Fiscal Note & Local Impact Statement

123 rd General Assembly of Ohio

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STATUS: **As Passed By The House** SPONSOR: **Sen. Johnson**

LOCAL IMPACT STATEMENT REQUIRED: **No — No local cost in the introduced version**

CONTENTS: **Provides for competition in retail electric supply and revises taxes on electric companies and rural electric companies**

State Fiscal Highlights

STATE FUND	FY 2000	FY 2001	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	$6.2 million loss	Annual loss of $34 to $46 million declining over time plus gain of up to $63 million. Additional loss of $30 million in FY 2002.
Expenditures	- 0 -	- 0 -	Annual increase of up to $63 million
Utility and Railroad Regulation (Fund 5F6)			
Revenues	$650,000 gain*	$450,000 gain*	$450,000 gain
Expenditures	$650,000 increase*	$450,000 increase*	$450,000 increase
OCC Operating expenses (Fund 5F5)			
Revenues	$859,000 gain*	$553,000 gain*	$553,000 gain
Expenditures	$859,000 increase*	$553,000 increase*	$553,000 increase
Universal Service Fund (new fund in the Department of Development)			
Revenues	- 0 -	Gain in excess of $21.8 million to $57.4 million	Gain in excess of $21.8 million to $57.4 million
Expenditures	- 0 -	Increase based on revenues in fund	Increase based on revenues in fund
Energy Efficiency Loan Fund (new fund in the Department of Development)			
Revenues	- 0 -	Up to $15 million gain	Up to $15 million gain until FY 2005; after that up to $5 million gain plus additional revenues
Expenditures	- 0 -	Potential increase	Potential increase
Kilowatt-hour Excise Tax Administration Fund (new fund in the Department of Taxation)			
Revenues	- 0 -	$32,500 gain	$32,500 gain
Expenditures	- 0 -	$32,500 increase	$32,500 increase

Note: The state fiscal year is July 1 through June 30. For example, FY 2000 is July 1, 1999 – June 30, 2000.

* Any increase in these funds assumes an increase in appropriation of the amount. The bill does not contain any appropriations for these or other funds.

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- The bill eliminates the gross receipts tax on electric companies and rural electric cooperatives (cost to GRF of $403 million in FY 2002). It subjects the electric companies to the corporate franchise tax (gain to GRF of $44 million in FY 2002, $74 million annually, thereafter) and establishes a new kilowatt-hour tax, in part, to replace revenues lost from the gross receipts tax. 59.976% of revenue from the kilowatt-hour tax is deposited into the state GRF; however, a certain amount is guaranteed to local governments, so that if less than $552 million is received in any year, the amount to the GRF would be reduced. (The estimated gain from this tax in FY 2002 is $297 million.) Thus, the net loss to the GRF in FY 2002 is $403 million minus $44 million minus $297 million = $62 million.

- The final payment of the gross receipts tax on electric companies in June 2001 would be $33 million less than under current law. This loss would be partially offset by the first payment of the kilowatt-hour tax (also in June 2001), of which $26.8 million is to be deposited in the state GRF, resulting in a net loss to the state GRF in FY 2001 of $6.2 million.

- The deregulation of retail electric services is likely to reduce the cost of electricity to state agencies. In FY 1998 the state spent $38.8 million on electricity. A 3% decrease in the price would result in a cost saving of over $1 million per year.

- Increased expenditures of the Public Utilities Commission (PUCO) and the Office of the Consumers' Counsel (OCC) are based on estimated expenses of these agencies. The bill contains no additional appropriation authority. Any such authority would be funded by assessments on utilities.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2002	FY 2003	FUTURE YEARS
School Districts (including Joint Vocational School Districts)			
Revenues	$69.3 million loss offset by $69.3 million gain plus $1.6 million gain	$138.6 million loss offset by $138.6 million gain plus $3.2million gain	$138.6 million loss offset by gain likely in excess of $138.6 million
Expenditures	Potential decrease	Potential decrease	Potential decrease
Other Local Governments			
Revenues	$59.3 million loss offset by $59.3 million gain plus $1 million gain	$59.3 million loss offset by $59.3 million gain plus $1 million gain	$59.3 million loss offset by gain likely in excess of $59.3 million
Expenditures	Potential decrease	Potential decrease	Potential decrease
Municipal Corporations			
Revenues	$13 million potential gain	$13 million potential gain	$13 million potential gain
Expenditures	- 0 -	- 0 -	- 0 -

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- Changes in electric utility property value reduce property tax revenues to schools and local governments, but the revenue is replaced by revenues from the newly created kilowatt-hour tax that are distributed to school districts and other local governments via the newly created school district property tax replacement fund and the local government property tax replacement fund. School districts receive 25.9 percent of the replacement revenues and local governments receive 11.1 percent.

- The first replacement payment is in February 2002, which is in the second half of the school district fiscal year, so the impact on school districts in FY 2002 is only a half-year impact.

- Additional increases in revenues to school districts and other local governments result from the additional revenues for the fixed-sum levies. It is estimated that school districts will receive between $3.2 and $3.5 million per year in the first five years, and close to $2 million in subsequent years. Other taxing districts will receive an additional $1 million per year due to the fixed-sum levies.

- Increased revenues to municipalities result from applying the municipal income tax to the income of electric utilities.

- The local government funds (LGF and LGRAF) are to be held harmless with respect to change in electric taxes. However, if the revenue from the corporate franchise tax on electric companies is less than $74 million, the local government funds could experience a revenue loss. If gains from the corporate franchise tax or the kilowatt-hour tax are greater than expected, the local government funds will gain revenue.

- Schools and other local governments are also likely to benefit from reductions in the price of electricity resulting from electric deregulation.

Detailed Fiscal Analysis

Introduction

The bill provides for competition in retail electric services to begin on January 1, 2001 (although the start date may be delayed until July 1, 2001). It revises the taxes on electric companies and rural electric companies to be more consistent with the new market structure.

The bill declares electric generation, aggregation, power marketing, and power brokering services to be competitive retail electric services as of the start date of competition. It establishes a market development period to facilitate the transition of utilities and utility customers to the new market structure. The Public Utilities Commission (PUCO) is charged with overseeing the transition to competition. Electric companies are required to file their transition plans with the PUCO. The PUCO must in turn approve or disapprove the plans based on guidelines established in the bill.

Utilities may receive transition revenues during the market development period. The PUCO is charged with determining the amount of transition revenues, transition charges, and the duration of the market development period for each utility. Transition revenues are to cover the "just and reasonable transition costs" of the utilities. The costs would include costs of employee assistance included in the firm's employee assistance plan in excess of the costs covered in any existing labor contracts. An Electric Employee Assistance Advisory Board is created to make recommendations to the Commission regarding its approval of any employee assistance plan. The market development period is to end December 31, 2005, although utilities may continue to receive revenues for their regulatory assets until December 31, 2010.

The bill revamps the state's current low-income energy assistance and energy efficiency programs. It codifies the percentage of income payment program (PIPP) with respect to the electric portion and establishes it in the Department of Development, along with the home energy assistance program (HEAP). It also moves the Ohio energy credits program from the Department of Taxation to the Department of Development.

The bill establishes several programs in the Department of Development geared toward enhancing energy efficiency of low-income and other residential, small commercial and small industrial consumers in the state. It establishes a universal service fund to provide funding for the low-income energy assistance programs and an energy efficiency revolving loan fund to fund the energy efficiency revolving loan program. It creates the Public Benefits Advisory Board to ensure that energy services are provided to low-income customers in the state in an affordable manner.

The bill also provides a rate cut for residential utility consumers who continue to purchase electricity from their incumbent electric utility. The cut would equal 5 percent of the generation cost of the utility (which is also subject to a rate cap) and would last through the market development period or until the PUCO determined that the rate cut was unduly discouraging market entry.

The bill provides for "opt-out" aggregation on the part of local governments. It contains a net-metering provision for customer-generators with small generating facilities (including renewables). It provides for a market-based standard service offer for customers of the incumbent utility who have not chosen a new supplier (or have defaulted to the incumbent utility) by the end of the market development period. The

standard service offer may be established through a competitive bidding process that the PUCO would facilitate.

The bill makes the following tax changes:

1) With respect to the public utility property tax:
   a) It reduces the assessment rate on generation and other non transmission and non distribution property,
   b) It changes the definition of true value for new generation property, and
   c) It changes the apportionment of generation property.
2) It eliminates the gross receipts tax with respect to the sales of electric power and it establishes the corporate franchise tax as the tax that electric companies are required to pay for the privilege of operating in Ohio.
3) It allows for the taxation of electric company profits under the municipal income tax.
4) It establishes a new excise tax on electricity distribution in the form of a kilowatt-hour tax and self-assessing purchasers tax. Revenue from the new tax is to be used to replace the revenue lost due to the changes in the public utility property tax and the replacement of the gross receipts tax with the corporate franchise tax.
5) It provides for the replacement of revenues lost by school districts, counties, and other local taxing districts (including park districts) due to the changes in the property tax.

The annual cost of the tax provisions is estimated to be as follows:

Electric Utility Tax Revenue			
Revenue target/Loss from current sources		Gain from replacement sources	
Assessment rate reductions on electric utility property	$198	Implementation of new public utility excise tax	
		Revenues from kWh tax base	$457
Replacement of public utility excise tax gross receipts tax base	$423	Revenues from self-assessing purchasers tax base	$61
Revenue commitment due to fixed-dollar levies	$5	Removal of electric utility exemption from corporate franchise tax	$74
Total	**$626**	**Total**	**$592**

Dollars are in millions.

The bill also establishes three funds related to the tax provisions. The school district property tax replacement fund and the local government property tax replacement fund are to receive revenues from the kilowatt-hour tax and the self-assessing purchasers tax to be distributed to school districts and local governments. It also establishes the kilowatt-hour excise tax administration fund to receive fees paid by self-assessing purchasers to fund the administration of the kilowatt-hour tax.

Finally, the bill requires that efforts be made to reach agreements with electric utilities in matters of current litigation regarding property value issues. Any refunds a utility receives as a result of such litigation is to be reflected in rate reductions to utility customers.

The Electric Power Industry in Ohio

Currently electric power is supplied to Ohio residents by for-profit electric companies (also known as investor-owned utilities or IOUs), non-profit rural electric cooperatives, and municipal electric utilities. There are 8 for-profit electric companies in the state, 27 rural co-ops, and 84 municipal utilities.

The IOUs are vertically integrated companies – combining the functions of generation, transmission, and distribution in one firm. The municipal utilities and the rural co-ops are more distribution-based. Buckeye Power, which is jointly owned by the co-ops supplies much of their power needs. Much of the power used by municipal electric utilities is obtained from American Municipal Power of Ohio (AMP-Ohio), although a few municipal utilities have their own generating facilities and many purchase power on the wholesale power market. For tax purposes AMP-Ohio is treated like a for-profit utility; whereas, Buckeye Power is taxed like a rural co-op. Municipal utilities are not taxed but they do make substantial payments in lieu of taxes (PILOTs) to their local municipality.

The for-profit utilities and the rural co-operatives are restricted by the certified territory law as to where they can supply electric power. The certified territories encompass the entire state. Due to the home-rule provisions of the Ohio Constitution, any municipal corporation can establish a public power system to provide its citizens with electric power, regardless of the certified territory law. However, municipal utilities cannot have more than 33 percent of their sales outside of the municipality. Municipal electric utilities are at present the chief source of competition to IOUs and rural co-ops (and vice-versa) – particularly in the cities of Cleveland and Columbus with respect to commercial and industrial electric consumers.

Currently a for-profit electric company's rates are established through a ratemaking process at the PUCO. (The rates of rural co-ops and municipal electric utilities are the business of the members of the cooperative and the legislative authority of the municipality, respectively.) The rates established provide for an allowed rate of return on investment – assuming that a utility's sales are at a given level.

Also included in rates are costs of certain energy efficiency programs (e.g., demand-side management) and low-income energy efficiency programs (i.e., the PIPP riders), as well as nuclear decommissioning costs and property and gross receipts taxes paid by the utility.

Changes to the industry due to restructuring

S.B. 3 eliminates the certified territories law as it applies to generation supply for for-profit electric companies (although it retains it with respect to distribution services). The certified territory law is eliminated for rural cooperatives only upon the election of the co-op. S.B. 3 also calls for the functional separation – if not divestiture – of the competitive services (e.g., generation) and the non-competitive services (transmission and distribution) of for-profit electric utilities. These changes are geared toward improving the competitiveness of the electric power market. They should result in lower energy prices and subsequent savings to residential, commercial, and industrial users of electricity – not to mention state and local governments.

Restructuring, "stranded costs" and nuclear decommissioning

The flip side of savings to electric consumers is revenue losses to electric producers. This gives rise to the notion of "stranded costs." So-called "stranded costs" result after a regulated utility is deregulated and the price of the product falls, so that the revenue generated from the sale of the product is no longer adequate to cover all the costs of production. There are two main ideas about what constitutes stranded costs. The first is that a utility's cost of operations may be too high to allow it to be competitive in the deregulated market. This is the idea of economic stranded costs. The second is that deregulation will put at risk the receipt of certain funds that a utility had expected to receive in the regulated environment. Any funds put at risk by deregulation are therefore "stranded." This is the idea of regulatory stranded costs (and "regulatory assets"). Although they are interrelated, they would be calculated differently, and regulatory stranded costs will always exceed economic stranded costs.

Ohio's two nuclear power plants are thought to be an important source of "economic" stranded costs. These plants were both expensive to build and are relatively expensive to run. (It was originally thought that they would be expensive to build but cheap to run, but this has not turned out to be the case. The high operating expenses result from the complexity of the plants, in addition to safety and environmental rules. For example, in order to fix a motor, the entire facility must be shut down; and the process of shutting down is a complicated action in and of itself.)

Prices are expected to fall with competition largely because new plants are smaller and more efficient to operate. As long as the market price exceeds the total average costs of one of these new plants, firms will build more such new plants. This will cause capacity to increase in the industry and prices will fall below that required to cover the costs in the older less-efficient plants.

As long as the price of electricity exceeds the operating costs of these older plants, they will continue to be operated. They could, however, be sold. The incumbent utility would end up taking a loss on the value of the plant; that would be a manifestation of "stranded costs." However, the purchaser would have reduced the "cost of capital" associated with the plant and could then operate the plant at a profit.

Alternatively, a plant could be shut down. In this case the total undepreciated value of the plant would be "stranded." This alternative raises particular concerns with respect to nuclear power plants because of the decommissioning process. Decommissioning is the safe removal of a nuclear facility from service. It entails the reduction of residual radioactivity at the plant to such a level that the facility's Nuclear Regulatory Commission's (NRC) license may be terminated.

Decommissioning is a costly undertaking. It is not as costly as operating a plant; but a facility being decommissioned is by definition receiving no return whatsoever. Costs incurred in the decommissioning of nuclear plants elsewhere in the country range from $190 million to $440 million. As one of the conditions for an operating license from the NRC, a nuclear plant operator or licensee must commit to decommissioning the nuclear facility after it ceases producing power. This commitment entails, among other things, the establishment of a designated fund to pay for the decommissioning process. Payments to the fund are included in a nuclear utility's rate base and are accumulated as the firm continues to operate. Restructuring could cause problems with this funding mechanism if it causes a firm to shut down sooner than was anticipated when the trust fund was originally set up. In such a case the fund may not have accumulated adequate monies to pay for the decommissioning process.

S.B. 3 requires each electric utility that owns nuclear generation in Ohio to periodically demonstrate compliance with NRC decommissioning requirements and to demonstrate to the PUCO that it has a financing mechanism that is adequate to fund the facility's decommissioning costs. Nuclear decommissioning costs are also designated as "regulatory assets," so that FirstEnergy can continue receiving transition revenues to help fund eventual decommissioning costs until 2010.

Restructuring provisions affecting rural cooperatives, municipal utilities and local government aggregation authority

Rural cooperatives and municipal utilities may decide whether or not to engage in competition. If they do, they must be certified by the PUCO to be a supplier of competitive retail services.

Both cooperatives and municipal electric utilities are to be subject to the new kilowatt-hour tax, but municipal systems may retain the revenue collected from their customers located within their municipalities. (Taxes collected from their customers located outside the municipality are to be remitted to the state.) Revenues received by a municipality are to be deposited in the general fund of the municipality. Since municipal utilities currently do not remit the gross receipts tax, and since many currently do make payments in lieu of taxes, some of which are likely to be displaced by the new tax, it is difficult to determine the net impact of this provision on municipalities.

Local government aggregation

The bill encourages aggregation of electric consumers in order to balance the demands of small consumers and to reduce the prices they will have to pay for electric power. Specifically, the bill allows local governments (such as municipalities, counties, and townships, separately or jointly) to aggregate their residents, in order to achieve cost savings for the residents, as well as the governmental unit(s). The bill specifically calls for both "opt-in" and "opt-out" aggregation on the part of these entities – although any "opt-out" aggregation would necessarily be subject to a popular vote. "Opt-out" aggregation allows the government entities to aggregate all residents except those that chose specifically not to participate in the aggregation. "Opt-in" would aggregate only those who specifically chose to be included. Experience from California (with only "opt-in" municipal aggregation) and Massachusetts (with "opt-out" aggregation) suggests that the "opt-out" alternative is the best way to achieve cost savings for a local government and its residents. The cost would be in the form of price savings, not tax savings. Municipal aggregation is not the same thing as a municipal electric utility or a municipal electric service provider. Individual households and businesses would still be subject to the kilowatt-hour tax based on their individual usage.

Unbundling

With electric restructuring, rates of for-profit utilities are to be unbundled and the various components are to be treated differently.

1. Rates for the transmission and distribution components and other non-competitive services will continue to be established as they currently are – via rate cases.
2. Rates for generation and any other competitive services are to be established in the market. This is subject to certain caveats discussed below under "transition rates and revenues."
3. The low-income and energy efficiency programs are removed from the companies' purview and consolidated in the Department of Development (see discussion of low-income programs below).

All electric consumers in Ohio would continue to pay for these programs via a kilowatt-hour based universal service charge.

4. The tax changes (discussed below) are also to be accounted for in the rates.

Transition rates and revenues

The bill establishes a transition – or market development – period during which time generation rates are subject to a "cap." These capped rates are to incorporate any planned rate reductions in existing rate agreements. Also, for at least part of the time period, residential rates will see an additional 5 percent reduction in their generation prices.

At the same time, the bill allows electric utilities to apply for and receive "transition revenues." The level and duration of transition revenues would be determined by the PUCO. The bill allows the PUCO to grant transition revenues based on costs that in the absence of electric restructuring the utility would be entitled the opportunity to recover and that:

1. Were prudently incurred;
2. Are legitimate, net, verifiable, and directly assignable or allocable to retail electric service provided to electric consumers in this state; and
3. Are unrecoverable in a competitive market.

The transition revenues may be recovered in two ways. First, in the rates paid by consumers who do not switch from their incumbent utility provider. Second, via a "non-bypassable and competitively neutral charge" on each consumer in the utility's erstwhile certified territory that receives electric generation service from an alternative supplier. The transition charge is based on kilowatt-hours used and is to vary by customer class. The duration of the transition charge for each utility coincides with the market-development period established for that utility by the PUCO. The amount of the transition charge is also established by the PUCO, taking into consideration the allowable amount of transition costs of the electric utility and the relevant market price for electricity. Midway through the market development period, the PUCO may adjust the transition charge (prospectively) depending on the market for electricity and the market for generation assets. A utility will recover any allowable transition costs more quickly, the fewer of its customers switch to alternative suppliers.

In any case the market development period for all utilities ends December 31, 2005; and most of the transition charges will end at that time, as well. Utilities may, however, continue to recover transition revenues for regulatory assets for an additional 5 years.

Electric cooperatives that choose to compete may establish their own criteria and procedures for collecting any transition revenues from their members.

Regulatory assets

A special subset of transition costs includes the costs associated with regulatory assets. Regulatory assets are certain assets on a utility's books the value of which result from a Commission order or rate-making decision or a Financial Accounting Standards Board (FASB) rule in conjunction with such a regulatory order or decision. In the absence of such a decision, the utility would have acted differently or handled the asset differently, particularly with respect to rates. (E.g., it would have acted like the monopoly it was and charged higher rates.) Included among regulatory assets are deferred demands-side management costs, deferred PIPP arrears, and future nuclear decommissioning costs and fuel

disposal costs. The transition charges for regulatory assets are to be identified separately from other transition charges. These charges may continue until December 2010.

Provisions affecting state agencies

The Public Utilities Commission (PUCO)

The bill requires the PUCO to adopt rules necessary for the commencement of competitive retail electric service within 180 days of the effective date of the bill. The PUCO is also to adopt rules regarding the minimum service quality, safety, and reliability requirements for noncompetitive retail electric services (to the extent the authority to do so is not pre-empted by federal law). It is also to develop minimum service standards.

Suppliers of competitive retail electric services (generation supply, aggregation, power marketing, etc.) are to be certified by the PUCO regarding their managerial, technical, and financial capability to provide service. The PUCO is to grant or deny any certification within 30 days of the initial application. The Commission may suspend or rescind a certification if the PUCO determines that the utility, company, cooperative, or aggregator has failed to comply with applicable certification standards.

Each electric utility supplying retail electric service in the state is to file a plan with the PUCO for the provision of retail electric service during the market development period within 90 days after the effective date of this bill, in accordance with rules established by the PUCO. The plan is to include unbundling, a corporate separation plan, a consumer education plan, and other technical matters, as required by the PUCO.

The transition plan may also include an application for the opportunity to receive transition revenues. The PUCO may require refiling of any plan found to be inadequate. Within 45 days after the utility files the transition plan, any person having a real and substantial interest in the plan may file preliminary objections with the PUCO. Within 90 days after the utility files, the Commission staff is to file with the Commission a report of its recommendations. The Commission is to file a final order approving or modifying a transition plan within 275 days after the utility files the plan – but no later than October 31, 2000. An interim plan may be issued if necessary.

The PUCO is to monitor service to ensure competition. If the Commission finds that competition has declined, it is to ensure that service is provided at compensatory, fair, and nondiscriminatory rates and services. It may declare that additional services (such as retail ancillary services, metering, billing, and collections) may also be offered on a competitive basis, if the Commission finds that market conditions would warrant that declaration. During the market development period the PUCO and the OCC are to report on a biennial basis their findings regarding the effectiveness of competition in the supply of competitive retail electric service in the state to the standing committees of the legislature having primary jurisdiction over public utility matters.

According to the PUCO, it will cost $650,278 in FY 2000 and $449,295 in FY 2001 to implement the provisions of S.B. 3. The agency would require 8 additional staff members, as follows:

Additional staff required by the Public Utilities Commission to implement S.B. 3			
Position (number)	Cost/FY 2000	Cost/FY 2001	Department
Assistant Attorney General (1)	$44,054	442,678	Attorney General
Attorney Examiner (1)	$60,786	$55,465	Legal
Utility Analyst (1)	$43,547	$40,357	Utilities
Customer Services Investigator (2)		$77,000	Consumer Services
Enforcement (3)	$150,891	$137,795	Consumer Services
Total Payroll	**$299,278**	**$353,295**	

The additional staff in the Attorney General's department reflects the more complex legal environment that the Commission will be operating in with the implementation of electric restructuring. The Commission anticipates needing additional legal advice and legal representation, in general, and expects an increase in workload with respect to rule-making, rate-filing, market oversight functions, and additional Commission enforcement authority.

The attorney examiner would be required to assist the Commission with the new proceedings that would be initiated for each utility as it prepared its plan for the transition. Each company plan would be filed as a separate case, and an additional attorney examiner would be needed to assist with resolving discovery disputes and conducting hearings. Additional court reporting expenses would also be incurred. The attorney examiner would also help with the certification process to be established for electric utilities, electric service companies, cooperatives, and governmental aggregators. The Commission also anticipates an increase in the number of complaints filed to resolve disputes between marketers, retail customers and/or electric utilities.

The bill establishes a market monitoring and assessment function for the PUCO. It requires the Commission to initiate a proceeding to determine if ancillary services, metering, and/or billing should be competitive services. The utility analyst position would be filled by an entry level economist who would be responsible for tracking and monitoring indicators of market power abuse and who would help to assess the likely impact of any proposed mergers.

The two customer service investigators reflect the experience of Pennsylvania during its recent transition to competition. The Pennsylvania public utilities commission hired 3 additional customer service representatives and contracted with an outsourcing agency for additional assistance. At the height of restructuring activity, 12 full-time employees were assigned to the Pennsylvania commission to help provide information and answer questions from the public. The Ohio Public Utilities Commission plans to contract with an outsourcing agency for staff during promotional time. It does anticipate the need to hire 2 additional full-time staff in FY 2001 to handle the increased calls due to electric choice educational promotions.

Finally, the PUCO will need to dedicate staff to the development and implementation of new rules within six months, including codes of conduct for suppliers and subsidiaries, rules for consumer protection, and

minimum service standards. After developing the policies, the new staff would be required to help enforce the policies as competition is implemented.

In addition to personnel needs, the Commission would incur additional expenses for court reporting services, maintenance and equipment, and added space requirements. Total expenses would be as follows:

Public Utilities Commission total expenses for implementation of S.B. 3		
Object	Cost/FY 2000	Cost/FY 2001
Total Payroll	$299,278	$353,295
Court reporting services	$30,000	$30,000
Maintenance	$36,000	$42,000
Equipment		
Computers	$7,500	$3,000
Modular	$22,500	$9,000
Total Equipment	$30,000	$12,000
Space for additional staff	$225,000	-
Total	**$650,278**	**$449,295**

PUCO operating expenses are funded out of an assessment on utilities based on the appropriation made for the agency each fiscal year (Fund 5F6). The bill would require electric service companies, electric cooperatives, and governmental aggregators subject to certification to pay these assessments, along with utilities. The assessment base would be limited to their activities in supplying or arranging for the supply of retail electric service to consumers in Ohio. However, neither the House-passed nor the Senate-passed version of the budget bill (H.B. 283) contains funds to defray the increased costs to the agency associated with electric deregulation.

The Office of the Consumers' Counsel (OCC)

The OCC foresees more or less the immediate filing of 8 rate cases by the electric utilities with the PUCO. These rate cases will for the most part be concluded within FY 2000. They will therefore constitute an immediate and intense – but short-term – demand on the agency. The OCC would anticipate handling the increased demand largely through the services of consultants and contractors supplementing regular staff and has asked for an increase in funding for consultants of $300,000 in FY 2000 only.

The OCC also anticipates additional costs for consumer education and outreach. Based on a letter addressed to the director of the Ohio Office of Budget and Management (dated June 16, 1999), the OCC estimates that it would need funding for 4 additional staff members, in order to fulfill the agency's responsibilities as a result of the passage of S.B.3. The additional personnel include one staff attorney, one aggregation specialist, and 2 outreach and education specialists. The cost of these 4 positions would be $274,000 in FY 2000 and $268,000 in FY 2001 (taking into account the additional pay period in FY 2000).

In addition the OCC would incur additional expenses for maintenance and equipment. These expenses include printing and mailing, producing media materials, and other educational tools. They include travel and vehicle expenses, additional office equipment and renovations. The OCC estimates these maintenance and equipment expenses to be $285,000 in FY 2000 and 2001. Total additional estimated expenses for the OCC for FY 2000 and 2001 would be $859,000 and $553,000, respectively:

Office of the Consumers' Counsel total expenses for implementation of S.B. 3		
Object	Cost/FY 2000	Cost/FY 2001
Total Payroll	$274,000	$268,000
Consultant funding	$300,000	-
Maintenance and Equipment	$285,000	$285,000
Total	**$859,000**	**$553,000**

Like the PUCO, the OCC is funded out of an assessment on utilities based on the appropriation made for the agency each fiscal year (Fund 5F5). As in the case of the PUCO, assessment authority is extended over electric service companies, electric cooperatives, and governmental aggregators to the extent of their activities in supplying or arranging for the supply of retail electric service to consumers in Ohio. Again, the House and Senate-passed versions of the budget bill (H.B.283) contain no funds to defray the increased costs to the agency associated with electric deregulation.

Consolidation of Low-Income and Energy Efficiency Programs

The bill consolidates the state's low-income energy assistance programs – in so far as they deal with electric energy usage – with the Department of Development. These programs currently include the percentage of income payment program (PIPP) – an uncodified program established and administered by the PUCO – the Ohio energy credits program, which is administered by the Department of Taxation, and the home energy assistance program (HEAP), which is currently administered by the Department of Development.

Percentage of income payment program (PIPP)

The PIPP program was established to avoid the problem of curtailment of electric or gas service to low income customers in the winter heating months because the customer cannot afford to pay his or her bill. The program allows low-income energy consumers to pay no more than 15 percent of their income on their winter heating expenses. (Specifically, no more than 10 percent to their primary heating source and 5 percent to their secondary heating source.) Any amount they owe a utility in excess of that is not forgiven but must eventually be paid. Amounts owed by PIPP customers in excess of payments are known as "arrearages." Each utility keeps a record of its PIPP arrearages. Arrearages on a utility's books for more than 2 months are spread out among all of its customers in the form of a PIPP "rider." The rider is a specific charge per kilowatt-hour. The original PIPP customer still owes the utility for his or her arrearage, but the utility is able to recover the bulk of the arrearages in a rate surcharge.

The PIPP rider and the accumulated arrearages differ widely by utility. In 1995 DP&L residential electric consumers paid an average rider of $.09 per month, while a Columbus Southern Power (CSP) consumer paid $.28 per month and an Ohio Edison consumer paid $.73 per month. In May 1998, Ohio Edison's total PIPP arrearages – after 16 years of the program – amounted to $65.3 million. The

cumulative arrearages of CSP were $24.3 million; and the cumulative arrearages of DP&L (including gas customers) were $14.9 million.

Ohio energy credits program (OECP)

The Ohio energy credits program provides winter heating assistance to very low-income elderly and disabled Ohioans. It is currently administered by the Department of Taxation, largely because the qualifications are tied to the determination of an applicant's income.

Both the costs of the program and the administrative expenses are funded out of the state GRF. In FY 1998, the program costs and the administrative costs were $6.7 million and $715,650 respectively. Program costs have been falling because the income guidelines have not been adjusted to keep up with inflation. A provision in H.B. 283 would tie the income guidelines to the GDP deflator. The appropriation for the program for FY 2000-2001 in H.B. 283 is currently $7.5 million per year.

The costs of the program would not change in the transfer to the Department of Development. However, the Tax Department would still have some duties with respect to the determination of who would qualify for the program, since that is based on confidential income data. The cost to the Tax Department of verifying program eligibility should be minimal.

Home energy assistance program (HEAP)

The low-income home energy assistance program (HEAP) is funded by a federal block grant (Li-HEAP) - so the amount of revenues available to this program is never known before October in any given year. The moneys are used to assist low-income households in meeting energy costs. Part of the block grant is also used to fund home weatherization assistance projects (HWAP) for low-income households. Often Li-HEAP funds are used in conjunction with the PIPP program in order to keep PIPP arrearages down. The Department of Development has had a good deal of experience working with utilities and with the Public Utilities Commission in administering Li-HEAP funds. In FY 1998, the agency spent $48.8 million on home energy assistance. It spent $7.6 million on weatherization.

The bill establishes an energy efficiency and weatherization program to help reduce the energy bills of certain low-income energy users, who are also large users of energy. Recent evidence suggests that providing weatherization assistance to PIPP consumers can greatly reduce the cost of energy in excess of the amount PIPP consumers are required to pay, reducing the total amount needed to be spent to provide energy assistance to low-income households. The bill also establishes an education program for consumers eligible to participate in the low-income energy assistance program. And it establishes a universal service fund to provide funding for the low-income customer assistance programs. It also provides a one-time amnesty for PIPP arrears owed by disabled individuals or individuals aged 65 years and over.

Program consolidation and funding

The bill consolidates the four existing low-income energy assistance programs (PIPP, OECP, HEAP and HWAP) and authorizes the director of development - beginning July 1, 2000 - to administer them along with the two new programs created by the bill. The consolidation is to provide for efficient program administration along with a one-stop application and eligibility determination for consumers at the local level. This latter purpose is significant, since consumers have in the past been able to apply for some of the programs through their utility's neighborhood office. These offices are disappearing as the utilities attempt to rationalize their activities to prepare for competition.

The consolidated program is to be funded out of the universal service fund. Revenues to the universal service fund include a (1) surcharge on retail electric service, (2) certain customer payments under PIPP, and (3) revenues remitted from municipal electric utilities and rural cooperatives that opt to participate in the program. Presumably a GRF appropriation would continue to fund the Ohio energy credits program component, and the HEAP program would still receive the Li-HEAP monies from the federal government.

The universal service rider

The surcharge is the universal service rider and it is to replace the current PIPP rider on a customer's electric bill beginning July 1, 2000. The surcharge varies by electric distribution company. For the first five years after the starting date of electric competition, the universal service rider must be the sum of (a) the level of the PIPP rider in existence on the effective date of this section of the bill, (b) an amount equal to the level of funding for low-income energy efficiency programs included in electric utility rates as of the effective date of this section, and (c) any additional amount necessary and sufficient to fund the low-income energy assistance programs. Between 1993 and 1997, electric utilities combined received between $21.8 million and $57.4 million in PIPP rider revenue. The revenue varied due to both weather and economic conditions. Because the current PIPP rider may not adequately reflect the current costs of the program to a utility, the PUCO is required to conduct an audit of the PIPP program by July 1, 2000, in order to establish a new PIPP baseline for each utility to be used in determining the universal service rider.

PIPP payments in the universal service fund

The PIPP payments deposited in the universal service fund are comprised of the arrearage payments that a PIPP or former PIPP customer made to a utility on or after July 1, 2000, for percentage of income payment program debt owed the utility. (The utility may recover any uncollected amounts through its transition revenues.) Alternatively, the utility may retain the right to collect the debt, but it would then remit to the department of development all the program revenues received by the utility for that customer.

Energy efficiency revolving loan program and fund

The bill also establishes an energy efficiency revolving loan program to help fund certain energy efficiency projects throughout the state. The program is funded through the energy efficiency revolving loan fund.

The energy efficiency revolving loan program supports investments in products, technologies, or services for residential, small business, local government, non profit, agricultural, or other such entities to improve energy efficiency in a cost-effective manner using the most appropriate standards and best practices in the context of the total facility or building.

Revenues to the energy efficiency revolving loan fund include a surcharge on retail electric distribution rates. This surcharge is based on an aggregate revenue target for a given year divided by the number of customers of electric distribution utilities in the state in the prior year. The aggregate revenue target, as well as the surcharge, is determined by the director of development. The revenue target cannot exceed $15 million in any year through 2005 and cannot exceed $5 million in any year after 2005. The surcharge would be collected by the distribution company and remitted to the director of development on a quarterly basis.

Additional revenues to the fund include revenues from energy efficiency revolving loan program loan repayments and revenues remitted to the director of development by municipal electric companies and rural electric cooperatives that decide to participate in the program.

In general, the funding for these new or enhanced programs comes from existing sources – such as, revenues embedded in current electric rates or surcharges on top of rates. In that sense the programs do not represent an increase in governmental programs as much as a consolidation of existing programs. The director of development is required to report every two years (until 2008) to the standing committees of the legislature that deal with electric utility matters on the effectiveness of the programs dealing with low-income customer assistance, consumer education, and energy efficiency revolving loans.

Public Benefits Advisory Board

The bill also establishes a 21-member Public Benefits Advisory Board to oversee the two funds and to ensure that energy services are provided to low-income consumers in the state in an affordable manner. The board is composed of 4 ex-officio members, two members each of the House and Senate, and 13 members appointed by the Governor, each representing specific stakeholder groups. Board members are to be reimbursed for their actual and necessary expenses from either the universal service fund or the energy efficiency revolving loan fund, as applicable. The amount is not capped. If the board members met five times in one year and the average reimbursement was $100 per member, the annual cost would be $105,000.

Tax Changes

Property tax changes

The bill makes three major changes to the valuation of public utility property:

a) It reduces the assessment rate on generation and other non-transmission and non-distribution property,

b) It changes the determination of true value for new generation property, and

c) It changes the apportionment of generation property.

Changes in assessment rates

The generation property of for-profit electric companies is currently assessed at 100 percent of true value; the rest of their tangible property is assessed at 88 percent of true value. All property of rural electric companies is currently assessed at 50 percent of true value.

The bill reduces the assessment rate on all non-transmission and non-distribution property – that is, all generation and other property – of both for-profits and rural electrics to 25 percent. Assessment rates on transmission and distribution property are not reduced. It also reduces the assessment rates on fuel rods that are used in electric generation but owned by non-electric companies from 88 to 25 percent.

In tax year 1998 the total value of all electric company personal property was $8.3 billion. Roughly 44 percent of that was generation. Of the property assessed at 88 percent, about 91 percent is categorized as transmission or distribution; the remainder (9%) is categorized as "other." Thus, the bill would reduce approximately 48 percent (generation and other) of the current value of electric company property to 25 percent. The total cost of these changes – based on tax year 1998 millage rates – would be $193.2

million. Adding in the cost of reducing the assessment rate on fuel rods (annual cost of $4.7 million), the total cost would be $197.9 million.

Since school districts receive approximately 70 percent of total property tax revenue, 70 percent of the property tax loss – or approximately $138.6 million – would be incurred by school districts (including joint vocational school districts). The remainder ($59.3 million) would be incurred by other local taxing districts.

Changes in the definition of true value

The true value of most electric property (the non-generating property) is equal to the property's original cost less annual allowances for depreciation determined by the Tax Department. The true value of electric generating property is defined somewhat differently. Currently, the true value of electric generating property is defined as the value of "the equipment's or property's cost as capitalized on the company's books and records less fifty per cent of that cost as an allowance for depreciation and obsolescence." In other words, fifty percent of book cost. The bill would retain that definition for existing generation facilities but would define the true value of new generation facilities or of newly sold or transferred generation facilities the same way that it is defined for other electric property.

It is difficult to project the impact of this provision on the taxable value of existing property. Many, if not most, existing power plants are likely to be sold or transferred with the advent of deregulation of electric generation, and those plants would be moved to the new schedule. However, it is difficult to predict what the impact of this would be on the property's taxable value. Many generating facilities in other states have been sold at greater than book value; but some of this additional value is recorded as "good-will" – an intangible, which would not add to the taxable value of the plant. Many of the plants in Ohio currently have more than one owner, and one of the things one would expect in a deregulated environment is for the utilities to rationalize their ownership of these plants. For example, the managing owner of a plant could trade its ownership share of other plants or buy out the other owners of the plant. Such plants are likely to be valued under the new provision.

Under this provision the value of plants will not remain constant (as it does under current law – as long as the plant remains in service) but will decrease as the plant ages. All plants are likely to be valued for tax purposes at about 90 percent of book value after the initial sale or transfer. This value will fall over time, but also unlike current law, as equipment is replaced, the value of the new equipment will increase the value of the plant. So that it is likely that over time the average depreciated value of plants will be close to 50 percent of original book cost.

Changes in the apportionment of generation property

Electric utility property – like most public utility tangible property – is apportioned throughout the state in accordance with the location of the company's property. In the case of most electric generation equipment, 70 percent of the value of the generating plant is allocated to the district where the plant is located. The remainder is apportioned, along with the rest of the company's tangible property, in accordance with the location of the company's transmission and distribution property.

For generation facilities with a book value in excess of $1 billion - that is, for Perry Nuclear Power Plant – the apportionment formula is somewhat different. For Perry only the first $420 million of valuation is apportioned in accordance with the 70 percent rule. The rest is apportioned in accordance with the location in Ohio of the transmission and distribution systems of the five companies that are part owners of Perry. As a result, nearly $200 million of the valuation of Perry that would under the general

apportionment formula be allocated to Perry Local School District in Lake County is instead shared with 317 other school districts throughout the state.

The bill situses all generation property. That is, it allocates the value of all such property to the district where the property is located. Consequently, the true value of electric property in the taxing districts that host electric power plants would increase, while that of the non-power plant districts would fall. However, with the assessment rate reductions, the taxable value of electric utility property will fall in all districts.

The apportionment change does not appreciably affect the anticipated aggregate local property tax loss due to the assessment rate reduction. Although different amounts of property are allocated to districts with different tax rates, and their property tax loss may be greater than or less than it would be under the current apportionment scheme, these differences seem to wash out in the aggregate. According to the Tax Department, the assessment rate reductions under the revised apportionment provisions would result in an aggregate property tax loss of $193.1 million. (It does not affect the revenue loss from the assessment rate change on fuel rods.)

Since the revenue losses due to the change in the apportionment scheme are covered by the property tax replacement mechanism (discussed below) – just like the revenue losses due to the assessment rate change, the change in the apportionment mechanism makes a great deal of sense. As mentioned above, it is expected that a restructured electric power industry will result in the rationalization of plant ownership. Under the current apportionment formula, both the change in ownership of a plant and the formation of a subsidiary would affect which taxing districts received what portion of the value. This could change annually in a rapidly evolving industry – producing seemingly arbitrary swings in district property values. By situsing the value of the plant, the taxing district where the plant is located is assured of receiving the property tax revenues derived from the plant, regardless of the owner of the plant – assuming, of course, that the plant continues to operate. The other districts do not have property value apportioned in and out of the district due to the current ownership structure of the company, but they are, at the same time, reimbursed for their property tax loss on a predictable basis.

Replacement of the Gross Receipts Tax with the Corporate Franchise Tax

The Gross Receipts Tax

Electric utilities – like other most public utilities in the state – are currently subject to the public utility excise tax (also known as the gross receipts tax). The public utility excise tax is a state tax, with 95.2 percent of revenues deposited in the state General Revenue Fund (GRF). The remainder is deposited in the local government funds (4.2% to the local government fund [LGF] and 0.6% to the local government revenue assistance fund [LGRAF]). The tax is based on the intrastate revenues of utilities. Competition is expected to increase the amount of electricity purchased from out-of-state. Such electricity would be exempt from the tax. This would cause state revenues to fall. The tax also raises a competitiveness issue, since electric companies located in Ohio would have to pay the tax on a large portion of their sales in Ohio, but companies located out-of-state could more easily avoid the tax. Consequently, the bill replaces the current gross receipts tax with the corporate franchise tax and a kilowatt-hour tax.

Tax year 1998 public utility excise tax liabilities based on the intrastate gross receipts of electric companies – including both for-profit and rurals but excluding the non-electric revenues of joint companies – were certified in November 1998 at $423 million. (This takes into consideration the $16.2

million in coal tax credits that the companies receive on an annual basis.) The elimination of this revenue source would cost the GRF, the LGF, and the LGRAF, $402 million, $17.8 million, and $2.5 million, respectively. The revenue loss to each of these funds would be made up by the corporate franchise tax and a portion of the new kilowatt-hour tax.

The electric companies and rural electric companies would continue to pay the gross receipts tax through June 2001. Under current law the tax is paid in three installments – in October, in March and in June – with each payment ultimately equal to 1/3 of the company's gross receipts liability for the period from May 1 to April 30. A reconciliation payment is made (or a refund is received) in November after the Tax Department certifies the company's liability for the current tax year.

The bill provides for three payments for tax year 2001 (from May 1, 2000 to April 30, 2001); however, the third payment is only ¼ rather than 1/3 of the current estimated liability – resulting in a net loss in FY 2001 of $35 million ($33 million to the GRF).

The Corporate Franchise Tax

The bill subjects the electric companies – but not the rural electric companies – to the corporate franchise tax. It also allows the electric companies to claim the coal tax credit against the corporate franchise tax but does not allow for any carry over of credits in excess of any year's tax liabilities. The electric companies would first be liable for the tax in the 2002 tax year – i.e., beginning in January 1, 2002, the companies would pay corporate franchise taxes on their 2001 net income.

The Tax Department estimated that the tax would raise approximately $74 million per year from the for-profit electric companies in the state. Again, this number is net of the estimated $16.2 million in coal tax credits that the utilities would be able to claim against the tax. They would, of course, be able to take advantage of many of the other tax credits available with the corporate franchise tax – such as, the day care tax credit and, conceivably, the jobs creation tax credit. They would not be able to claim the investment tax credit for investment in new generation facilities (although self-generators and customer-generators would be allowed the tax credit). The director of development is to study and report to the General Assembly by December 31, 2000, on the "desirability of implementing a tax credit program for the creation of new jobs in Ohio to manufacture or assemble generating equipment and components for global use."

The four large electric companies in the state (AEP, CINergy, DP&L and FirstEnergy) estimated that their corporate franchise tax liability for tax year 1998 (based on 1997 income and current rates) would have been $132.3 million if they had been subject to the tax in 1998 (net of coal tax credits).

LBO does not have an independent estimate of the likely revenue from this source. The utilities' calculation is based on historical data. However it reflects circumstances that are unlikely to carry into the future. Regulation both guarantees a return in excess of expenses and it restricts much activity to within the state. In a competitive environment, returns are likely to be narrower and utilities will have somewhat greater discretion over where their income-earning activity takes place. This could result in the utilities' net income under competition falling short of that projected on the basis of historical returns. The Tax Department also has the benefit of experience. In 1987 the interexchange telecommunications companies switched from the gross receipts tax to the corporate franchise tax and in 1990 the railroads did likewise. In neither case did the revenue from the corporate franchise tax come close to the amount projected by the respective industry before the switch. On the other hand, neither of these industries received "transition revenues," an item that could substantially enhance the net income of the electric utilities for the duration of the market development period.

The Tax Department's $74 million estimate was used to devise the bill's initial "revenue neutral" tax structure. Of this $74 million, $70.4 million would be deposited in the state GRF, $3.1 million would be deposited in the LGF, and $0.4 million would be deposited in the LGRAF.

Privilege year adjustment

The corporate franchise tax is a "privilege" tax – corporations pay it in exchange for the privilege of operating in the state in a given tax year. S.B. 3 replaces the public utility excise tax "privilege" tax with the corporate franchise tax as the tax electric companies pay for the privilege of operating in the state. The last year covered by the public utility excise tax privilege tax is May 2001 through April 2002, and the first year covered by the corporate franchise tax privilege tax is January 1, 2002 through December 31, 2002. Due to the 4-month overlap (January through April 2002), the electric companies' corporate franchise tax liability in 2002 is calculated as 2/3 the amount of the liability based on the companies' net income in the 2001 taxable year. Thus, the companies' estimated liability in 2002 (based on the Tax Department's estimate) would be $44 million (i.e., two-thirds of $90 million minus $16 million – the coal tax credits do not appear to be similarly reduced. Of course, if the utilities' estimates are correct, FY 2002 revenues would be $83 million.) The tax payments would be made in three separate installments – 1/3 of the liability in each of January, March, and June 2002.

Establishment of a kilowatt-hour tax

The bill establishes a new excise tax on the amount of electricity distributed to electricity consumers in the state. The tax would not apply to the following:

- sales to the federal government,
- sales to end-users at a federal facility that uses electricity for uranium enrichment,
- sales to a self-generator for its own use or "sold" to an electric company for resale,
- sales to a qualified end user.

A qualified end user is an industrial user that uses more than 3 million kilowatt-hours of electricity per day in certain manufacturing processes – such as that involved in manufacturing aluminum. Since none of these entities currently pays the gross receipts tax – for one reason or another – their continued exemption would not have a discernible fiscal impact. (However, cumulative incentives for self-generation could have an erosive effect on the tax over time.)

The kilowatt-hour tax is graduated by levels of usage for each 30-day period. The following table shows the tax rate and the estimated revenue by usage class.

Kilowatt-hours distributed to an end-user	Rate per kilowatt-hour	Estimated annual revenue
The first 2,000 kWh	$.00465	$256.8 million
2,001 to 15,000 kWh	$.00419	$124.8 million
15,001 kWh and above	$.00363	$107.6 million
Total		$489.2 million

The tax rates fall slightly as usage rises. However, all users would pay the same rate for the first 2,000 kilowatt-hours. All who used more than 15,000 kWh per month would pay the same tax on the first 15,000 kWh. The different usage classes approximate the three classes of consumers. Most residential

consumers use less than 2,000 kWh per month, so virtually all of their usage would be taxed at the higher rate. A typical residential consumer uses approximately 750 kWh per month, which translates into a total tax of $3.49 per month. Most commercial establishments use between 2,000 and 15,000 kWh per month; and a large number of industrial users use in excess of 15,000 kWh per month.

For very large industrial users (other than qualified end users) – i.e., for industrial and commercial establishments that use more than 120 million kilowatt-hours per year – the bill provides a self-assessment option. Self-assessing purchasers would be taxed at a rate of $.00075 per kilowatt-hour plus 4 percent of the total price. In order to qualify for the self-assessment option, firms would be required to register with the Tax Department and pay an annual fee of $500. The fee would be deposited in the (newly created) kilowatt-hour excise tax administration fund to be used to cover the costs of administering the self-assessing purchasers tax. The Tax Department estimates that 65 firms would qualify for this tax treatment; so the fund would generate $32,500 per year.

At current prices and usage levels, the self-assessing purchasers tax would generate approximately $48 million per year. Such large industrial users are currently paying closer to $63 million in taxes. In order to achieve a more revenue neutral result with respect to these users, the bill provides a mechanism that would recalculate the price-based component of the tax after 6 months, if revenue from the tax falls short of the 6-month target by more than $500,000. The recalculation would take both price and kilowatt-hours consumed into consideration. Again, based on current prices and current usage, LBO estimates that with the price adjustment, revenue from the self-assessing purchasers tax would be close to $61 million the first year.

Problems with the self-assessing purchasers tax could arise because the bill does not include a definition of price. Many marketing arrangements could be developed that would allow certain users to avoid much of the tax. (Payment of an energy services fee to an electric service company in exchange for a lower demand charge or lower kilowatt-hour rate is one example.) With the adjustment mechanism, this avoidance would not cost the state tax revenue as much as it would shift more of the burden to other users.

Secondly, it is not clear whether large users could aggregate in order to qualify for the self-assessing purchasers tax. The Tax Department's calculations assume that firms do not aggregate for this purpose. However, the language is unclear. If aggregation is allowed, then some users who might not otherwise qualify could pay the tax on the self-assessment basis – leading to a loss in revenue from that calculated on the kilowatt-hour basis. The adjustment mechanism is not designed to produce a revenue neutral result in such an event.

The adjustment mechanism is calculated on a 6-month basis in FY 2002 (in December 2001 and June 2002) and on an annual basis in fiscal years 2003 through 2007. The tax rate may be adjusted up or down depending on how the revenue generated compares to the target revenue amount (based on kilowatt-hours sold). The tax rate calculated in June 2007 would then become permanent.

Overall, based on current prices and usage patterns, it is estimated that the revised excise tax on electric power distribution would raise between $34 million and $46 million less than the revenue target for overall revenue neutrality. The bulk of the revenue loss results from the fact that residential consumers overall will pay roughly $28 million less in taxes than they currently do, while other groups will pay no more.

As electric consumption is expected to grow over time, it is expected that the "short-fall" vis-à-vis the $552 million target for the replacement tax will disappear in a few years. (It may actually disappear

before the tax changes take effect.) The $552 million target is based on the overall annual revenue "loss" of $626 million due to the initial tax changes. (See "Introduction" on page 5 of this fiscal note.) Assuming that electric companies pay $74 million per year in corporate franchise tax revenue, the kilowatt-hour tax needs to raise $552 million to achieve overall revenue neutrality: $626 - $74 = $552.

Disposition of replacement tax revenues

The electric companies would first be subject to the kilowatt-hour tax in May 2001 with the first remission of revenues to the state in June. The revenues would be divided among the GRF (59.976%), the LGF (2.646%), the LGRAF (0.378%), the school district property tax replacement fund (25.9%), and the local government property tax replacement fund (11.1%), with two caveats:

(1) Some of the revenues that would otherwise be deposited in the school district property tax replacement fund are to be deposited in the state GRF to defray the cost of the "state education aid offset."

(2) If the total amount generated by the tax in any year is less than $552 million, the state GRF is reduced by the amount necessary to credit each of the other funds the amount if would have received had the tax raised the $552 million.

Consequently, (ignoring, for the moment, the state education aid offset) on an annual basis, the LGF will always receive at least $14.6 million from the tax; the LGRAF will receive at least $2.1 million; school district property tax replacement fund will receive $143 million; and the local government property tax replacement fund will receive at least $61.3 million. And if revenues from the kilowatt-hour tax exceed $552 million, all of these funds – along with the state GRF – would benefit proportionately.

School district and local government replacement payments

The changes the bill makes affect local property values and, in turn, affect local property tax revenues of school districts and other local governments and taxing districts. These effects range from small for most districts to significant for a few districts. However, the bill also implements a revenue replacement mechanism that mitigates the revenue losses resulting from the changes in the property values. The mechanism differs somewhat between school districts and other local governments. The school district replacement mechanism is tied in with the school foundation aid funding formula. The replacement mechanism for local governments relies more on phasing the districts off the replacement formula. But for both school districts and other local governments, the bill creates a fund that continues to generate revenues for school districts and local governments beyond the time when the last replacement payment is made.

Determination of Replacement Revenue

The property tax changes would first take effect in calendar year 2001 and would first affect property tax revenues in CY 2002. Before the tax changes take effect the Tax Commissioner is required to determine certain values.

First, the Tax Commissioner must determine the "Tax Value Loss" based on 1998 property values for each taxing district. This tax value loss is computed only once, and this property value difference is used to calculate the revenue replacement amounts for each school district for the duration of the replacement payments.

The ***tax value loss*** is equal to the difference between the actual 1998 assessed values on electric company tangible property and what the 1998 assessed values would be if the property were valued in accordance with the changes made by Senate Bill 3. The values to be used in calculating the tax value loss are those that appear on the preliminary assessments of the property issued in 1998. These values are used to guard against possible tax losses due to on-going court cases – such as *Duquesne v. Tracy*, which is currently being considered by the Ohio Supreme Court. Even if public utility property values fall due to successful litigation on the part of the electric companies, the state would still base the tax value loss and any subsequent replacement revenues on the higher valuation. So, taxing districts are in a sense "guaranteed" certain replacement revenues, even though they are not guaranteed that the tax base that they are calculated on would continue beyond tax year 1998 (calendar year 1999 collections).

Second, the Tax Commissioner must also determine the revenue associated with the tax value loss for both fixed-rate and fixed-sum levies in existence in the taxing district in 1998. Fixed-sum levies include bond levies and school emergency levies.

A reduction in property values in a taxing district would result in a loss of tax revenues equal to the change in the property values times the sum of the ***fixed-rate levies*** levied on the property – this is called the ***fixed-rate levy loss***. All taxing districts will receive annual replacement revenues for at least 5 years equal to their fixed-rate levy loss. Some will receive replacement revenues for up to 15 years.

The ***fixed-sum levies*** would not result in any property tax loss. Fixed-sum levies are set to raise a specific amount of money. If valuation changes, the tax rate adjusts (up or down) to raise the required amount. Therefore the valuation changes created by S.B. 3 would not have a direct impact on the amount of revenue received by the taxing district from fixed-sum levies. However, if a taxing district is sufficiently dependent on electric company property, the valuation changes could create problems for other taxpayers in the district, as the tax rate adjusts upward to raise the required amount of revenues. S.B. 3 provides additional revenues for districts whose combined tax rate on fixed rate levies in 1998 would increase by more than 1/4 mill as a result of the valuation change.[1] The payments would last for 5 years, in the case of school emergency levies. In the case of bond levies, they would last for the duration of the levy. The county auditor is to take these revenues into consideration each year in estimating the rate at which any fixed sum tax is to be levied for any taxing district in order to raise a required amount of money.

State Education Aid Offset

A change in taxable value will also generally affect the amount of state aid a school district receives. Currently, school districts are guaranteed a certain level of funding per pupil. The guaranteed amount is equal to the amount of revenue that 23 mills would raise on approximately $186,000 of valuation per pupil. If valuation falls, state aid increases by the change in value times the 23 mills. S.B. 3 takes the impact of the change in valuation on state aid into consideration in determining how each district receives its replacement revenues. Beginning in FY 2003, the Department of Education is to determine a district's state aid first using current property tax values and then using property values which add back in the *tax value loss* calculated by the Tax Department. The difference is equal to the "State Education Aid offset." School districts are reimbursed for this part of their tax revenue loss through the foundation

[1] Alternatively the fixed-sum revenue to be replaced could be calculated using the value of fixed-sum levies in 1999, if that tax rate is higher, as long as the levies in question were approved by voters by June 30, 1999. This would allow the calculation to take into account the impact on such levies if the value of the property in the taxing district were to fall considerably in 1999 vis-à-vis its 1998 value – another piece of insurance against the *Duquesne* decision.

formula. Any revenue loss not reimbursed through the formula is paid directly to the school district through payments from the school district property tax replacement fund. If all school districts were on the foundation formula, the state education aid offset would in FY 2003 equal approximately $63 million.

Not all school districts receive state aid via the foundation formula. Approximately 10 percent of districts receive state aid via the "guarantee." Essentially, school districts are guaranteed the same level of state aid they received in 1998. If the amount of state aid a district received in 1998 were greater than the amount it would receive via the formula in any fiscal year, the district would receive the guarantee amount.

About half of the districts currently on the guarantee are so because their valuation exceeds the formula amount (currently $186,000 per pupil). The rest are on the guarantee because recent valuation increases or decreases in enrollment have led to reductions in the formula amount they would receive. The change in valuation due to the changes in electric company property values could push a district with a significant amount of electric company property (i.e., a generation district) off of the guarantee, but it is unlikely to affect the funding status of most school districts. However, annual increases in the school funding formula will likely push more districts on to the formula.

Timing and duration of property tax replacement payments to school districts

All school districts receive property tax replacement payments for 5 years - beginning in calendar year 2002. Valuation changes in calendar year 2001 affect foundation aid payments beginning in fiscal year 2003 (July 2002 through June 2003). However, property tax losses are first incurred in the second half of fiscal year 2002. Consequently, the first property tax replacement payment to school districts (made in February 2002) does not take into consideration the state education aid offset. Each school district receives a payment equal to one-half of its tax value loss times the sum of the fixed rate levies (The payments are to be made twice a year, hence any payment is equal to one-half of the total replacement payment to be made for a year). In subsequent years - from July 2002 through December 2006 - school districts receiving foundation aid will receive part of their replacement payments via additional foundation aid and part through the school district property tax replacement fund. School districts not on the formula for any time period will receive their total tax revenue loss payments from the school district property tax replacement fund for that time period.

Beginning in calendar year 2007, school districts receive additional payments only if the inflation-adjusted property tax loss incurred by the school district exceeds the cumulative increase in state aid since fiscal year 2002. This calculation takes into consideration the increase in state aid due to the initial property tax loss, as well as subsequent increases in state aid, which occur annually as the state raises the per-pupil-funding amount.

Most school district will not receive additional replacement tax payments after this time. The exceptions include school districts that remain on the guarantee and school districts with substantial amounts of electric company property (i.e., generation school districts). Over time many of these districts will be phased off.

However, even as property tax replacement payments are discontinued, school districts will continue to receive revenues from the property tax replacement fund on a per-pupil basis. Revenues distributed to school districts on a per-pupil basis are to be used for capital improvements.

The bill creates a property tax study committee (effective January 1, 2011), consisting of 7 members – the Tax Commissioner and three members each of the House and Senate. The committee is to study the extent to which each school district or joint vocational school district has been compensated for the property tax loss caused by the assessment rate reductions on electric and rural electric personal property. The committee is to produce a report by June 30, 2011, making recommendations for any additional compensation or remedial legislation required.

Timing and duration of property tax replacement payments to other local governments

The other local governments receive replacement revenues for 15 years, as well. However, they do not receive annual increases in funding from the state based on notions of adequate funding levels to assist in determining how long they should continue to receive replacement revenues. Consequently, for the first five years all taxing districts receive replacement revenues equal to their fixed-rate levy loss (plus any additional amount due to fixed-sum levies). For the second five-year period the local governments begin to receive replacement revenues equal to 80 percent of their fixed-rate levy loss. And for the third five-year period, taxing districts receive revenues equal to a declining percentage of their fixed rate levy loss – 66.7%, 53.4 %, 40.1%, 26.8%, and 13.5%, respectively. An exception is made for the Lake County park district, which is to receive 100 percent of its fixed rate levy loss for the full 15 years. Also, taxing districts with very small total losses may receive one lump-sum payment in February 2002 equal to 9.4 times their total fixed-rate levy loss for that year.

The remaining revenue in the fund each year is allocated to each county in part on the basis of the combined tax value loss of taxing districts within the county and in part on a per capita basis. The revenue distributed to each county is then allocated to each taxing district within the county in the same proportion as other property tax revenues are distributed within the county. The revenue replacement mechanism is ultimately phased out after a total of 15 years; and the new formula – based in part on a per capita formula and in part on a valuation formula – is used to determine the distribution of the revenues in the local government tax replacement fund.

Replacement of Administrative Fee Losses to Counties

A reduction in property values due to the assessment rate reduction will also result in a loss of administrative fees to counties. Currently, county auditors and county treasurers collect administrative fees for services rendered in collecting property taxes. The fees are imposed as a percentage of the moneys collected in the county, and a portion is paid to the real estate assessment fund. The bill establishes a formula to reimburse those losses for tax years 2002 through 2011. The reimbursements would be made from both the local government property tax replacement fund and the school district property tax replacement fund. The loss to these funds (.9659 % for large counties and 1.1159% for small counties) is negligible in most cases, since if the districts were receiving the money from the property taxes that the funds are replacing, they would be paying part of it in the form of administrative fees to the counties anyway.

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