ordered extension of up to 180 additional days. The PSC certification process is coordinated with Department of Natural Resources permitting requirements.

Before issuing a CPCN, the PSC must determine that the proposed facility meets a number of statutory standards. These standards relate to electric energy reliability, service efficiency, future electricity needs, wholesale market competition, the environment, and existing land use and development plans. Some facilities, such as merchant plants, are specifically excluded from certain standards, and other standards are specifically limited to high-voltage transmission lines and PSC-regulated public utilities. Based on its findings, the PSC may approve, deny, or modify proposed facilities.

For electric generating facilities, construction must begin within one year of the latest of: (a) the date the Commission issues the certificate; (b) the date on which the electric utility has been issued every required federal and state permit, approval, or license; (c) the date on which every deadline has

expired for requesting administrative review of such permits and licenses; or (d) the date on which the electric utility has received the final decision, after exhausting every proceeding for judicial review. The PSC may grant an extension of this deadline upon a showing of good cause by the electric utility. If construction is not begun within this one-year period, the original certificate becomes void.

For smaller facilities not meeting the CPCN threshold of 100 megawatts or 100 kilovolts, the PSC may require a certificate of authority.

Wind energy systems with an operating capacity of less than 100 megawatts are subject to special provisions in state law and administrative rule, as a result of 2009 Wisconsin Act 40. The Act directs the PSC to establish a 15-member Wind Siting Council and promulgate administrative rules with the Council's assistance addressing setback requirements and decommissioning and providing reasonable protection from health effects. The rules must also enumerate the procedural requirements for approving systems at the state and local levels and may include other requirements relating to visual appearance, lighting, connections to the power grid, setback distances, maximum audible sound levels, shadow flicker, proper means of measuring noise, interference with communication signals, or other matters.

Municipalities and counties are prohibited from imposing more restrictive requirements on the installation of wind energy systems than those imposed under the PSC rules. Appeals of municipal or county decisions affecting wind energy systems may be made to the local government or to the PSC. Any judicial review must be preceded by a PSC decision or order, and any judicial review is limited to the PSC decision or order, rather than the local government decision or enforcement action.

On August 31, 2010, the PSC submitted a proposed rule to the Legislature implementing the provisions in Act 40. The PSC modified the pro-

posed rule based on hearings before the Assembly Committee on Energy and Utilities and the Senate Committee on Commerce, Utilities, Energy, and Rail. The Commission promulgated a final rule on December 27, 2010. The rule is expected to be effective on March 1, 2011.

### **Renewable Energy Portfolios**

The PSC has administered a renewable energy policy since 1994, when state law directed the Commission to encourage public utilities to develop and demonstrate technologies using renewable sources of energy. That provision was replaced in 1997 with a standard pertaining only to eastern Wisconsin public utilities. This requirement has been replaced by the state's current renewable energy portfolio standard.

The renewable energy portfolio standard requires electric utilities and cooperatives to sell a minimum, specified amount of electricity from renewable resources to their customers by certain dates. Prior to a 2005 law change, the standard was extended so that any electric utility or cooperative was required to generate an escalating percentage of its retail electricity sales through renewable resources, increasing to 1.2% by the end of 2005 and 2.2% by the end of 2011. In 2005, those benchmarks were repealed. Instead, for 2006 through 2009, current law prohibits each utility and cooperative from decreasing its renewable percentage below its average renewable percentage in 2001 through 2003. Relative to that average, each utility and cooperative is required to increase the amount of renewable energy it sells by an additional two percentage points by 2010 and by an additional six percentage points by 2015. If a utility or cooperative provides more renewable energy than required, it generates a renewable resource credit that it may retain for future use or sell to another utility or cooperative in an interstate credit trading market.

The standard is based on the total amount of electricity that a utility or cooperative sells in a year

relative to the amount of renewable resource credits it claims or electricity it generates from renewable resources. Renewable resources are certain energy sources used to generate electric power and include fuel cells that use a renewable fuel, tidal or wave action, solar thermal electric or voltaic energy, wind power, geothermal technology, synthetic gas created by the plasma gasification of waste, densified fuel pellets made from certain waste material, fuel produced by pyrolysis of organic waste material, and certain hydroelectric facilities.

The use of renewable resource credits was expanded by 2009 Wisconsin Act 406, which directs the PSC to promulgate administrative rules that recognize credits based on electric consumers' use of technology that displaces electricity use. Examples include solar applications such as water heaters or light pipes. Other displacement technologies may utilize geothermal energy, biomass, biogas, synthetic gas, densified fuel pellets, or fuel produced by pyrolysis, all as enumerated above. Under Act 406, the PSC must submit the rules necessary to implement the new credits in early 2011.

State law establishes a goal for the renewable resource program of realizing 10% of all electric energy consumed in the state being renewable energy by 2015. By June 1, 2016, state law directs the Commission to report to the Legislature and Governor on whether or not the goal has been met. Further, the PSC is required to submit biennial reports to the Legislature and Governor evaluating the impact of the renewable resource requirements on electric rates and revenues. The Commission's October, 2010, Strategic Energy Assessment reports that 4.87% of all electrical energy sold in Wisconsin was generated from renewable resources and that all electrical providers and aggregators were in compliance with the renewal portfolio standard. These benchmarks were achieved in 2008, the latest full year for which data was available at the time of the PSC report.

Other PSC duties relating to the program in-

volve granting extensions to the percentage requirements for utilities and cooperatives, receiving annual reports from utilities and cooperatives identifying their renewable percentages, and promulgating rules governing the calculation and sale of renewable resource credits. Violations of the renewable resource standards are subject to penalties enforced by actions of the Attorney General.

### **Strategic Energy Assessment**

State law directs the PSC to prepare a biennial report that evaluates the adequacy and reliability of the state's current and future electrical supply. Each Strategic Energy Assessment (SEA) covers a seven-year period and must identify the projected demand for electric energy and assess whether sufficient electric capacity and energy will be available to the public at a reasonable price. Also, the SEA must identify and describe electric generation and transmission facilities planned for construction, existing and planned renewable resource generating facilities, plans for assuring that there is adequate ability to transfer electric power into the state, and activities to discourage inefficient and excessive power use. In addition, the SEA must assess factors related to competition, purchased generation capacity and energy, and regional bulk-power, as well as consider other factors. The Commission's latest report was issued in October, 2010, covering the period between 2010 and 2016.

### **Other PSC Programs**

***Energy Efficiency and Renewable Resource Program.*** Energy efficiency and renewable resource programs include multiple programs organized under one of four broad categories of programs enumerated in the statutes. These include: (1) statewide programs; (2) large energy customer programs; (3) utility-administered programs; and (4) voluntary utility-administered programs. Energy efficiency programs are intended to decrease energy usage or increase the efficiency of energy usage of utility customers. Renewable resource programs are intended to encourage the develop-

ment or use by utility customers of renewable resource applications.

Statewide programs and utility-administered programs are funded through a statutory provision requiring investor-owned utilities to spend 1.2% of their annual operating revenues on energy efficiency and renewable resource activities. The statutes permit large energy customers to administer and fund their own energy efficiency programs, with PSC approval, and to deduct the expense from their utility bills. The utility may then deduct that amount from its amount required under the 1.2% revenue requirement. Currently, there are no large energy customer programs or utility-administered programs that have been approved by the Commission. There are three voluntary utility-administered programs, but they are not funded through the 1.2% revenue requirement.

Through the rate-making process, the PSC adjusts utility rates to ensure that the required contributions are raised. However, the revenue raised from each large energy customer is "frozen" by statute at the amount raised in 2005.

The statewide energy efficiency and renewable resource programs are to be administered collectively by the state's energy utilities through competitively bid contracts with one or more individuals or organizations. The state's investor-owned energy utilities formed a nonprofit organization called the Statewide Energy Efficiency and Renewable Administration (SEERA) to manage the statewide programs. SEERA has contracted with the Energy Center of Wisconsin to administer the environmental and economic research and development program and with the Wisconsin Energy Conservation Corporation to administer the business, residential, and renewable programs. Program oversight is provided by the PSC, and the statutes require the Commission to contract for financial and performance audits.

The Energy Center of Wisconsin (ECW) solicits proposals and funds research regarding the impact

of energy use on the Wisconsin environment and economy. The programs administered by the Wisconsin Energy Conservation Corporation (WECC) are collectively known as the state's Focus on Energy program. Each of the three program categories (residential, business, and renewable) targets resources in four general areas, which include incentives, implementation, marketing, and administration. Incentives include financial inducements to consumers for installing energy efficient equipment and improvements and renewable resource applications. Implementation involves information and technical assistance provided to individuals and businesses, including those consumers participating in incentive programs.

The current contract period was scheduled to end on December 31, 2010, but was extended to March 31, 2011. At the time this paper was prepared, SEERA had released a request for proposals for a program administrator for the period from April, 2011, through December, 2014. The new contract will require a somewhat different administrative structure. A single program administrator will replace the two current administrators, and the new administrator will not be permitted to implement programs.

At least once every four years, the Commission must conduct a formal evaluation of the energy efficiency and renewable resource programs and set or revise goals, priorities, and measurable targets for the programs. On April 3, 2008, the Commission opened a docket on the quadrennial planning process, as required by statute, and based on that process, promulgated its decision to increase contribution levels as an order, adopted unanimously on November 9, 2010.

Under the order, contributions would not be tied to a percentage of revenues but, instead, would be set at \$120 million in 2011, \$160 million in 2012, \$204 million in 2013, and \$256 million in 2014 and thereafter. Relative to the current 1.2% requirement, it is estimated that the order will increase the contribution level to 1.5% of revenues in

2011, with additional increases in succeeding years peaking at 3.2% in 2014. State law establishes a procedure by which the Joint Committee on Finance could object to the proposal, thereby prohibiting the increase. The Joint Committee on Finance approved the request on December 14, 2010, so higher contribution levels will be imposed beginning in 2011.

**Pipeline Safety Program.** Both the federal and state governments impose regulations regarding pipeline safety. These regulations cover the design, construction, operation, inspection, repair, and maintenance of pipelines, the training and testing of pipeline employees and contractors, and the maintenance of pipeline company records. The Office of Pipeline Safety (OPS) in the U.S. Department of Transportation has certified the Public Service Commission to regulate, inspect, and enforce intrastate gas pipeline safety requirements in Wisconsin. OPS has retained authority over safety requirements for interstate gas pipelines and for intrastate and interstate liquid pipelines in Wisconsin. PSC activities include completely inspecting every natural gas company at least once every three years, reviewing every natural gas company's maintenance records at least once every year, inspecting in-state gas pipeline construction plans, making unscheduled inspections of pipeline construction projects, and advising natural gas companies about safety matters. The federal government reimburses the state for up to 80% of its costs for performing the pipeline safety program.

**Universal Service Fund.** The PSC administers a variety of programs relating to the accessibility and affordability of telecommunications service. These programs are funded through PSC assessments on landline and commercial mobile radio intrastate services of telecommunications providers. Providers pay assessments monthly based on an assessment rate that the PSC adjusts annually. The assessments are deposited in the universal service fund (USF), which is administered by a private firm under contract with the Commission.

The USF was established to ensure that all state residents receive essential telecommunications services and have access to advanced telecommunications capabilities, such as the internet. The PSC is required to appoint a USF Council consisting of representatives of telecommunications providers and consumers of telecommunications services to advise the Commission regarding the administration of the fund. With the Council, the PSC is required to establish programs funded from the USF that ensure the delivery of essential services and advanced service capabilities anywhere in the state. Essential services include: (a) single party service with touch-tone capability; (b) line quality capable of carrying facsimile and data transmissions; (c) equal access; (d) emergency services number capability; (e) a statewide telecommunications relay service for the hearing impaired; and (f) blocking of long distance toll services. To implement this general statutory directive, the PSC has promulgated administrative rules establishing the various USF-funded programs.

The fund supports 14 programs, with 2010-11 appropriations totaling \$44.5 million. The PSC administers eight of the programs, and these programs were funded by a single appropriation of \$5.9 million annually. The Commission makes a biennial report to the Legislature on the USF and the PSC-administered programs.

The following programs are administered by the PSC:

- **Telecommunications Equipment Purchase Program** provides vouchers to disabled persons to be used to purchase special telecommunications equipment;
- **Lifeline Program** pays the portion of basic telephone service charges exceeding \$15 per month for low-income individuals;
- **Link-Up America Program** provides a waiver of certain regulated service charges when low-income residential customers initiate or move telephone service;

- **High Rate Assistance Credit Program** reimburses telecommunications providers for credits they extend to residential customers when the total rate for residential service exceeds a specified percentage of the median household income for a county in their service area;

- **Medical Telecommunications Equipment Program** provides grants to nonprofit medical clinics and public health agencies to purchase telecommunications equipment that promotes technologically advanced medical services, enhances access to medical care in rural or underserved areas, or enhances access to medical care to underserved populations or persons with disabilities;

- **Public Interest Pay Telephone Program** provides subsidies to telecommunications companies for the operation of pay telephones in locations where there is a public need even though the telephones are not commercially feasible;

- **Access Program or Project by Nonprofit Groups** provides grants to nonprofit groups to partially fund programs or projects that facilitate affordable access to telecommunications and informational services; and

- **Two-Line Voice Carryover** provides a second telephone line to certain hearing- or speech-impaired customers who use telecommunications relay service.

Not all programs receive funding every year. Among the eight PSC-administered programs, funding is not currently provided for the public interest pay telephone program, based on a determination of the USF Council and the Commission.

The remaining six programs funded with USF assessments are administered by other state agencies and comprise over 85% of the 2010-11 USF appropriations. These include: \$17.1 million to the Educational Telecommunications Access (TEACH) program administered by DOA for educational entities' access to new data lines for direct internet access and video links; \$2.4 million to the BadgerLink program administered by the Department of

Public Instruction (DPI) to pay for contracts with vendors who provide statewide access to reference databases of magazines and newspapers; \$16.7 million to the Aid to Public Library Systems program administered by DPI for aid payments; \$1.2 million for library service contracts between DPI and four providers of specialized statewide library services and resources; \$1.1 million to the University of Wisconsin (UW) System to reimburse DOA for BadgerNet telecommunications services provided to UW campuses; and \$111,100 to fund a contract between DPI and the National Federation of the Blind to provide the Newsline electronic information service, which gives telephone access to audio versions of newspapers for sight-impaired individuals. Although listed separately, the Newsline program is funded from DPI's BadgerLink appropriation.

**Wireless 911 Services.** In 2003, the Legislature 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 has been funded through surcharges on consumers' wireless telecommunications bills, imposed between December 1, 2005 and November 30, 2008. The PSC promulgated 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 was uniform for all customers. The surcharges have been 83 cents per month, 92 cents per month, and 43 cents per month over the course of the fund's life. Effective July 1, 2008, the PSC set the surcharge at "zero" as the fund had a balance sufficient to pay all outstanding grants.

These surcharges covered local governments' costs for the following: (a) necessary network equipment, including database equipment, computer hardware and software, and radio and telephone equipment used within a wireless public safety answering point; (b) training operators of a

wireless public safety answering point; (c) network costs; (d) collection and maintenance of data used to identify callers and their location; and (e) relaying messages to emergency call centers.

To encourage countywide and regional cooperation, no more than one grant could be awarded per county. In addition, the PSC provided supplemental grants to local units of government to encourage multi-jurisdictional grant applications. Wireless telecommunications providers also were reimbursed for costs related to enhancing the systems necessary to operate the wireless public safety answering point. State law sunset the grants and other program expenditures on April 1, 2009.

***Telecommunications Assessment for Consumer Protection.*** Consumer protection functions related to telecommunications issues that are performed by the Department of Agriculture, Trade, and Consumer Protection are funded through an assessment imposed by the PSC on telecommunications utilities, including commercial mobile radio (wireless) providers. Total assessments equal the amount appropriated for this function (\$415,800 annually in the 2009-11 biennium) and are based on providers' gross operating revenues in the year preceding the assessment. State law prohibits providers from recovering assessments through a separate line on billing statements to their customers. This funding mechanism was created in 2009 Wisconsin Act 28 and currently funds 6.0 positions.

***Environmental Trust Financing.*** State law establishes an alternative means for public utilities to finance the construction, installation, or placement of equipment or technology that reduces or prevents environmental pollution. This 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.

After 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. Before issuing an environmental trust financing order, the Commission must: (a) 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; (b) 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; (c) identify the revenue stream under the proposal that may be used to retire or secure environmental control equipment bonds; and (d) 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 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. 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. Each year, the utility must provide customers with an explanation of the environmental control charges. The utility's right to collect environmental control charges continues until all environmental control costs and related financing costs have been fully recovered. The PSC may not consider environmental control charges as costs or revenue of the utility.

To date, no utility has used environmental trust financing.