Testimony of

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Mr. Chairman, my name is Ron Harper and I am the Chief Executive Officer of Basin Electric Power Cooperative (**Basin Electric**) headquartered in Bismarck, North Dakota. I am pleased today to testify before this Senate Finance Committee field hearing on behalf of Basin Electric, which delivers approximately 1700 mw of primarily coal & lignite-based generation to its 121 member cooperatives, serving over 1.5 million customers in Montana, North and South Dakota, Wyoming, Nebraska, Iowa, Minnesota, Colorado and New Mexico.

Basin Electric provides supplemental power to Upper Missouri G& T Cooperative and Central Montana Power Cooperative, two Montana generation and transmission cooperatives that serve 17 distribution cooperatives in Montana. We also own and operate joint transmission facilities with Western Area Power Administration (WAPA) in the State of Montana, including the Miles City DC tie facilities which interconnect and move power between the Western and Eastern Power Grids.

GENERATION NEEDS OF MONTANA

During the past several months we have been involved in studies evaluating our members' future power generation needs. Two areas of interest and concern that have dominated those studies are the expansion of coal bed methane development in northeastern Wyoming and the power supply needs of Central Montana Power Cooperative, which may require additional power starting in 2008.

As a generation and transmission cooperative, Basin Electric's mission is to provide low-cost, reliable power to serve our member cooperative needs. At this time, in conjunction with our cooperative members, we are conducting engineering studies to explore the feasibility and best location for the construction of a coal-based generation unit in Montana. We are focusing on coal because we have found in our other operations that coal is the most abundant, low-cost fuel available in the United States. Coal is also found in abundance here in Montana and could provide many mining jobs, an increased tax base and very affordable electricity.

The construction of such electric base units requires capital investment in many hundreds of millions of dollars which would need to be recaptured over thirty or more years, while also anticipating the considerable investment necessary to ensure compliance with current environmental requirements and transmission constraints. In addition to those considerations, an assessment of the general economy of the regions that we serve and the national economy, with the associated long-term planning and investment decisions involving considerable risk must be made.

To initially address some of that risk in the early planning stages, Basin Electric and its members need to secure long-term cooperative and customer contracts in Montana before embarking on the construction of such a project, since it is not our mission to build merchant plants.

IMPORTANCE OF COAL BASED GENERATION

On May 17th President Bush released his National Energy Plan which stresses that the American economy in the 21st century will require reliable, clean and affordable electricity in order to maintain growth. The Department of Energy forecasts that, by the year 2020, the United States will experience an increase of over 40 percent in the consumption of electricity. The current portfolio of generation is not capable of meeting these new demands. As a result, a large number of new generating plants must be built if we are going to maintain our current levels of reliable and affordable electricity.

As you are aware, more than 50 percent of the electricity generated in the United States comes from coal-fired power plants. In the Rocky Mountain states, nearly 70 percent of the electricity generated comes from coal-fired power plants. Coal-fired generation is, and will continue to be, the predominant source of generating electricity in Montana and throughout the West for the foreseeable future.

However, new coal based generating plants that would be capable of using this great resource are not being built. To illustrate, over 43,000 megawatts (MW) of coal capacity came on line between 1980 and the end of 1984. In the past five years, only 3,500 MW of new coal capacity have been brought on line. This is largely due to uncertainty about new environmental requirements from the U.S. Environmental Protection Agency, coupled with the risks associated with large investments as the utility industry becomes more diverse and more competitive.

CLEAN COAL TECHNOLOGY DEVELOPMENT

Mr. Chairman, Basin Electric has long been a leader in clean coal technologies and, along with its consumer-members, has a vested interest in being a good steward of the environment in the areas in which we live and serve. I believe the development and commercialization of more efficient and lower emitting clean coal technologies is required to meet new electricity demands while continuing to improve the environment. In the short term the challenges are two. The first challenge is to expand the use of newer, more advanced NOx and SO_2 control technologies in existing plants through retrofits. While such investments are extremely costly, technologies are available to do this while improving the efficiency of fuel combustion and increasing output. The second challenge is to move new advanced clean coal technologies that have been proven at the demonstration stage to, and through, placement in the commercial marketplace.

The newest clean coal technologies are, however, more expensive to install and there will be construction and production problems to work out as there are with all new technologies. To implement state-of-the-art clean coal technologies that will respond to the ever-increasing environmental requirements adds considerable expense when considering new power plant construction. This clearly is an area where taxation and other government incentives can be of great public benefit to further reduce the cost and risk of such projects insuring that the energy and environmental needs of the future will be met.

S. 60 - THE NATIONAL ELECTRICITY & ENVIRONMENTAL TECHNOLOGY ACT (NEET)

Earlier this year, Senator Byrd, along with several of your colleagues, introduced the "National Electricity and Environmental Technology Act" (NEET) which would reduce environmental impacts and increase efficiencies when converting coal to electricity. This bill would assure that our Nation has the affordable electricity we need for continued economic growth while making significant reductions in emissions. The legislation would establish:

- A research and development program that addresses long-term clean coal technology needs;
- Financial incentives - a limited investment tax credit - designed to provide financial incentives to apply to the use of advanced technologies in existing coal facilities; and,
- A limited demonstration program to provide tax incentives (a combination of investment tax credits and efficiency production tax credits) for initial commercial scale application of advanced coal based generating technologies in both existing and new facilities.

NEET is a win for the economy, a win for the environment and for the lower income Americans who pay a far higher percentage of their income for electricity then others in society. Let me also mention that the group of industry representatives supporting S. 60, including the National Rural Electric Cooperative Association, support the removal of those provisions in the bill exempting utilities from Environmental Protection Agency's New Source Review (NSR).

TAX CODE CHANGES TO ACCELERATE CLEAN COAL TECHNOLOGY

As the subject of this hearing is specifically on changes to Federal tax code, I will now focus on how to use the Tax Code to accelerate the development and use of technologies that limit harmful emissions from coal-fired generation facilities. Priority could be placed on rewarding those utilities, including electric cooperatives that invest in the cleanest and most up-to-date technologies. Tax changes proposed in the NEET proposal include:

1) For existing coal-fired generating units: NEET proposes to amend the Internal Revenue Code to provide a 10 percent investment tax credit on the first $100 million investment in a qualifying system of continuous emission control retrofitted on an existing coal-based generating unit. If an existing unit is repowered with a qualifying clean coal technology, NEET proposes that units under 300MW be eligible for a $0.0034/Kwhr production tax credit for the first 10 years of operation. All units must meet improved efficiency targets to qualify for any tax credit.

2) For advanced clean coal technologies installed on new generating plants: NEET proposes to amend the Internal Revenue Code to provide a 10 percent tax credit and a variable, efficiency based 10 year production tax credit for investments in advanced clean coal technologies for use in new or repowered units. Again, these technologies must meet increasingly improved design efficiency standards. The "bar" to qualify for tax credits gets higher in the out years of the program. NEET limits the amount of capacity for each technology that would qualify for credits with the understanding that, once a technology is proven commercially, tax credits are not needed to make that technology competitive.

TRADABLE TAX CREDITS FOR RURAL ELECTRIC COOPERATIVES

Mr. Chairman, S. 60 makes tradable tax credits available to electric cooperatives and publicly owned utilities enabling us to also utilize the financial benefits of the NEET bill.

Many rural consumer-owned electric cooperatives and publicly-owned utilities do not have sufficient federal income tax liability against which to apply a tax credit. Therefore, in order for Congress to provide rural electric cooperatives and publicly-owned utilities with useful incentives, we will need the ability to trade or sell our tax credits to private entities that can utilize them.

It is anticipated that we would net a smaller amount from the credits than our for-profit counter parts. Investor-owned utilities will be able to use the full amount of the credits assuming they have sufficient tax liability. Consumer-owned utilities will have to offer them at a discount to encourage their purchase by taxpayers and will have to incur transaction costs to effect the disposition.

Because renewable energy sources and environmentally clean, advanced fossil fuel technologies usually are more expensive to operate than traditional sources, the federal government has made it a policy to provide investment incentives to encourage IOUs to build these facilities. The rewards are cleaner, more secure, independent, and diverse energy sources. Without comparable incentives, rural electric cooperatives and publicly owned electric utilities are not afforded the same opportunities to make these investments.

We hope you agree that cost-based power production, such as offered by cooperatives, should also be entitled to incentives associated with the development and implementation of clean coal technology and renewable energy production. Offering incentives that are not usable by this significant segment of the market removes the opportunity to employ the existing capacity of cooperative and publicly owned utilities to deploy their expertise and resources in seeking solutions to the nation's energy challenges. To offer incentives to investor-owned companies and not to consumer-owned cooperatives would place us at a great competitive disadvantage in addressing the energy needs of Montana and our country.

PARALLELS IN LAW SUPPORTING TRADABLE TAX CREDITS

There are several provisions in the Tax Code similar to the tradable tax proposal. The only way to benefit from nearly all of the tax credits in the IRC is to have tax liability equal to or in excess of the credits. Exempt organizations can qualify for tax credits by engaging in an unrelated trade or business; however their ability to benefit from the general business credit (the term used to include virtually all credits) is extremely limited. However, some of the credits are directed toward the economic event targeted in the law as opposed to taxpayer's investing in the property or activity generating the credit. For example,

- Section 41 Research credits are allowed for qualified research expenses paid to tax exempt universities;
- Section 38(b)(3) Alcohol fuel credits apply to the alcohol sold or used as fuel, regardless of the tax status of the producer or user;
- Section 47(a) credit addressing, in part, certified historic structures, allows the credit even though the structure may be used by a tax exempt entity; and
- Sections 613A and 619 provide for the depletion allowance for oil and gas and timber, regardless of the tax status of the owner of the property.

Each of these examples advance the public policy without penalizing any member of the economy that implements the public policy objective. In addition, while not a tax provision, an excellent and parallel example of the Tradable Tax Credit proposal is found in the tradable credits of 1990, 42 U.S.C. section 7651 et seq. The Clean Air Act Amendments of 1990 established a system to issue emission allowances for airborne pollutants, implemented by the Environmental Protection Agency. Electric utilities were issued emission allowances authorizing the emission of a specified amount of airborne pollutants by the utility during a specified calendar year or later period. Starting in 1993, unused allowances may be sold, traded or held in inventory for use against emissions in future years.

Thank you for the opportunity to appear before you today. I would be pleased to answer any questions that you may have.