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COMMUNITY ENERGY SYSTEMS AND THE LAW OF PUBLIC UTILITIES

Volume Thirty-Six

NORTH DAKOTA

Final Report of
A Study of the Impacts of Regulations
Affecting the Acceptance of
Integrated Community Energy Systems

DUANE A. FEURER — CLIFFORD L. WEAVER
Program Managers

KEVIN J. RIELLEY — KEVIN C. GALLAGHER
SUSAN B. HARMON — DAVID T. HEJNA

Professor Edmund W. Kitch, Consultant

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ROSS, HARDIES, O'KEEFE, BABCOCK & PARSONS
One IBM Plaza, Suite 3100
Chicago, Illinois 60611
Telephone: (312) 467-9300

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DISCLAIMER

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ABSTRACT

This report contains a detailed description of the laws and programs of the State of North Dakota governing the regulation of public energy utilities, the siting of energy generating and transmission facilities, the municipal franchising of public energy utilities, and the prescription of rates to be charged by utilities including attendant problems of cost allocations, rate base and operating expense determinations and rate of return allowances. These laws and programs are analyzed to identify impediments which they may present to the implementation of Integrated Community Energy Systems (ICES). This report is one of fifty-one separate volumes which describe such regulatory programs at the federal level and in each state as background to the report entitled "Community Energy Systems and the and the Law of Public Utilities -- Volume One: An Overview." This report also contains a summary of a strategy described in Volume One -- An Overview for overcoming these impediments by working within the existing regulatory framework and by making changes in the regulatory programs to enhance the likelihood of ICES implementation.

PREFACE

One response to current concerns about the adequacy of the nation's energy supplies, in addition to reducing consumption of energy, is to make more efficient use of existing energy resources. The United States Department of Energy (DOE) has funded research, development and demonstration programs to determine the feasibility of applying proven cogeneration technologies in centralized energy systems, known as Integrated Community Energy Systems (ICES), to provide heating, cooling and electrical services to entire communities in an energy conserving and economic manner.

The relevant "community" which will be appropriate for ICES development will typically consist of a combination of existing or potential energy "wasters" -- i.e., installations with large energy conversion facilities which, when operated in a conventional manner, exhaust usable amounts of waste heat or mechanical energy -- and existing and potential energy users -- i.e., industrial, commercial, institutional or residential structures which obtain electricity and gas from a traditional central utility and convert part of it on site to space heating and cooling purposes.

In most current applications, energy conversion facilities burn fuels such as coal, oil or natural gas to produce a

single energy stream such as process steam or electricity for various industrial processes or for sale to other parties. In the conversion process, substantial amounts of energy may be wasted. For example, it has been estimated that from 60 to 75 percent of the potential energy available in fuel burned to generate electricity is lost in the process of generating and delivering the electricity.

The technology exists, however, to produce and utilize more than one energy stream from most energy conversion processes so that the input of a given amount of fuel could lead to the production of far more usable energy than is generally true in most steam production processes. This technology is the foundation of the ICES concept. Current examples of the technology can be found on university campuses, industrial or hospital complexes and other developments where a central power plant provides not only electricity but also thermal energy to the relevant community.

It is generally assumed by DOE that ICES will be designed to produce sufficient thermal energy to meet all the demands of their communities and that they will be interconnected with existing electric utility grids. Through such an interconnection, an ICES would be able to purchase electricity when its community's need for electricity exceeds the amount which could be produced from the level of operations needed to meet the community's thermal needs. In addition, when operations to meet thermal needs result in generation of more electricity than

necessary for the ICES community, the ICES would be able to sell excess electricity to the grid.

ICES may take a variety of forms, from a single owner-user, such as a large industrial complex or university campus, where all energy generated is used by the owner without sales to other customers, to a large residential community in which central power plant produces heat and electricity which is sold at retail to residents of the community. Since successful operation of an ICES presupposes that the ICES will be able to use or sell all energy produced, it can be anticipated that all ICES will at some point seek to sell energy to customers or to the electric utility grid from which the electricity will be sold to customers. By their very nature ICES are likely to be classified as public utilities under the laws of many, or even all, states.

Ross, Hardies, O'Keefe, Babcock & Parsons has undertaken a contract with the Department of Energy to identify impediments to the implementation of the ICES concept found in existing institutional structures established to regulate the construction and operation of public utilities. These institutional structures have been developed in light of policy decisions which have determined that the most effective means of providing utility services to the public is by means of regulated monopolies serving areas large enough to permit exploitation of economies of scale while avoiding wasteful duplication of production and delivery facilities. These existing institutional structures have led to an

energy delivery system characterized by the construction and operation of large central power plants, in many cases some distance from the principal population centers being served.

In contrast, effective implementation of ICES depends to some extent upon the concept of small scale operations supplying a limited market in an area which may be served by other suppliers of utility services. ICES may in many instances involve both existing regulated utilities and a variety of non-utility energy producers and consumers who have not traditionally been subject to public utility type regulation. Implementation of the ICES concept will also require a variety of non-traditional relationships between existing regulated utilities and non-regulated energy producers and consumers.

The purpose of this report is to generally describe the existing scheme of public utility regulation as it is likely to relate to the development and operation of an ICES, the construction of ICES facilities and the determination of relevant cost of service, rate of return and rate structure for the sale and purchase of energy by an ICES. Attention is given to the problems of the entry of an ICES into an energy market which has traditionally been characterized by a form of regulated monopoly where only one utility has been authorized to provide a particular service in a given area.

This report is one of a series of reports covering the law of each of the 50 states and the federal government and should be read in conjunction with Volume One in this series entitled Community Energy Systems and the Law of Public Utilities: An Overview. That volume provides a national overview of the regulatory programs described in detail for the particular state covered by this report. It also provides an analysis of the impediments to effective implementation of the ICES concept and a series of recommendations for responding to those impediments. In many jurisdictions legal issues similar to those likely to arise in the implementation of the ICES concept have not previously been faced. Thus, this series of reports cannot give definitive guidance as to what all of the answers are with respect to all issues which may face ICES implementation. However, by having an understanding of the issues which may arise in the course of an effort to implement ICES, an ICES developer will be better equipped to seek solutions.

Ross, Hardies, O'Keefe, Babcock & Parsons has been assisted in this study by Professor Edmund Kitch, Professor of Law at the University of Chicago Law School; Deloitte, Haskins & Sells, independent public accountants; and Hittman Associates, Inc., engineering consultants.

ACKNOWLEDGEMENTS

We wish to acknowledge the efforts of numerous individuals who have assisted in the preparation of the series of reports which make up the Study of the Impacts of Regulations Affecting the Acceptance of ICES. A number of lawyers and paralegal personnel of Ross, Hardies, have assisted in the research, writing, critiquing, rewriting, proofreading and other efforts including Drew Kaplan; Linda Arbetman; Cheryl K. Hachman; Barbara L. Ross; Joel F. Bonder; Sally H. Newton; Susan N. Stearns; Richard F. Babcock; Donald W. Glaves; Theda C. Snyder; Patricia J. Crowe; Susan E. Merritt; Eileen A. Muench; Elizabeth West; Catherine B. Lipscomb; Margaret R. Hessler; and Elizabeth Walter.

Preparation of reports covering regulatory programs in every state has taken considerable research effort and we are grateful to a group of law students who spent not only countless hours in libraries, but also a great deal of time on telephones contacting public officials around the country to secure information about utility regulatory programs. Among the students were Marchall Seeder; Carl Anderson; Locke E. Bowman, III; James G. Bullard; Bruce W. Dewald; Norman B. Julius; Bruce S. Klafter; Ruth B. Kleiman; Suzanne Metzel; Terrence J. Molinari; Alison Moss; Rose M. Urban; Garth D. Wilson; Linda Yi; Shell Bleiweiss and Neal Heriaud.

We would also like to acknowledge the contributions of subcontractors Hittman Associates, Inc. and Deloitte, Haskins & Sells, Inc. who have assisted us in an appreciation of some of the engineering and public utility accounting and ratemaking aspects of this project.

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CHAPTER 1

EXECUTIVE SUMMARY

I. REGULATION OF PUBLIC UTILITIES

The authority to regulate utilities in North Dakota is vested in the Public Service Commission (PSC), which is comprised of three members elected to serve for terms of six years. Municipalities are not given any control over utility regulation other than exercising those powers inherent in their franchising and zoning authority.

The PSC exercises regulatory authority over public utilities, which are defined by statute to include any association, person, firm, corporation or agency engaged in any of the following businesses: Common carrier, telegraph or telephone, pipeline, electric light, gas, water, heating, warehouse or stockyard. Sales are not expressly required, and service need not be offered to the public, although counsel for the PSC has suggested that some retail customers must be served before the PSC will exercise jurisdiction. Not-for-profit utilities owned and operated by the state or any other political subdivision are exempt from regulation.

The PSC is empowered to regulate, among other things, rates, systems of accounts, sales or leases of utility property, siting and expansion of facilities, franchises, standards of service and certificates of public convenience and necessity. The PSC also regulates abandonments of service and service area disputes.

Certificates of public convenience and necessity must be obtained by all public utilities prior to the construction, operation or extension of a utility plant or system, except that extensions may be made without certificates within the corporate limits of any municipality in which the utility lawfully operates. The issuance of a certificate is not an exclusive grant of authority. Competition among utilities is permitted.

After an application for a certificate is filed, notice is given to all interested parties. Hearings are available at the request of any interested party. In determining whether to issue a certificate, the PSC considers, among other things, the need for service, the ability of the applicant to provide service, the adequacy of the proposed service, the proposed rates and rate design and any other information the PSC deems appropriate. The case law indicates that in addition to these factors, the PSC considers the problem of economic waste and duplication. Customer preference is given little, if any, consideration.

An aggrieved party need not exhaust administrative remedies prior to seeking judicial relief from a PSC determination. Appeals may be taken to a district court, with review made on the record. Subsequent appeals may be taken to the state supreme court.

II. SITING OF ENERGY FACILITIES

The authority over the siting of energy facilities

in North Dakota is vested by statute in the PSC. The PSC has siting jurisdiction over "energy conversion facilities" and "energy transmission facilities." An "energy conversion facility" is one capable of generating 50,000 kilowatts or more of electricity, manufacturing or refining 1,000,000 cubic feet or more of gas per day, manufacturing or refining 50,000 barrels or more of liquid hydro-carbon products per day or enriching uranium materials. An "energy transmission facility" can be either an electric transmission line designed for 115 kilovolts or more, a gas or liquid transmission line designed to transport coal, gas or liquid hydro-carbon products, or a liquid transmission line designed to transport water. All publicly, cooperatively or investor-owned conversion or transmission facilities are subject to PSC siting authority.

No utility may begin construction of a facility without first obtaining a certificate of siting compatibility. Extensions also require certificates unless they were contemplated by the original certificate.

The PSC's siting jurisdiction is not exclusive and does not preempt the authority of other state and local agencies. Thus, depending upon the facility to be constructed, a utility may be required to first obtain the approval of the Air Pollution Control Agency, the Water Pollution Control Agency, the State Planning Division, the Soil Conservation Committee, the Little Missouri River Commission or local

zoning agencies.

A party owning or operating a facility subject to PSC siting authority is required annually to submit a ten-year plan describing the location, size, type and preferred site of any facility as well as the utility's efforts to coordinate and involve agencies in its planning process.

Any party seeking to construct a facility requiring a certificate of site compatibility must file an application with the PSC. The PSC serves notice on interested parties and then holds a public hearing. Any party aggrieved by a PSC determination may seek a rehearing or appeal to the district court, with review made on the record.

Factors considered by the PSC in evaluating applications for certificates include the environmental effects of the proposed facility, the alternatives to the proposed site, the economic impact of the proposed facilities and the problems raised by other agencies. The PSC has also enumerated certain exclusion areas and avoidance areas to facilitate its decision-making. Other criteria enumerated by the PSC include the proposed site's impact on agriculture, municipal services, and the public welfare.

III. FRANCHISING OF PUBLIC UTILITIES

The authority to grant franchises for the use of public streets and places in connection with providing utility service in North Dakota is vested by statute in the municipalities. Municipalities are also left to promulgate

procedural provisions for the granting of franchises. State authority over franchising extends only to common pipeline carriers. General procedures for adopting ordinances are applicable to franchise applications.

The duration of a franchise granted by a municipality may not exceed twenty years. Any grant of a franchise which does not strictly conform to state law will render the franchise null and void. The legislature has expressly prohibited the granting of exclusive franchises. Approval of the PSC is necessary prior to any sale or transfer of a franchise. A municipality may impose conditions as an incident to granting a franchise.

IV. UTILITY RATE REGULATION

The statutes of North Dakota vest the authority to regulate the rates of public utilities in the PSC. The PSC has rate jurisdiction over all investor-owned utilities but not over those publicly owned or operated. Cooperatives are also exempt from PSC rate authority. The PSC has adopted the NARUC system of accounts for use by jurisdictional utilities.

Any utility seeking to change its rates must first file the proposed rates with the PSC. The PSC may suspend the proposed change for a period of up to eleven months. Upon complaint or its own motion, the PSC may hold a public hearing on the proposed change. The PSC may also negotiate with the utility to arrive at a reasonable rate for the utility's services.

Rates must be just and reasonable. In determining a utility's rate base, the PSC has used both year-end and projected test periods and the prudent investment less depreciation method of valuation. The PSC will not include construction work in progress in rate base.

In allocating rate base, the PSC has used the twelve-month coincident peak demand method. In determining cost of service, the PSC has permitted informational, instructional and conservation advertising as expenses but denied institutional or corporate advertising. Charitable contributions and organized dues have also been excluded from rate base determination. The PSC appears to accept any reasonable method for allocating joint expenses.

An official of the PSC has indicated that the commission allows the full normalization of liberalized depreciation and the investment tax credit.

The PSC has found the discounted cash flow method of determining return on equity as acceptable. The PSC has not enunciated any specific factors to be considered in rate-making. The state statutes make no provision for lifeline rates.

The PSC is empowered to regulate the issuance of securities by jurisdictional public utilities unless they are payable within one year of the date of issue.

CHAPTER 2

REGULATION OF PUBLIC UTILITIES IN NORTH DAKOTA

The North Dakota Public Service Commission (PSC) is a constitutional body[1/] responsible for the regulation of all public utilities. The PSC is composed of three elected commissioners who serve for six year terms. Section 83 of the state's Constitution gives the legislature the power to prescribe the powers and duties of the PSC. Pursuant to this authorization, the legislature adopted Title 49 of the North Dakota Century Code prescribing the jurisdiction as well as the powers and duties of the PSC. It also prescribes various rules and regulations pertaining to electric, gas and other public utilities. All authority over public utilities is vested in the PSC. Local governments, except for the powers inherent in their franchising and zoning authority, are not given any control over utility regulation.

I. JURISDICTION OF THE REGULATORY AGENCY

A. Utilities Covered

Title 49 specifies that the PSC has jurisdiction over the following:

1. Contract and common carriers engaged in the transportation of persons and property;

2. Telegraph and telephone, and communications utilities engaged in the transmission of messages or conversations;

3. Pipeline utilities engaged in the transportation of gas, oil coal and water;

4. Electric utilities engaged in the generation and distribution of light, heat or power;

5. Gas utilities engaged in the distribution of natural, synthetic, or artificial gas.

6. All heating utilities engaged in the distribution of heat;

7. Warehouse companies engaged in the marketing, storage or handling of agricultural products;

8. All other public utilities engaged in business in this state or in any county, city, township, village or other political subdivision of the state.2/

A public utility is defined in the statute as "any association, person, firm, corporation or agency engaged or employed in any business enumerated in this title."3/ Although the statute does not specifically refer to steam or cold, an ICES providing steam or air conditioning service to the public would probably be subject to jurisdiction as a heating company or "other" public utility.4/

The statute does not require a sale or the receipt of compensation for the function to be subject to jurisdiction. Neither does it explicitly provide that the service must be offered to the "public," although the epithet "public"

repeatedly appears before the word "utility" throughout the statute. No judicial interpretation of the law has been found dealing with the issue of what constitutes a "public" utility. Similarly, nowhere in the public utility law does there appear a definition of the term. Some PSC decisions have discussed this issue and Mr. Ray Walton, Commerce Counsel for the PSC, has acknowledged there must be some public element before the PSC will assert jurisdiction. He suggested that the utility must, at a minimum, be serving retail customers before it is amenable to regulation.[5/]

In an administrative decision, the PSC declined to assert jurisdiction over a coal gasification company seeking a certificate of public convenience and necessity. The company sought to construct and operate a coal gasification plant manufacturing substitute natural gas from lignite coal for resale in interstate commerce. In a memorandum opinion, the Commission corroborated the opinion of Mr. Walton stating that "should the applicant . . . engage in the distribution and sale of its products at retail within the State of North Dakota, all of the applicant's activities would then be subject to PSC regulation."[6/] It should be noted, that though the Commission decided it did not have jurisdiction to issue a certificate of public convenience and necessity, it acknowledged that it did have jurisdiction over the

siting of the plant pursuant to the North Dakota Plant Siting and Transmission Line Routing Act.[7/]

B. Utilities Exempt From Regulation

The North Dakota Century Code provides the following exemption:

> Nothing in this chapter shall authorize the commission to make any order affecting rates, contracts, services rendered, adequacy or sufficiency of any facilities, or the rules or regulation of any public utility owned and operated by the state or by any city, county, township or other political subdivision of the state or any public utility that is not operated for profit, but all other provisions herein shall apply to such utilities.[8/]

The exemption of not-for-profit utilities is designed principally to cover cooperatively-owned and operated utilities. While a utility owned and operated by a political subdivision of the state or operated on a not-for-profit basis is exempt from a substantial portion of the PSC's jurisdiction, such utility must still obtain the required certificate of public convenience and necessity before commencing operation. (See generally, the discussion in Part IV of this chapter.)

II. POWERS OF THE PSC

The powers of the PSC are listed generally in chapter 49-02 of the North Dakota Century Code. Various other specific responsibilities are enumerated throughout Title 49. Some of the more general powers of the PSC include the power to supervise the rates of all public utilities;[9/]

prescribe a system of accounts;[10] value utility property;[11] regulate the sale or lease of property;[12] authorize the construction or siting of new plants or the expansion of existing plants;[13] authorize the extension of service to new customers;[14] control the transfer of franchises or property;[15] issue certificates of public convenience and necessity;[16] and establish and regulate standards of service.[17]

The PSC also has the power to resolve service area disputes between parties. Presumably, this would occur only where one utility attempts to provide service in an area without having obtained a certificate of public convenience and necessity. In such a case, the PSC is empowered, after complaint, notice and hearing, to enjoin the utility from operating or otherwise doing business in a particular area.[18] The language of the particular sections indicates that all public utilities - whether publicly, cooperatively or investor-owned - are subject to PSC's authority in this regard.

The PSC also has control over the abandonment of services. The statute places a utility under a duty to furnish, provide and maintain service to patrons.[19] Similarly, a 1977 enactment states that no public utility shall dispose of or encumber any part of its system necessary or useful in the performance of its duties without first having occured from the PSC an order authorizing it to

do so.[20] Prior to the enactment of this provision, a utility could be ousted by a municipality without the consent of the PSC.[21] Today, however, a utility may not withdraw from an area without first having obtained approval from the Commission.

IV. AUTHORITY TO PROVIDE SERVICE IN A GIVEN AREA

A. Generally

A public utility in North Dakota may not begin construction or operation of a public utility plant or system, or of an extension of a plant or system, without first obtaining from the Commission a certificate stating that public convenience and necessity require or will require such construction and operation.[22]

Although the statute provides that a certificate is required to extend existing facilities, there are limited exceptions. No certificate is required for a public utility which extends its facilities, or for an electrical utility which extends its electric distribution lines, within the corporate limits of any municipality where it has lawfully commenced operations.[23] No authorization for the extension is required provided such exclusion does not interfere with existing services supplied by another utility and provided any duplication of services which results is not deemed unreasonable by the PSC.

The issuance of a certificate is not an exclusive grant of authority allowing a single utility to operate in a

given area. According to counsel for the PSC, the purpose of requiring certificates is to avoid wasteful duplication and to protect a satisfactory supplier, not necessarily to enhance the monopolistic position of the first utility to provide service. Competitors have been and will be given authorization to provide similar services in the same service area. If an ICES were subject to jurisdiction, it would have to show good cause before being granted a certificate impinging on an already established supplier.[24/] The specific factors considered prior to issuing the second certificate are discussed below.

B. Certification Procedures

The North Dakota Century Code outlines the procedures to be followed when making an application for a certificate of public convenience and necessity. The articles of incorporation or charter of the utility must first be filed with the PSC.[25/] Evidence must be submitted showing that the "applicant has received the consent, franchise, permit, ordinance or other authority of the proper municipality or other public authority, if required, or has or is about to make application therefor."[26/] In addition, a non-electrical public utility must submit "a financial statement, a description of the type of service to be offered, a map and description of the area to be served, and a list of all other public utilities providing similar service in the area."[27/]

Once an application is complete, notice is to be given to all utilities operating in the area proposed to be served by the applicant and to all other interested parties as determined by the PSC. A hearing follows after which the PSC makes its determination. If no interested party requests a hearing, the PSC may grant a certificate without a hearing.[28/]

No particular procedure is outlined by the legislature for the transfer of a certificate to another utility. The statute only requires that the prior approval of the PSC be obtained for a transfer.[29/]

C. Factors Considered Regarding Issuance of Certificate

Both the statutory and case law of North Dakota outline various factors to be considered before issuing a certificate of public convenience and necessity. The North Dakota statutes, in dealing with non-electric public utilities, directs the Commission to consider the:

1. Need for the service,
2. Fitness and ability of applicant to provide service,
3. Effect on other public utilities providing similar service,
4. Adequacy of proposed service,
5. Proposed rates,
6. Proposed design, and
7. Such other information as the Commission may deem appropriate. [30/]

While these factors are contained in a section relating to non-electric utilities, counsel for the PSC opined that these factors are also applicable to electrical utilities. (Telephone conversation with Ray Walton, Commerce Counsel, June 19, 1978).

The case law of North Dakota has also developed certain guidelines to be considered before issuing a certificate of public convenience and necessity. Included are concerns for:

1. Reliability and capacity of the supplier,
2. The most efficient and economical supplier, and
3. Avoidance of wasteful duplication.31/

Another case has pointed to concerns for:

1. Existence of reasonable necessity,
2. Avoidance of economic waste and public burdens, and
3. Duplicate facilities jeopardizing existing structures.32/

The preference of individual customers is given little, if any, consideration. Indeed, the North Dakota Supreme Court has remarked that customer preference is not to be a controlling factor in determining extensions of services by public utilities, but rather the public convenience and necessity should be the paramount concern of the PSC.33/

V. APPEALS OF REGULATORY DECISIONS

After the PSC has made a final determination on any matter, the aggrieved party is entitled to appeal according to the procedures outlined in chapter 28-32 of the North Dakota Century Code.[34] Although the chapter allows for a petition for rehearing, the North Dakota Supreme Court has held that an aggrieved party is not required to request a rehearing as a condition precedent to an appeal to the district court.[35]

The aggrieved party may first appeal, within thirty days, to the district court designated by law. A subsequent appeal may then be taken to the North Dakota Supreme Court if filed within sixty days of the district court's decision.[36] An appeal to the district court is based on the record as certified to the court by the PSC.[37] The court will not, generally, hear new evidence. Rather, if new, material evidence is presented, the court may direct the agency to reopen the hearing and reconsider its decision in light of the new evidence.[38]

Chapter 28-32 also provides that the court shall affirm the decision of the agency unless it shall find that any of the following are present:

1. The decision or determination is not in accordance with the law.

2. The decision is in violation of the constitutional rights of the appellant.

3. The provisions of Chapter 28-32 have not been complied with in the proceedings before the agency.

4. The rules or procedure of the agency have not afforded the appellant a fair hearing.

5. The findings of fact made by the agency are not supported by a preponderance of the evidence.

6. The conclusions and decisions of the agency are not supported by its findings of fact.39/

FOOTNOTES

1. N.D. Const. §82

2. N.D. Cent. Code §49-02-01 (Supp. 1979).

3. Id. §49-01-01 (1978).

4. Id. §49-02-1 (7) (Supp. 1979). The cooling capabilities of an ICES could possibl be subject to regulation under the provision reaching pipeline companies transporting water. §49-02-01(3). The latter point is obviously less clear and no cases have dealt with the issue.

5. Telephone conversation of June 19, 1978.

6. (Emphasis added). In re ANG Coal Gasification Co., Hearings Before the Public Service Commission of North Dakota, Case No. 9173, mimio p. 4, (1975).

7. Id. at 3, 4. See, ch. 3 infra.

8. N.D. Cent. Code §49-02-01.1 (1978). (Emphasis added).

9. Id. §49-02-02 (Supp. 1979).

10. Id. §49-02-12 (1978).

11. Id. §49-06-02 to 49-06-23.

12. Id. §49-09-10.

13. Id. §49-22-07 (Supp. 1979).

14. Id. §49-03-01, §49-03.1-01 (1978).

15. Id. §§49-04-05, 49-04-06.

16. Id. §49-03-01, §49-03.1-01.

17. Id. §§49-02-04, 49-02-11.

18. Id. §§49-03-01.4, 49-03.1-08.

19. Id. §49-04-01. (Emphasis added).

20. Id. §49-04-05.

21. See, e.g., In Re First Farmers Telephone Assoc., 1930B P.U.R. 115, discussed in ch. 4, infra.

22. N.D. Cent. Code §§49-03-01, 49-03.1-01 (1978). For the purpose of the statutory provisions dealing with the issuance of certificates of public convenience and necessity, "electric public utility" means "a privately owned supplier of electricity offering to supply or supplying electricity to the general public." §49-03-01.5(1). "Public utility" includes any party engaged or employed in furnishing "its product or services to the public generally but does not include an electric public utility. §49-03.1-02(2). For purposes of this report, the term public utility includes electric public utilities as well as public utilities.

23. Id. §§49-03-01, 49-03-01.3.

24. Telephone conversation with Ray Walton, Commerce Counsel, June 17, 1978.

25. N.D. Cent. Code §§49-03-02, 49-03.1-05 (1978).

26. Ibid.

27. Id. §49-03.1-03.

28. Id. §§49-03-02, 49-03.1-05.

29. Id. §49-04-05.

30. Id. §49-03.1-04.

31. Tri-County Elec. Co-op Inc. v. Elkin, 224 N.W.2d 785 (N.D. 1974).

32. Eckre v. Public Service Commission, 247 N.W.2d 656 (N.D. 1976).

33. Tri-County Elec. Co-op Inc. v. Elkin, 224 N.W.2d 785 (1974).

34. N.D. Cent. Code §49-05-12 (1978).

35. In Re Wheatland, 77 N.D. 194, 42 N.W.2d 321 (1950).

36. N.D. Cent. Code (Supp. 1979), §§28-32-21, 49-05-15 (1978).

37. Id. §28-32-17 (1974).

38. Id. §28-32-18. Notwithstanding the provision that the district court is limited to the record certified to it by the administrative agency, case law prior to 1977 had established that on an appeal from a decision by the PSC, a trial de novo was required. In Re Midwest Motor Express, 23 N.W. 2d 49 N.D. (1946). However, a 1977 modification of the statute has reaffirmed that the "evidence considered by the court shall be confined to the record filed with the court." §28-32-19 (Supp. 1979).

39. Id. §28-32-19 (Supp. 1979).

CHAPTER 3
SITING OF ENERGY FACILITIES IN NORTH DAKOTA

I. PUBLIC AGENCIES REGULATING SITING

A. Public Service Commission and Siting Act

North Dakota has recently enacted a comprehensive siting statute which could affect many ICES developments. The statute[1] provides for the issuance by the PSC of a certificate of site compatibility for an energy conversion or transmission facility.

Under the statute the PSC has siting jurisdiction over an "energy conversion facility" if that facility is designed for or capable of:

a. Generating 50,000 kilowatts or more of electricity;

b. Manufacturing or refining one hundred million cubic feet or more of gas per day;

c. Manufacturing or refining fifty thousand barrels or more of liquid hydrocarbon products per day; or

d. Enrichment of uranium materials.[2]

Jurisdiction is given to the PSC to site a transmission facility" if that facility is:

a. An electric transmission line and associated facilities designed for one hundred fifteen kilovolts or more;

b. A gas or liquid transmission line or associated facilities designed for or capable of transporting coal, gas or liquid hydrocarbon products; or

c. A liquid transmission line or associated facilities designed for or capable of transporting water from or to an energy conversion facility.3 /

There has been no case or administrative interpretation discussing whether a steam pipeline falls within the purview of the siting statute. However, it is the opinion of the head of the Siting Division of the PSC that a steam pipeline would be covered because the statute is intended to be as broad as possible.4/

The ownership of the energy conversion or transmission facilities is immaterial to the jurisdiction of the PSC with respect to siting. All utilities operating such facilities are covered regardless of whether they are publicly, cooperatively or investor-owned, for a utility is very broadly defined and includes any party involved with energy generation or transmission.5/

The express language of the statute provides that no "utility shall begin construction . . . or exercise the right of eminent domain . . . without first having obtained a certificate of siting compatibility . . . ."6/ After acquiring the siting certificate, a utility may proceed to construct or improve the site for the intended purposes. However, if the construction or improvement commences more than four years after issue of the siting certificate, the utility must certify that the site continues to meet the conditions which were the basis for the original authorization.6a/

An extension of an existing facility requires a siting certificate unless such extension was contemplated in the original certificate for the facility. Thus, the PSC always has jurisdiction over conduct altering the status quo. This is consistent with the statutory policy that siting jurisdiction should extend to the location, construction and operation of energy facilities to assure that they "will produce minimal adverse effects on the environment."[7/]

The statute provides that a facility shall be constructed, operated and maintained in conformity with any terms and conditions contained in the certificate of site compatibility.[8/] Furthermore, the PSC has the right to revoke a certificate if any conditions are violated.[9/] Hence, the PSC's authority over siting extends to a limited extent to the operation of a sited facility.

The PSC is authorized to promulgate rules and regulations.[10/] Such rules have recently been adopted and codified in the North Dakota Administrative Code.[11/] The rules and regulations, while echoing the procedural formalities outlined in the siting statute, also enumerate criteria to be considered when evaluating a proposed site.[12/]

Since the adoption of the siting statute in 1975, there have been no court cases testing the PSC's jurisdiction or interpreting the statute. However, the PSC apparently

perceives its jurisdiction as quite comprehensive and it has asserted control over most utility projects.[13/]

B. Other Agencies with Role in Siting

The PSC's siting jurisdiction is not exclusive and does not preempt or supersede the authority of other agencies to approve various aspects of the construction of a facility subject to the siting act. However, state agencies are bound by the decision of the PSC with respect to the site designation of a facility. A utility must still obtain permission from other concerned authorities before constructing or operating facilities at a site.[14/] In addition, the statute specifically provides, "no site or route shall be designated which violates the rules of any state agency."[15/] The following is a brief description of some of the major agencies which may have authority over one or another aspect of an ICES project which is subject to the siting law.

1. Air Pollution Control Agency - Department of Health

The Air Pollution Control Act[15a/] authorizes the State Department of Health, along with an advisory council, to promulgate such rules as are necessary to control the quality of the air. The Act requires a person to obtain a permit before constructing any source "capable of causing or contributing to air pollution."[16/] The department is responsible

for issuing permits and otherwise administering the provisions of the Air Pollution Control Act.

2. Water Pollution Control Agency

The State Department of Health is responsible for administering the North Dakota water pollution control laws.[17] A ten member water pollution control board assists and advises the department in development of water pollution control programs. Authority is conferred on the Department of Health to establish any plans or rules and regulations that are necessary to conserve the waterways and prevent pollution. Permits are required "to discharge sewage, industrial wastes, or other wastes into state waters . . . ."[18]

3. State Planning Division

The State Planning Division is authorized to prepare plans for the physical development of the state and to coordinate the planning activities of local agencies. The enabling statute states that its purpose is "to advise, consult, coordinate, assist and contract with or on behalf of the various planning agencies in developing and harmonizing the planning activities of this state."[19] Although the statute allows the division to "exercise all powers necessary and proper for the discharge of its duties,"[20] it does not require that a utility obtain the Division's approval prior to constructing an industrial facility.

4. Soil Conservation Program

A Soil Conservation Law[21] creating a Soil Conservation Committee, and authorizing the establishment of local soil conservation districts has been adopted, among other things, to conserve the soil and soil resources of the state to control soil erosion, and to preserve the state's natural resources.[22] The State Soil Conservation Committee is empowered to coordinate the programs of local districts, to provide assistance to districts in carrying out their responsibilities, to encourage the formation of districts, to conduct studies and analysis of programs of districts as they relate to other districts and state programs, and to develop policy guidelines for districts to follow.[23]

The districts are established by petition to the state committee.[23a] Among other things, each district has the power:

> To develop comprehensive plans for the conservation of soil resources and for the control and prevention of soil erosion within the district, which plans shall specify in such detail as may be possible the acts, procedures, performances and avoidances which are necessary or desirable for the effectuation of such plans including the specification of engineering operations . . .[23b]

In addition, districts have authority to formulate and submit to qualified electors in the district regulations "governing the use of lands within the district in the interest of conserving soil and soil resources and preventing and

controlling soil erosion."[23c] Such regulations may include:

> 1. Provisions requiring the carrying out of necessary engineering operations, including the construction of terraces, terrace outlets, check-dams, dikes, ponds, ditches, and other necessary structures;
>
> * * *
>
> 5. Provisions for such other means, measures, operations, and programs as may assist conservation of soil and water resources and prevent or control soil erosion in the district, having due regard to the declaration of policy set forth in section 4-22-01.[23d]

District supervisors are empowered to enforce the regulations[23e] and to seek appropriate court orders to compel compliance by a defendant or to permit the supervisors to perform any necessary work at the expense of the defendant.[23f]

5. Little Missouri River Commission

This Commission is given the power and duty to promulgate management policies coordinating all activities within the confines of the Little Missouri River.[24] The statute expressly prohibits the diversion of any water from the Little Missouri River or its tributaries for any purpose other than agricultural or recreational purposes. Thus, an ICES development could not rely on the Little Missouri River for diversion of cooling or other water.

6. Local Agencies

The energy facility must also comply with county or city land use, zoning or building regulations. However, an exception may be allowed with respect to energy transmission facilities. A permit from the PSC for the construction of a transmission facility in a designated corridor may supersede and preempt local land use, zoning or building regulations if, and only if, the PSC finds "that such rules, regulations, or ordinances, as applied to the proposed route, are unreasonably restrictive in view of existing technology, factors of cost or economics, or needs of consumers . . . ."[25/]

Listed below are the various local authorities having control over the location of an energy facility.

a. County Zoning

The Board of County Commissioners is granted authority to regulate and restrict the location and use of buildings and structures within the county.[26/] A general plan is required to be filed in the Office of the County Auditor. The county zoning authority does not apply within a municipal district having its own zoning power.[27/]

The statute permits the county to require an entity to obtain approval from the county prior to commencement of construction.[28/] If construction is

commenced in violation of the zoning plan, the Commission, or any affected citizen, may institute legal action to prevent or restrain further construction.[29/]

b. Municipal Zoning

Chapter 40-48 confers upon municipalities the broad power to develop master plans for their future growth. The plan shall, inter alia, include the municipal recommendations concerning the "general location and extent of public utilities and terminals whether publicly or privately owned."[30/]

Once a master plan is adopted, no " . . . structure shall be constructed or authorized in the area shown on the master plan until the location, character, and extent thereof shall have been submitted to and approved by the planning commission."[31/] However, the governing body may overrule the planning commission by a two-thirds vote and directly authorize the construction.

II. CERTIFICATION PROCESS

A. Applicant's Duties

A party owning or operating, or intending to own, operate or construct, a facility subject to the siting law is required annually to prepare and submit a ten year plan to the PSC setting forth the following:

1. A description of the general location, size, and type of all facilities to be owned or operated by the utility during the ensuing ten years, as well as those facilities to be removed from service during the ten-year period.

2. An identification of the location of the tentative preferred site for all energy conversion facilities and the tentative location of all transmission facilities on which construction is intended to be commenced within the ensuing five years and such other information as may be required by the Commission. The site and corridor identification shall be made in compliance with the inventory published by the Commission pursuant to section 49-22-05.1.

3. A description of the efforts by the utility to coordinate the plan with other utilities so as to provide a coordinated regional plan for meeting the utility needs of the region.

4. A description of the efforts to involve environmental protection and land-use planning agencies in the planning process, as well as other efforts to identify and minimize environmental problems at the earliest possible stage in the planning process.

5. A statement of the projected demand for the service rendered by the utility for the ensuing ten years and the underlying assumptions for the projection, with such information being as geographically specific as possible, and a description of the manner and extent to which the utility will meet the projected demands.

6. Any other relevant information as may be requested by the Commission.32/

One year prior to seeking to construct a facility requiring a certificate of site compatibility, a party is required to file a letter of intent with the PSC containing a description of the facility and area to be served, a map

of the proposed site or corridor, a projected construction and operation schedule and an estimate of the cost of construction.[33]

An application for site certification must be filed with the PSC setting forth the following information:

a. A description of the size and type of facility;

b. A summary of any studies which have been made of the environmental impact of the facility;

c. A statement explaining the need for the facility;

d. An identification of the location of the preferred site for any energy conversion facility.

e. An identification of the location of the preferred corridor for any transmission facility.

f. A description of the merits and detriments of any location identified, and a comprehensive analysis with supporting data showing the reasons why the preferred location is best suited for the facility;

g. A description of mitigative measures that will be taken to minimize all foreseen adverse impacts resulting from the location, construction, and operation of the proposed facility.

h. An evaluation of the proposed site or corridor with regard to the applicable considerations set out in Section 49-22-09 and the criteria established pursuant to Section 49-22-05.1.

i. Such other information as the applicant may consider relevant or the Commission may require.[34]

An application fee in the amount of $500.00 for each one million dollars of investment in a proposed energy conversion site and/or $5,000 for each one million dollars of investment in a proposed energy transmission site is required.[35]

B. Public Service Commission's Duties

The PSC is required to serve notice of the filing of an application upon:

1. The chairman of the board of the relevant county commissioners;

2. The chief executive officer of each relevant city;

3. The head of each government agency charged with protecting the environment in the relevant area;

4. The twenty-three additional state agencies enumerated in N.D. Admin. Code §65-06-01-05.[36]

In addition, copies of the application are to be provided to the above enumerated parties upon their request.

Public hearings are required to be held prior to the issuance of a certificate of site compatibility.[37] Notice shall be given by mail to the parties listed above in addition to publication in the official newspaper of each county affected.[38] Costs of such notice are to be borne by the applicant.[39] Consultation with other agencies occurs at these hearings where agencies may present their views for consideration by the PSC.

The PSC is under a time constraint to act upon the applications. The Code provides that "the designation shall be made in a timely manner no later than six months after the filing of a completed application for a certificate requesting designation of a [energy conversion] site or no later than three months after the filing of a completed appliction for a certificate requesting designation of a [transmission line] corridor.[40] These limitations may be

extended for just cause. However, the statute also provides that the "failure of the Commission to act within the time limits provided . . . shall not operate to divest the Commission of jurisdiction in any certification proceeding."[41/]

C. Appeal

The siting statute provides that any party aggrieved by a decision may request a rehearing by the PSC.[42/] Furthermore, a right of appeal to the district court is given following any adverse ruling by the PSC.[43/] As discussed more fully in chapter 2, the statute allows appeals to the district court followed by a subsequent review in the supreme court. Appellate review is based on the record as certified to the district court by the administrative agency. The court is empowered to reverse the agency's decision if it is not in accordance with the law, if it is in violation of the constitutional rights of the appellant, or if the findings of fact are not supported by a preponderance of the evidence.

D. Waiver of Procedure and Time Schedules

The statute provides for a waiver of the otherwise applicable procedures and time schedules for siting certification.

> Any utility which proposes to construct an energy conversion facility or a transmission facility within the state may make an application

> to the Commission for a waiver of any of the procedures or time schedules set forth in this chapter or in the rules adopted pursuant to this chapter. The Commission, after hearing and upon a finding that the proposed facility is of such length, design, location, or purpose that it will produce minimal adverse effects..., may issue an order waiving specified procedures and time schedules required by this chapter..., including, but not limited to, applications, notices, and hearings, and may forthwith issue a certificate of site compatibility, a certificate of corridor compatibility, a route permit, with such conditions as the Commission may require. 43/

There is some indication from the policy criteria adopted by the PSC as well as from the statutory factors to be considered by the PSC that an energy conserving facility such as an ICES would be looked upon favorably. Thus, a waiver may prove to be more readily available to an ICES than to other facilities.

III. CERTIFICATION STANDARDS

North Dakota has been quite explicit in codifying factors to be considered during site evaluation. The statement of policy introducing the siting act provides that "sites... shall be chosen which minimize adverse human and environmental impact while ensuring continuing system reliability and integrity and ensuring that energy needs are met and fulfilled in an orderly and timely fashion.

The statute then proceeds to enumerate eleven broad considerations, including problems or issues raised

by federal, state or local agencies, to be used in the evaluation of a proposed site:

1. Available research and investigations relating to the effects of the location, construction, and operation of the proposed facility on public health and welfare, natural resources, and the environment.

2. The effects of new energy conversion and transmission technologies and systems designed to minimize adverse environmental effects.

3. The potential for beneficial uses of waste energy from a proposed energy conversion facility.

4. Adverse direct and indirect environmental effects which cannot be avoided should the proposed site or route be designated.

5. Alternatives to the proposed site which are developing during the hearing process and which minimize adverse effects.

6. Irreversible and irretrievable commitments of natural resources should the proposed site, corridor, or route be designated.

7. The direct and indirect economic impacts of the proposed facility.

8. Existing plans of the state, local government, and private entities for other developments at or in the vicinity of the proposed site, corridor, or route.

9. The effect of the proposed site or route on existing scenic areas, historic sites and structures, and paleontological or archaeological sites.

10. The effect of the proposed site or route on areas which are unique because of biological wealth or because they are habitats for rare and endangered species.

11. Problems raised by federal agencies, other state agencies, and local entities.45/

One of the most significant considerations for an ICES is the directive that the PSC weigh "the potential for beneficial uses of waste energy from a proposed energy conversion facility."46/

The PSC has expanded on the considerations suggested by the legislature by enumerating certain exclusion areas, avoidance areas, selection criteria and policy criteria to guide participants in siting hearings.

Exclusion areas are those excluded from consideration from energy conversion or transmission sites.47/ These include areas designated or registered by federal or state authorities as parks, landmarks, historic sites, wilderness or scenic areas, preserves, refuges, forests and the like;

other public parks or woodlands; prime and unique farmland; irrigated land or other areas critical to threatened or endangered plant or animal species.[48/] There has been some suggestion that the PSC may ease its restriction on prime farmland; but no action has yet been taken.[49/]

Avoidance areas are defined as those removed from consideration "unless it is shown that under the circumstances there are no reasonable alternatives."[50/] Such areas generally encompass municipalities, woodlands, wetlands, floodplains, geologically unstable areas and areas of historical, archeological, recreational or paleontological significance which are not within the exclusion category. In determining whether to permit construction in an avoidance area, the PSC:

> may consider, among other things, the proposed management of adverse impacts; the orderly siting of facilities; system reliability and integrity; the efficient use of resources; and alternative sites. Economic considerations alone shall not justify approval of these areas.[51/]

If a proposed area is not eliminated by the exclusion and avoidance criteria, it is then evaluated using a detailed list of selection criteria. These criteria, with respect to energy conversion facilities, include:

A. The impact upon agriculture:

(1) Agricultural production.

(2) Family farms and ranches.

(3) Land which the owner demonstrates has soil, topography, drainage, and an available water supply that cause the land to be economically suitable for irrigation.

(4) Surface drainage patterns and ground water flow patterns.

(5) The agricultural quality of the crop land.

B. The impact upon the availability and adequacy of:

(1) Law enforcement.

(2) School systems and education programs.

(3) Governmental services and facilities.

(4) General and mental health care facilities.

(5) Recreational programs and facilities.

(6) Transportation facilities and networks.

(7) Retail service facilities.

(8) Utility services.

C. The impact upon:

(1) Local institutions.

(2) Noise sensitive land uses.

(3) Rural residences and businesses.

(4) Aquifers.

(5) Human health and safety.

(6) Animal health and safety.

(7) Plant life.

(8) Temporary and permanent housing.

(9) Temporary and permanent skilled and unskilled labor.

D. The cumulative effects of the location of the facility in relation to existing and planned facilities and other industrial development.52/

The list of selection criteria for transmission facilities is somewhat shorter but of a similar nature.53/ All the above criteria, incorporating the gamut of environmental concerns, are applied and considered by the PSC before issuing a certificate of site compatibility. See, e.g. Hearings before the Public Service Commission, In Re ANG Coal Gasification Co., Docket No. 9174 and 9433, mimeo at 15-23 (1977) and In Re Basin Electric Power Co-op, Docket No. 9661 and 9692, mimeo at 15-25 (1977).

In addition to evaluating the foregoing considerations, the PSC may give preference to an applicant who conforms to certain policy criteria.54/ Of significance to an ICES, it should be noted that "recycling of the conversion by-products and effluents" and "energy conservation through location, process and design" are two criteria applicable to energy conversion facilities which should benefit an ICES developer.55/

While the standards specified by the legislature and by the PSC are applied to facilities (i.e. energy conversion and transmission) covered by the siting statute, reports and testimony received from other agencies are also considered though not necessarily binding on the PSC. No

particular weight is assigned to such other agency input though in practice the inputs of other agencies are evaluated as part of the selection criteria.

The statute does provide, however, that "no site or route shall be designated which violates the rules of any state agency."[56/] Nor shall a site "be designated which violates local land use, zoning, or building rules, regulations or ordinances" unless, in the case of a permit for construction of a transmission facility, the PSC finds such local provisions "unreasonably restrictive."[57/] In addition, state agencies may indirectly veto the approval of a site by failing to issue a needed permit for reasons other than the site designation.

FOOTNOTES

1. N.D. Cent. Code, ch. 49-22 (1978).

2. Id. §49-22-03(5) (Supp. 1979).

3. Id. §49-22-03(11).

4. Telephone conversation with Gary Anderson, Department Head, Siting Division, North Dakota PSC, June 20, 1978.

5. N.D. Cent. Code §49-22-03(12) (Supp. 1979).

6. Id. §49-22-07 (Emphasis added).

6a. Id. §49-22-17 (1978).

7. Id. §49-22-02 (Supp. 1979).

8. Id. §49-22-07.

9. Id. §49-22-20(2) (1978).

10. Id. §49-22-18 (Supp. 1979).

11. N.D. Admin. Code, Article 69-06.

12. See part III, infra.

13. Telephone conversation with Mr. Anderson, June 19, 1978.

14. N.D. Cent. Code §49-22-16(3) (Supp. 1979).

15. Id. §49-22-16(4).

16a. Id. §23-25-04.1 (Supp. 1979).

16. Id. §23-25-04.1 (Supp. 1979).

17. Id. §61-28-04.

18. Id. §61-28-04(18).

19. Id. §54-34.1-03 (1974).

20. Id. §54-34.1-04(7).

21. Id. §Ch. 4-22 (1975).

22. Id. §4-22-01 (Supp. 1979).

23. Id. §4-22-06 (1975).

23a. Id. §4-22-08.

23b. Id. §4-22-26(8).

23c. Id. §4-22-27.

23d. Id. §4-22-30.

23e. Id. §4-22-33.

23f. Id. §4-22-34.

24. Id. §61-29-05 (Supp. 1979).

25. Id. §49-22-16(2).

26. Id. Chapter 11-33 (1976).

27. Id. §11-33-20 (Supp. 1979).

28. Id. §11-33-18 (1976).

29. Id. §11-33-17.

30. Id. §40-48-08(3)(1968).

31. Id. §40-48-12.

32. Id. §49-22-04 (1978).

33. Id. §49-22-07.1, N.D.Admin. Code §69-06-03.

34. Id. N.D. Cent. Code §49-22-08 (Supp. 1979).

35. Id. §49-22-22.

36. Id. §49-22-08(2) and N.D. Admin. Code §69-06-04(3).

37. N.D. Cent. Code §49-22-13 (Supp. 1979).

38. N.D. Admin. Code §69-06-01-02(2).

39. N.D. Cent. Code §49-22-13(4) (Supp. 1979).

40. Id. §49-22-10 (1978).

41. Ibid.

42. Id. §49-22-19.

43. All administrative appeals are governed by Chapter 28-32 of the N.D. Cent. Code. See Chapter 2, supra.

43a. N.D. Cent. Code §49-22-07.2 (Supp. 1979).

44. Id. §49-22-02.

45. Id. §49-22-09.

46. Id. §49-22-09(3).

47. N.D Admin. Code §69-06-01-01(7). See Appendix A for for detail.

48. Id. §§69-06-08-01(1), 02(1).

49. Land Use Planning Report, Nov. 21, 1977, p. 373.

50. N.D. Admin. Code §69-06-08.2,-02.2).

51. Id. §§69-06-08-02(2), 02(2), 02(2). See Appendix A for detail.

52. Id. §69-06-08-01(3).

53. Id. §69-06-08-02(3). See Appendix A for detail.

54. Id. §§69-06-08-01(4), 02(4). See Appendix A for detail.

55. Id. §69-06-08.4.a and b.

56. N.D. Cent. Code §49-22-16(4) (Supp. 1979).

57. Id. §49-22-16(2).

CHAPTER 4
FRANCHISING OF PUBLIC UTILITIES IN NORTH DAKOTA

I. AUTHORITY TO GRANT FRANCHISE

Local control over the franchising of utilities in North Dakota is protected by the state constitution. Though the constitution does not specifically grant the municipalities the power to confer franchises, it does provide that:

> No law shall be passed by the legislative assembly granting the right to construct and operate a street railroad, telegraph, telephone or electric light plant within any city, town or incorporated village without requiring the consent of the local authorities . . . N.D. Const. §139

The extent to which this restricts the state from granting a franchise is discussed in Part IV(C) below.

The specific grant of franchising power to municipalities is found in §40-05-01.57 of the North Dakota Century Code which provides that the governing body of a municipality shall have the power:

> To grant franchises or privileges to persons, associations, or corporations . . . to extend for a period of not to exceed twenty years and to regulate the use of the same, franchises granted pursuant to the provisions of this title not to be exclusive or irrevocable but subject to the regulatory powers of the governing body;

The words "persons, associations or corporations" indicate that a franchise may be given to anybody, with no limitations on the type of entity or service. Likewise, the

statute confers this power on all municipalities. There have been no cases testing the limits of the franchising power conferred by this statute and, hence, it may be interpreted as broadly as the language permits. An additional statute authorizes municipalities to "grant the right of way for the construction and operation of a railway, telephone line, electric light system, or a gas or oil pipeline system . . . ."[1/]

Notwithstanding the constitutional provision requiring the consent of local government to certain state authorized franchises and the otherwise broad grant of franchising power to local authorities, it appears that the state has preempted a limited area of franchising: The right to lay, maintain and operate pipeline carriers.[2/] A common pipeline carrier is defined in the statute as any person who is in any way connected with the ownership, operation or management of any part of any pipeline within the state involved in the transportation of crude petroleum or gas, or any person producing natural gas which is transported through pipelines.[3/]

II. PROCEDURES FOR GRANTING FRANCHISES

The North Dakota legislature, in delegating almost complete authority to the local government to grant franchises, has also left the promulgation of procedural provisions to municipal control. A party need not obtain any type of

certification from the state as a prerequisite to applying for a franchise. Indeed, the issuance of a certificate of public convenience and necessity by the PSC is made contingent upon the utility having applied for or received a valid franchise.[4/]

An exception exists in the case of common pipeline carriers. Because the state has virtually preempted this aspect of franchising, directly granting the right to lay, maintain, and operate pipelines along, across, or under any public stream or highway to all common pipeline carriers, it has specified certain procedural prerequisites. To avail itself of this automatic right, a common pipeline carrier must file "with the [Public Service C]ommission an acceptance of the provisions of this chapter, expressly agreeing in writing that in consideration of the rights so acquired, the applicant shall be and become a common pipeline carrier, subject to the duties and obligations conferred or imposed in this chapter."[5/]

The legislature has not enacted specific franchising procedures except for the franchising of common pipeline carriers. As a result, the general procedures for adopting ordinances are applicable. These general procedures require that a proposed ordinance be read twice, the second reading commencing not less than one week after the first.[6/]

To pass the proposed ordinance, a majority of all of the members of the governing body must concur.[6a/] Approval by the mayor is required in those cities operating under the council form of government, although a two-thirds vote will be effective to override the mayor's veto.[7/] Once passed, an ordinance "shall be published in one issue of the official papers of the municipalities.[8/] The ordinance becomes effective at the time of publication unless otherwise provided.[9/]

There are no judicial decisions which add to the general procedural requirements discussed above.

III. CRITERIA APPLIED TO REQUESTS FOR UTILITY FRANCHISES

The enabling clause conferring on municipalities the power to grant franchises is very broad and unspecific. A franchise or privilege may be granted to any "persons, associations, or corporations" with no limitation that the franchise serve or otherwise accommodate the public.[10/] There have been no judicial decisions interpreting or limiting this seemingly broad statutory authorization.

Indeed, counsel for the PSC has confirmed that the municipal franchising power is virtually without restrictions. While he opined that a franchise may be granted to a private investor for private distribution, he also noted that the more usual case involves a utility selling to the general public.[10a/]

It follows from this broad grant that there are no requirements that the franchise be awarded to the highest bidder, that the franchisee first obtain a certificate of public convenience and necessity, or that the franchise meet any specified standards.

IV. CHARACTERISTICS OF A FRANCHISE

A. Duration and Termination

The statute restricts the duration of a franchise granted by a municipality to a maximum period of twenty years.[11/] Once a franchise is granted, it will generally continue throughout the designated period. However, any grant of a franchise which does not strictly conform to state law will render the franchise null and void.

In Re Montana-Dakota Utilities Co.,[12/] the utility, having obtained a franchise from certain North Dakota communities to serve natural gas, failed to comply with a state statute regulating the sale of gas. The statute required that a franchise to furnish natural gas must contain a reservation therein that a percentage of native natural gas will be used by the franchisee when it is available.[12a/] At a hearing before the PSC, the utility sought to obtain a certificate of public convenience and necessity in order to extend its distribution system into those communities from which it had obtained franchises. Instead of granting

the certificate, the PSC found the franchise invalid on its face, stating that "the public convenience and necessity require this commission to prohibit the exercise of these franchise rights unless and until their provisions conform to North Dakota" law.[13/]

Generally, a franchise will end at its expiration date. However, the city must give adequate notice to the utility before it may oust the company. An implied consent or agreement to remain is deemed to arise at the termination of a franchise unless clearly refuted by the city. To terminate this implied agreement, "a reasonable notice is necessary on the part of the city to the . . . company and some affirmative act taken by the city to show the decision to terminate such implied agreement and to oust the . . . company" is required.[14/]

B. Exclusivity

In addition to placing a time limit on the duration of a franchise granted by a municipality, the legislature has expressly prohibited the granting of an exclusive franchise.[15/]

C. Other Characteristics

Neither the statutory nor the case law limits the franchising authority to particular utilities or provides for the abandonment of a franchise. However, approval of

the PSC is required for the sale or transfer of a franchise to another utility.[16] There is no provision for a mandatory franchise tax to be paid to a municipality.

A municipality may, however, impose conditions as an incident to granting the franchise. It may, for example, require the utility to sell to the city at a rate less than that established by the PSC. Thus, the PSC may not interfere with or regulate the contract rates between a city and a utility if agreed as to part of the franchise.[17] D. Buchanan, a past member of the legal staff of the Public Service Commission, has reviewed the Western Electric case and the related case of Chrysler Light & Power Co. v. Belfield, 58 N.D. 33, 224 N.W. 871 (1929) in 49 N.D.L. Rev. 41 (1972) and has concluded that the courts tend to favor the municipal power to franchise over the state's power to regulate. Although no case directly on point has been found, it appears that this preference for municipal authority may permit a municipality to prevent the operation of a utility certificated by the PSC by denying the utility a local franchise.

This conclusion is supported by the North Dakota Supreme Court's decision in Montana-Dakota Utilities Co. v. Divide County School Dist. No. 1.[18]

In an earlier case, Grafton v. Otter Tail Power Co.,[19] even though utility service within the city was provided

by a municipally owned utility, the courts held that the city could not preclude the sale of power by a private utility to a state school located within the city because the school was created by the legislature to carry out a specific governmental purpose. In the Montana-Dakota case, the court limited the Grafton holding, pointing out that it involved a sale of electricity to an institution created by the state constitution. In Montana-Dakota, a cooperative sought to supply electricity to a public school district in a city in which the cooperative had been denied a franchise. The court held Grafton inapplicable since the public school district was created by the legislature rather than the constitution. To provide service to the school district, the cooperative would need a franchise from the city. Although neither of these cases are directly on point, they do suggest that a city may prevent the operation of a utility certificated by the PSC by withholding a franchise to operate in the city.

FOOTNOTES

1. N.D. Cent. Code §49-09-16 (1978).

2. Id. §49-19-09 (1978).

3. Id §49-19-01 (1978).

4. Id. §§49-03-02, 49-03.1-03.

5. Id. §49-19-09. For an enumeration of the rights, duties and conditions affecting a common pipeline carrier see Chapter 49-19.

6. Id. §40-11-02 (1968).

6a. Ibid.

7. Id. §40-11-05.

8. Id. §40-11-06.

9. Id. §40-11-07.

10. §40-05-01.57.

10a. Telephone conversation with Ray Walton, Commerce Council, June 19, 1978.

11. §40-05-01.57.

12. 11 PUR 3d at 352 (N.D. PUC 1952).

12a. N.D. Cent. Code §49-19-04 (1978).

13. 11 PUR 3d at 360.

14. In Re First Farmers Telephone Assoc., 1930B PUR 115,118.

15. N.D. Cent. Code §40-05-01.57.

16. Id. §49-04-05 (1978).

17. Western Elec. Co. v. Jamestown, 47 N.D. 157, 181 N.W. 363 (1921).

18. 193 N.W.2d 723 (N.D. 1971).

19. 86 N.W.2d 197 (N.D. 1957).

CHAPTER 5

RATE REGULATION IN NORTH DAKOTA

I. RATEMAKING AUTHORITY

A. General

The North Dakota statutes authorize the Public Service Commission (PSC) to "supervise the rates of all public utilities."[1] The PSC has the power to originate, establish, modify or adjust the rates of public utilities after notice and a public hearing. Whenever the PSC, after a hearing, finds that existing rates are unjust, unreasonable, insufficient, or unjustly discriminatory, it may determine and fix appropriate rates.[2] The PSC has rate jurisdiction over all investor owned facilities,[3] but it does not have rate jurisdiction over any publicly owned or operated utility, nor over "any public utility that is not operated for profit."[4] This latter provision would generally exempt co-operatives from PSC rate jurisdiction.

The North Dakota statutes define "public utility" to include any association, person or corporation engaged in the business specifically enumerated in the statutes.[5] Those businesses include electric light companies engaged in generating and distributing light, heat or power; gas companies engaged in the manufacture or distribution of natural or artificial gas; or heating companies engaged in the distribution of heat. The provision of steam is not specifically mentioned in the statute, but such a utility service is likely to be subject to PSC rate jurisdiction as a form of distribution of heat.

The PSC is empowered by statute to prescribe a uniform system of accounts for use by jurisdictional utilities and it has adopted the NARUC system of accounts for use by jurisdictional utilities.[6/] There are no reported cases or PSC orders which further define the scope of PSC authority in this area.

B. Ratemaking Procedures

No public utility may change any tariffs, rates, classifications or service which have been filed and published without first giving the PSC thirty-days' notice.[7/] The PSC is empowered to suspend any proposed rate change for a period of up to eleven months beyond the time when the proposed change would otherwise take effect. In the absence of PSC action, proposed rates take effect thirty days after filing, unless the PSC, for good cause shown, authorizes a lesser time. Upon complaint or upon its own motion, the PSC may call a public hearing for the purpose of investigating the proposed increase. The statutes make no provision for public notice in advance of such a hearing.[8/] Rule 4.1 of the PSC's Rules of Practice and Procedure, however, provides that where the proceeding involves "the rights of persons who are members of the public generally," the PSC shall provide at least twenty-days' notice to the Chairman of the Board of County Commissioners of counties affected and to the Chief Executive Officer of each city in each county affected. The PSC may elect to provide notice to the public through "the official newspaper of each county" affected by the proposed change.

Upon its own motion or upon petition for revaluation of utility property filed by twenty-five percent of the utility's customers, the PSC is authorized by statute to negotiate with the public utility in question to arrive at a reasonable rate to be charged for the utility's services. The negotiated new rate cannot be more than fifteen percent less than existing rates. Should the utility and the PSC fail to negotiate a new rate within thirty days, the PSC shall proceed with the valuation of the utility's property.[9] In such an event the utility must file a bond with the PSC to guarantee the repayment of any difference, if any, between the finally determined rate and the rate in force during the period of investigation.[10] If the utility fails to file such a bond, the PSC must immediately fix a temporary rate to be in force during the period of investigation. Such rate must be sufficient to provide a return of no less than five percent per year based on the original cost of the utility's property, less accrued depreciation.[11]

C. Statutory Ratemaking Criteria

Public utilities under PSC jurisdiction operate under a general mandate that their rates be "just and reasonable."[12] The North Dakota statutes impose on a utility the burden of showing that any proposed rate change is just and reasonable.[13] In support of a proposed rate increase, a utility must file with the PSC the following information:

1. The original cost of all its property;
2. The date of the acquisition of said property;
3. The amount of money invested in said property;

4. The amount of stock outstanding;
5. The amount of bonds outstanding against said property;
6. All books, papers, and memoranda of the utility showing the financial condition thereof;
7. Its total monthly salaries and wage expense for such time as the commission may request;
8. An itemized statement of its expenditures;
9. The details of its profit and loss account; and
10. All other books, papers, vouchers, and accounts which the said commission shall ask to have produced as evidence at the hearing.

In addition, Rule 1(b) of the PSC's Standards of Electric Service provides that where an electric company wishes to change its rates, it must provide the PSC with a statement of:

1. The reason for the proposed change;
2. The number of customers affected;
3. The estimated increase or decrease in annual revenue (and the basis for the estimate);
4. The existing rate schedule to be superseded.

No comparable rule exists in the PSC's Standards for Gas Service.

II. RATE BASE DETERMINATION

A. Test Period

The PSC has not used a single test period methodology with any consistency. Older cases show that the PSC used a twelve month simple averaging method.[14/] In more recent cases, however, the PSC has used both year-end and projected test periods. In one case the PSC accepted the utility's use of a year-end rate base.[15/] The PSC noted that "when there is little fluctuation in a utility's accounts from the beginning of the year to the end of the year, it is probably best to

predicate the rate base on the average investment for the test period . . . ." However, the PSC went on to note that it is equally defensible "and, in these times, perhaps preferably," to use a year-end rate base.[16]

In one case, however, the test year was simply described as the "actual year 1976 and a projected test year ending July 31, 1978."[17] The PSC accepted the projected fiscal year which had also been used by its staff. A projected test year has also been used in other cases.[18] It should be noted that even where the year-end test has been accepted, the PSC has also required that projected test year figures be provided.[19]

B. Rate Base Valuation

The rate base is valuated on the basis of "prudent investment," less depreciation.[20]

The statutes provide specifically that the value of the public utility's property shall be "the money honestly and prudently invested therein by the utility less accrued depreciation."[21] In addition, the statute requires that the value of public utility property for rate making purposes must not include or be affected by good will value, going concern value, or franchise value in excess of payments made therefor.[22]

The PSC is empowered to determine whether the utility has paid an "advanced or fictitious" cost or price in excess of fair market value for any commodity, machinery, equipment, material or service. Where it so finds, it must fix and allow

only the reasonable and fair market value of the item or service at the time of purchase as a part of the valuation or rate base. All fictitious or excessive prices or values are to be eliminated.[23]

C. Rate Base Components and Adjustments

The PSC generally does not permit the inclusion of construction work in progress in rate base. In one of its decisions, the PSC explicitly stated that it did not find "construction work in progress includable under the 'used and useful concept of our law.'"[24] In addition, a PSC official has stated that the PSC always excludes CWIP. A legislative attempt to mandate the inclusion of CWIP in rate base was turned back by a gubernatorial veto last year.[25]

The inclusion in rate base of items such as research and development and initial organization or start up costs has not been addressed in any reported PSC decision. A PSC official stated that he knew of no such instance, but did offer that such costs have been allowed as expenses.[26]

D. Rate Base Allocation

According to a utility spokesman, North Dakota utilities generally follow the NARUC allocations manual when determining rate base allocations. One method specifically mentioned as having been used is the 12-month coincident peak demand method.[27] In one reported telephone utility case the PSC stated that separation of intrastate from interstate property for rate base determination is to be governed strictly by the separations policy adopted by the Federal Communications Commission.[28]

III. COST OF SERVICE

A. Allowable Expenses

The PSC decisions contain very little discussion of what constitutes an allowable operating expense. The PSC has consistently held that "informational, instructional and conservation advertising on the part of public utilities is a proper expense for rate determination, but that institutional or corporate advertising is not, and that the latter expense should be borne by the stockholders."[29/]

The PSC has excluded all charitable contributions and organization dues from allowable expenses. Noting that such expenditures were commendable, the PSC went on to find, however, that requiring ratepayers to bear the cost constituted involuntary contributions. Hence, the PSC required that such costs should be borne by the stockholders.[30/]

Aside from the discussion of these expense items, the PSC has provided no general statement concerning the allowance of expenditures as operating expenses. A spokesman for the PSC has stated that there is no general rule, and that expenses are approached on an item by item basis.[31/]

The PSC may require proof that no unreasonable profit was made in the sale of materials to or services supplied for any utility where the selling or providing company is affiliated with the utility. If any unreasonable profit has been made by the company, the valuation of the service or material may be appropriately reduced by the PSC before inclusion in valuations or cost of operations for rate making purposes.[32/]

B. Allocation of Expenses

Where the utility provides multiple services, the PSC would appear to accept any reasonable method for allocation of joint expenses which a utility proposes. According to a utility official, utilities generally use a four-part allocation procedure which looks at ratios of revenues, plant-in-service, customers, and employees.[33/] In addition, the PSC has not adopted any specific methodology for allocation of expenses between customer classifications. A utility official indicated, however, that the non-coincident peak demand method is employed by most North Dakota utilities.[34/] The industry official also noted that allocation issues arising under power pool arrangements are controlled by FERC procedures. There are no PSC decisions that discuss either the issues of power pooling or interchanges.

IV. FEDERAL INCOME TAX ISSUES

Although there are no PSC decisions in which the treatment of tax benefits resulting from liberalized depreciation are discussed, an official of the PSC has stated that the PSC allows full normalization of such tax benefits. The PSC allows full normalization of all Federal tax benefits including Investment Tax Credits.[35/] Unamortized investment tax credits will be deducted from rate base.[36/]

An official of the PSC stated that he knew of no situation where a utility switched from flow-through to normalization. As far as he knew utilities always have used normalization procedures.[37/]

V. METHODS USED FOR DETERMINING RETURN TO BE ALLOWED A REGULATED UTILITY

Recent PSC decisions contain little discussion of any preferred methodology for determining a return on equity or overall allowed rate of return. The PSC has said in Re Montana-Dakota Utilities Co.,[38] the applicant utility used comparable earning analysis, discounted cash flow analysis and regression analysis to determine its proposed return on equity.[39] The PSC approved the rates as filed by the utility.

According to an official of the PSC, its consultant has employed discounted cash flow in his calculations, and the PSC has found this methodology generally acceptable.[40]

The table in Appendix A lists the overall return on equity that have been allowed in recent rate cases.

Beyond describing what rates are "just and reasonable," PSC rate decisions are almost devoid of any identification of specific factors to be considered in ratemaking. In Re Montana-Dakota Utilities Co.,[41] the PSC arrived at its prescribed return on common equity after "consideration of all the relevant factors, including present and indicated money market conditions, the need for adequate earnings in times of uncertainty and perhaps unusual risk for investors in public utilities securities."[42] The PSC did not, however, expand upon this general description of the utility's situation. An official of the PSC was unable to recall any decisions in which particular risks or potential incentives or penalties played a part in determining

what rate of return a utility would be permitted to earn on its equity.[43]

VI. RATE DESIGN CRITERIA

PSC decisions contain little or no discussion as to the underlying philosophy or purpose of prescribed rate structures. An official of the PSC was reluctant to describe rates as cost-based, but did note that recent cases have shown "some leveling-off" of the rate structures, although nowhere near the point where they could be described as inverted.[44]

North Dakota statutes make no provision for lifeline rates, or for other special rates for specific classifications of customers.

In Re Otter Tail Power Co.,[45] the PSC noted, without further explanation, that rates should also serve the purpose of promoting the conservation of energy. The utility was directed to continue its development of "off-peak rates and any other load management techniques, including time-differential pricing with the goal of the best utilization of its utility plant."[46]

There are no PSC decisions in which pricing for the sale of excess power is discussed. A utility spokesman has stated that all excess power is bought and sold within the Upper Mississippi Power Pool, and that these rates are controlled by FERC.[47]

VII. REGULATION OF SECURITIES ISSUANCE

A. Securities

The PSC is empowered to regulate, supervise, restrict and control the issuance of securities by jursidictional public utilities except such securities which are payable within one year from the date of issue.[48] The statute does not prescribe specific purposes for which a utility may issue securities.

In one case, a utility sought authority to issue a promissory note, the proceeds of which were to be used to satisfy prior obligations of the company about to come due.[49] The purpose of the issuance was to reduce the company's interest payments. Though no cost savings would be passed through to utility customers, the PSC did find that the financial condition of the company would be improved as a result of the issue of such securities. Since such an improvement was generally in the public interest and was likely to result in improved utility services, the PSC authorized the issuance.

B. Capital Structure

Though there are no other reported cases or decisions discussing PSC standards or criteria for authorization of securities issuances, the PSC has considered the appropriateness of certain capital structures. In one case, the PSC found a gas and electric company's capital structure of 37.73% common stock equity, 13.30% preferred stock, and 53.97% debt to be reasonable.[50] A capital structure of 14.45% preferred stock, 33.17% common stock equity and 54.38% debt was held reasonable in another case.[51]

APPENDIX A

CASE	ALLOWED % OVERALL	RATE OF RETURN ON COMMON EQUITY
Re Northern States Power Co., 24 P.U.R.4th 252 (1978)	8.70	11.43
Re Northern States Power Co., Case No. 9461, April 26, 1977	8.75	11.94*
Re Montana-Dakota Util. Co., Case No. 9446, May 10, 1977**	8.73	11.58
Re Montana-Dakota Util. Co., Case No. 9447, May 10, 1977**	8.85	11.94*
Re Otter Tail Power Co., Case No. 9374, July 12, 1977	8.75	11.46*
Re Northwestern Bell Tel. Co., 21 P.U.R.4th 224 (1977)	8.75	11.21

* Not contained in order, but implied from ordered return on rate base.

** These are two companion cases in which the utility's gas and electric operations were separated for ratemaking purposes.

FOOTNOTES

1. N.D. Cent. Code §49-02-03 (1978).
2. Ibid.
3. Id. §49-02-01 (Supp. 1979).
4. Id. §49-02-01.1 (1978).
5. Id. §49-01-01.
6. Id. §49-02-12.
7. Id. §49-05-05.
8. Id. §49-05-06.
9. Id. §49-06-05.
10. Id. §49-06-06.
11. Id. §49-06-07.
12. Id. §49-04-02.
13. Id. §49-05-06.
14. See, e.g., Re Northern States Power Co., 6 P.U.R.4th, 38 (1974).
15. Re Montana-Dakota Util. Co., Cases No. 9446, 9447 May 10, 1977.
16. Id. at 5.
17. Re Northern States Power Co., 24 P.U.R.4th 252, 254 (1978).
18. E.g., Re Northwestern Bell Tel. Co., 21 P.U.R.4th 224, 227 (1978); Re Otter Tail Co., Case No. 9374, July 12, 1977, at 3.
19. Telephone conversation with Mr. Howard Cotton, Commission Accounting Department, April 19, 1979 (hereinafter "Cotton conversation").
20. E.g., Re Northern States Power Co., Case No. 9461, April 26, 1977, at 3.

21. N.D. Cent. Code §49-06-02 (1978).

22. Id. §49-06-03.

23. Id. §49-06-04.

24. Re Otter Tail Power Co., Case No. 9374, April 22, 1977, at 4.

25. Cotton conversation.

26. Ibid.

27. Telephone conversation with Mr. Robert Ball, Rate Department, Montana-Dakota Utilities Co., April 29, 1979 (hereinafter

28. Re Northwestern Bell Tel. Co., 21 P.U.R.4th 224, 223 (1977).

29. Re Northern States Power Co., 24 P.U.R.4th 252, 255 (1978).

30. Ibid.

31. Cotton conversation.

32. N.D. Cent. Code. §49-02-02(6) (Supp. 1979).

33. Ball conversation.

34. Ibid.

35. Cotton conversation.

36. Re Montana-Dakota Utilities Co., Case No. 9446, May 10, 1977, at 5.

37. Cotton conversation.

38. Case No. 9446, May 10, 1977.

39. Id. at 7.

40. Cotton conversation.

41. Case No. 9446, May 10, 1977.

42. Id. at 7.

43. Cotton conversation.

44. Ibid.

45. Case No. 9374, July 12, 1977.

46. Id. at 5.

47. Ball conversation.

48. N.D. Cent. §49-04-04 (Supp. 1979).

49. Re Montana-Dakota Util. Co., 17 P.U.R.(n.s.) 431 (1937).

50. Re Northern States Power Co., 6 P.U.R.4th 38 (1974).

51. Re Montana-Dakota Util. Co., Case No. 9447, April 26, 1977.

CHAPTER 6

SUMMARY OF IMPEDIMENTS TO IMPLEMENTATION OF ICES

I. Types of Impediments

In order to analyze the extent to which the traditional public utility regulatory system may impede the implementation of ICES, one must first identify what is meant by the word "impediment." For the purposes of this analysis, four broad types of impediments can be identified. The first major category of impediment is the "no-subsidy impediment." This impediment consists of the failure of the government or the regulatory system to provide some desired degree of monetary or other encouragement of ICES. Such subsidies could take the form of grants or tax incentives. On the other hand, a subsidy could result from state public utility regulatory commission (PUC) departure from strictly cost-based rates for purchases and sales of electricity between an ICES and conventional electric utilities, thereby compelling the customers of the electric utility grid to subsidize ICES.

The second major category of impediment is the "uncertainty impediment." The absence of certainty with respect to the manner in which an ICES will be regulated will impose costs that must be borne by the ICES operator. Uncertainty impediments will appear in many forms. ICES will be faced with uncertainty because it represents a new concept which can be

expected to raise issues with which utility regulators are unfamiliar. Such uncertainties will be aggravated as a result of the fact that regulatory jurisdiction in the United States is decentralized. Thus, these uncertainties will have to be resolved largely on a jurisdiction-by-jurisdiction basis. In addition, ICES will necessarily be involved in the sale of excess electrical power to and the purchase of back-up electrical power from conventional electric utilities. These arrangements, however, can be altered by a PUC even though the ICES and utility initially agreed upon the terms. Therefore, ICES will face transactional uncertainties not normally encountered in doing business outside the utility field.

Another major category of impediment is the "discriminatory impediment." This type of impediment takes the form of rules or regulations which, for whatever reasons, affect ICES more harshly than competing energy technologies. These diferences in impact may be the result of any number of factors including, but not limited to, ICES size, the type of customers it can be expected to serve and the manner in which it will do business.

The final general category of impediment is the "prohibition impediment." These impediments could be either regulations which impose so substantial a cost on the ICES that it cannot operate economically or regulations which would actually preclude operation of an ICES.

II. Regulatory Impediments to ICES Implementation

The degree and manner in which the existing regulatory system will impede the development of ICES will vary depending on the form of ownership, class of customer and method of doing business chosen by an ICES developer. The ICES type which can be expected to encounter the most serious impediments is the investor-owned ICES seeking to construct a new facility to serve customers in a community already being served by a conventional utility. Such an ICES will face impediments in the form of general PUC regulation, regulations relating to the siting of facilities and the granting of local franchise and regulations concerning rates charged for energy service.

A. General Regulatory Impediments

Public utility regulation probably is more pervasive and complex than any other form of government regulation of business. A businessman not engaged in the utility business may be reluctant to become involved in a business which will subject him to such pervasive governmental regulation. Some examples of areas of regulation which might discourage investors from becoming involved in ICES implementation are the requirement that a regulated utility maintain its books in conformity with a system of accounts prescribed by the PUC and PUC regulation and scrutiny of the financial affairs of the utility. When the ICES is operated in conjunction with a non-utility business, such regulation necessarily will extend beyond the operator's utility operations and involve PUC examination of

its non-utility business. Attempts at minimizing the effects of these types of impediments by setting up a subsidiary corporation to own and operate the ICES could subject the parent company to extensive Securities and Exchange Commission regulation pursuant to the Public Utility Holding Company Act of 1933.

Even if an ICES developer is willing to face the possibility of extensive PUC regulation, it will face a significant uncertainty in determining whether it will be deemed a public utility and therefore subject to PUC regulation. All states require that a utility provide service "to or for the public" before it becomes subject to the jurisdiction of the PUC. Few states, however, have provided any real guidance with respect to the meaning of the phrase "to or for the public." Thus, an ICES operator can expect very little guidance in determining whether its operations will be sufficient to bring it within the classification of "public utility."

Similarly, many states require that a utility "sell" utility service before it will be classified as a public utility. Again, statutes, administrative rules and caselaw provide very little guidance with respect to when a transaction will be classified as a "sale." Thus, the ICES operator must face another significant area of uncertainty with respect to PUC regulation of its operations.

Assuming that some aspects of the ICES operations will bring it within the classification of public utility, a

serious question remains with respect to whether sales of both of the ICES energy streams will be subject to PUC regulation and, if not, whether and by whom the non-PUC regulated energy stream will be regulated. This uncertainty arises because many state statutory schemes provide for the regulation of only certain enumerated utility services such as heat, electricity and gas. In such states, the provisions of refrigeration or motive power may not be within PUC jurisdiction. Regardless of whether these energy streams will be regulated by local governments, or left unregulated, such split regulation may raise significant problems with respect to the marketing of both energy streams at competitive rates.

State territorial assignment programs could present an impediment capable of precluding operation by ICES. Several states have enacted legislation which specifically provides that the PUC is to divide the state into a finite number of service areas and assign each of these service areas exclusively to a particular utility. Where such programs exist, service area assignments have been made and, generally, these programs make no provision for the assignment of service areas to new utilities unless there is some indication that customers are not being adequately served. Even where no specific statutory allocation scheme exists, PUCs generally have sought in granting certificates of public convenience and necessity to avoid what they viewed as wasteful duplication of facilities by granting the first utility serving a given area in effect an exclusive

right to serve that area so long as the utility provides adequate service. Thus, in many cases, an ICES may find that it is precluded from initiating operations as a result of these territorial assignment programs.

B. Siting Impediments

The siting of energy production facilities is regulated in some manner in all states. The types and degree of impediments presented will vary depending on the type of siting program in effect in a particular jurisdiction and the type of facility proposed to be constructed. In those states which have not adopted comprehensive one-stop siting programs, a utility desiring to construct an energy production facility generally must seek approval from a variety of state and local agencies. Because an ICES developer in such a state will be forced to obtain numerous approvals, the procedural requirements related to obtaining such multiple approvals could present significant impediments to the implementation of ICES. In those states which have attempted to minimize the procedural difficulties presented by the need to obtain multiple approvals by implementing one-stop comprehensive siting programs, an ICES operator may face significant impediments in the form of substantive requirements in obtaining the required approval.

C. Local Franchising Impediments

In addition to obtaining certificates of convenience and necessity from PUCs and siting approvals from one or more state agencies, ICES operators generally will be required to

obtain franchises from local governments to use public rights-of-way for transmission and distribution facilities. Because of the total lack of uniformity in the law and procedures governing local franchising, ICES operators will face many uncertainties in this area. One major uncertainty related to whether a franchise is needed or available and, if a franchise is not available, whether this will preclude the use of public rights-of-way in conjunction with the operation of the ICES. Many franchise enabling statutes list specific services which local governments are authorized to franchise. In addition, most statutes require that the franchisee be serving a public purpose in order to be eligible for a franchise. These types of restrictions raise the question of whether, if an ICES is providing a service which is not deemed to be serving a public purpose, a franchise may be granted. If a franchise cannot be granted, significant uncertainty exists with respect to whether the ICES may operate along public rights-of-way without a franchise. If not, it may be precluded from operating unless all facilities are maintained on private property with the permission of the property owners.

Assuming a franchise is available to an ICES, additional uncertainty exists with respect to the procedure pursuant to which the franchise will be granted and the standards which will be applied in determining whether the franchise should be granted. These procedures and standards vary substantially from state to state and from municipality to municipality within each state.

Finally, an ICES which might otherwise be eligible for a franchise may be unable to obtain the necessary franchise as a result of a prior grant of an exclusive franchise to another utility serving the area. Nearly one-half of the states have not resolved the issue of whether exclusive franchises are permissible.

D. Rate Regulation Impediments

Assuming that an ICES operator can overcome or operate in spite of the impediments described above and begin its operations, it must be able to market both energy streams at competitive rates in order to stay in business. Several areas of PUC rate regulation may impede the ICES' ability to operate profitably. For example, an ICES may find that the rates for one energy stream are regulated on a statewide basis by the PUC while the remaining stream is regulated by one or more local governments. With such split jurisdiction, there can be little assurance that rates will be regulated consistently and in such a way as to enable competitive marketing of both energy streams.

Even if both energy streams are regulated by the PUC, resolution of various cost and rate-base allocation issues could present serious issues unique to ICES. Depending on the method chosen to allocate costs and rate base between the two services being marketed, the ICES operator may find that it will be compelled to sell one energy stream at a rate too low for the whole ICES to be profitable while the second energy stream must be sold at a rate too high to be competitive.

In addition, PUCs traditionally have exercised rate-making authority only with respect to sales by conventional utilities operating in a monopoly market. Investment in these conventional utilities traditionally has been considered a low-risk investment and, therefore, the rates of return on equity permitted by PUCs have been commensurately low. Because ICES, as a new industry and as a utility operating in competition with other utilities, will be viewed as a more risky investment, PUC decisions with respect to allowable rates of return will have a significant impact on the ability of ICES to attract investors. Rates of return satisfactory to investors in conventional utilities are unlikely to attract investors to the more risky ICES operations.

Finally, ICES must be able to obtain reasonable rates for sales of excess electrical power to and purchases of back-up electrical power from conventional electric utilities. These rates also will be regulated by PUCs and the PUC determinations will substantially affect the ability of the ICES to operate profitably. The uncertainty surrounding the factors that will be considered by PUCs in establishing these rates is very likely to be perceived as an impediment by prospective ICES operators and investors.

CHAPTER 7

OVERCOMING IMPEDIMENTS TO ICES -- SUMMARY

The Chapter 6 analysis demonstrates that the traditional public utility regulatory system presents numerous impediments to the implementation of ICES. These impediments do not appear in the form of a list of individual statutory or rule provisions which can be easily modified to accommodate ICES. Rather, the impediments take the form of the existing regulatory system itself -- a system which is based largely on a set of assumptions and practices foreign to the ICES concept.

Because the existing regulatory system is, in effect, the major impediment to the implementation of ICES, there are only two available alternatives for dealing with this impediment. Advocates of ICES can attempt to change the system, or they can work within the system in order to demonstrate the value of the ICES concept. Because many of the regulatory provisions which appear to be impediments to the implementation of ICES are integral parts of the existing regulatory system, however, any effort to change the system sufficiently to encourage the widespread implementation of ICES will require changes so fundamental that traditional forces operating within the system would have little trouble blocking such changes. Thus, a widespread effort by the advocates of ICES to change the system may result in a substantial expenditure of resources while bringing about very little change.

There is no single configuration or form of ICES. While differences can result from employing different technologies to produce different energy streams, the most useful classifications for purposes of analyzing potential institutional impediments to the implementation of ICES are those based on type of owner/developer and the nature of the customer group served. The classification scheme used in the following analyses includes ICES-Utility -- an ICES owned and operated by a conventional electric utility, ICES-Complex -- an ICES designed to serve existing institutional complexes such as government, commercial, industrial, residential or medical centers, ICES-Heat Plant -- an ICES providing thermal service for its own use or the use of a limited class of customers and selling all electrical output to a conventional utility, ICES-Co-Op -- an ICES owned by its customers and serving only these member/customers and ICES-Entrepeneur -- an ICES owned and operated by any entity intending to sell or provide utility service at retail to all users within a particular service area. Obviously, additional types, of ICES can be developed by combining these various modes of ownership with the various available customer classes.

ICES may be established gradually in forms that will not encounter, or not be significantly affected by, many of the impediments discussed above. When the various types of ICES are compared against the existing regulatory framework, it is apparent that there is a wide range in the degree of compatibility

between that framework and the various ICES types. The degree to which the implementation of ICES will be impeded by the existing regulatory system varies greatly depending on the form of ownership of the ICES, the number and type of customers which it intends to serve and the manner in which it will conduct its utility operations. Therefore, if advocates of ICES seek implementation along the paths of least resistance, this gradual implementation will provide ICES technology with an opportunity to establish its viability and adapt to the existing regulatory system while permitting the existing system to become familiar with and adapt to the peculiar problems and benefits of ICES. The following may be the most appropriate sequence of implementation of ICES.

I. ICES-Utility

ICES-Utility would include any ICES owned by an existing electric utility and operated as a part of its existing utility business. The utility could either operate its own cogeneration equipment or operate equipment owned by another entity on behalf of the owner. The utility would carry on its electrical operations in the same manner as it had before becoming involved with the ICES, but the particular arrangements for the sale of thermal energy could vary. Thermal energy might be distributed by the ICES-Utility to individual customers or it could be sold in bulk to a single customer for use by that customer or for further distribution by it.

ICES-Utility, because it would be operated by an existing utility, would be least affected by the regulatory impediments discussed in Chapter 6. As an existing utility, the ICES operator would already be subject to PUC regulatory jurisdiction and would have the experience necessary to function within that system with a minimum of inconvenience. In addition, the ICES-Utility might be able to install and maintain its ICES equipment pursuant to existing franchises, certificates or other approvals or obtain minor modifications in these prior approvals so as to permit the ICES operations.

II. ICES-Complex, ICES-Heat Plant

A second approach would be to structure ICES so as to take advantage of traditional exemptions built into the existing regulatory scheme in most states. In all states, a utility must be providing service "to or for the public" before it will be subject to PUC regulatory jurisdiction. In about half of the states, a utility will be subject to PUC jurisdiction only if it is deemed to be making "sales" of energy service. If the ICES is structured so as to either not be deemed to be providing service "to or for the public" or not to be making "sales" of energy services, that ICES would not be subject to PUC regulatory jurisdiction. ICES-Complex and ICES-Heat Plant would be structured so that energy services would be provided only to a limited and clearly defined class of customers. In addition, in many cases, such ICES may be able to provide energy service

as a part of an over-all rental package rather than on an individual metered basis. Such ICES could, in many cases, avoid classification as public utilities. Examples of such ICES would be an ICES established to serve a residential, industrial, commercial, governmental or university complex.

A great deal of uncertainty exists with respect to what types of service can be provided and to how many customers before a utility will be deemed to be subject to PUC jurisdiction. These uncertainties, however, could be remedied by means of fairly simple legislative or administrative action.

By operating so as to avoid PUC regulatory jurisdiction, these ICES will also give up the protections afforded by the regulatory system. Thus, such ICES may be able to operate in competition with conventional utilities without having to obtain PUC approval, but they also must be capable of waging a competitive battle with the existing utilities in the area to be served because they would not enjoy the luxury of the traditional monopoly status of a public utility. Similarly, such ICES would not be subject to PUC rate regulation but would also possibly not receive adequate regulatory protection in their attempts to negotiate contracts to purchase back-up power from or sell surplus power to conventional utilities.

III. ICES-Co-Op

ICES-Co-Op, unlike the ICES discussed above, could lend itself to broad implementation of ICES. By operating as a

cooperative -- a utility which is owned by its customers and provides service only to these owner/customers -- the ICES-Co-Op could avoid many of the more troublesome aspects of the traditional regulatory system while still enjoying many of its benefits. For example, utility cooperatives are exempted from PUC rate regulation and regulation of financial affairs in many states. On the other hand, utility cooperatives often are subject to service area restrictions and, therefore, are afforded the protections of the various methods of territorial allocations utilized by PUCs.

This traditional utility concept could be utilized by, and modified to better serve, ICES projects intended to serve large numbers of customers. One area of possible modification would be to permit qualifying ICES-Co-Ops to commence operations in service areas of conventional utilities under certain circumstances. Qualifying ICES-Co-Ops could be allowed to serve only large concentrations of new customers or they could be allowed to serve existing concentrations of customers. The prejudicial effect of such an extension of the cooperative concept could be minimized by requiring ICES-Co-Ops to purchase those facilities of the conventional utility within the ICES service area which are necessary for serving the ICES customers and which would be rendered unnecessary to the utility.

IV. Exempt-ICES

By utilizing the ICES types discussed above, advocates of ICES can implement ICES in forms which will be least affected by regulatory impediments in order to establish showcase ICES designed to demonstrate the viability and special benefits of the ICES concept. After these showcase ICES have existed in peaceful coexistence with conventional utilities for a time, conventional utilities, utility regulators and legislators may be more amenable to the type of system modifications necessary to encourage widespread implementation of ICES in many forms. At this point, the advocates of an ICES might effectively petition PUCs and state legislatures to define certain categories of ICES which will be exempt from certain troublesome aspects of the traditional regulatory system while enjoying some of its benefits.

In order to qualify as an Exempt-ICES, the ICES must, of course, be required to establish that it would be a reliable, responsible supplier of energy. Once utility regulators are convinced that the ICES has the financial and technological ability to adequately serve its proposed customers, the ICES could be exempted from many traditional areas of regulation without jeopardizing the best interest of the customers.

The Exempt-ICES should be permitted to commence operations to appropriate groups of customers in the service areas of conventional utilities. However, like the ICES-Co-Op, it should be required to purchase any equipment owned by the conventional utility which is rendered useless as a result of

the ICES being permitted to serve customers within the conventional utility's service area. Once it has established its service area, the Exempt-ICES should receive the type of territorial protection traditionally afforded public utilities.

The Exempt-ICES could also be freed from traditional PUC rate regulation. Rather than establishing traditional cost-based rates, the Exempt-ICES could be permitted to market its energy package at any rate which does not exceed the rates for comparable service from conventional utilities. If the Exempt-ICES believed that it was, for some reason, entitled to higher rates, it should be compelled to submit to traditional rate-making procedures. This should assure that, if the ICES concept is in fact economically viable, investors will be able to achieve sufficient returns on their investment while ICES customers are guaranteed reliable energy service at reasonable rates.