GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2009

Legislative Fiscal Note

BILL NUMBER: Senate Bill 967 (Third Edition)

SHORT TITLE: Creation of Yadkin River Trust.

SPONSOR(S): Senator Hartsell

FISCAL IMPACT

Yes (x) **No ( )** **No Estimate Available ( )**

	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
REVENUES:					
Local Governments	*** See Assumptions and Methodology***				
General Fund	*** See Assumptions and Methodology***				
EXPENDITURES:					
General Fund	*** See Assumptions and Methodology***				
POSITIONS (cumulative):					

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Local government districts in which the Yadkin River Trust acquires property; State General Fund

EFFECTIVE DATE: When the bill becomes law

BILL SUMMARY:

SB 967 would authorize the creation of the Yadkin River Trust. The Trust would have a Board of Directors consisting of seven members to be appointed by the Governor upon the advice of the House Utilities Committee and the Senate Commerce Committee. Created as a body politic and corporate, completely owned by and to be operated for the benefit of the people of the State, the Trust would have all powers necessary to:

- develop the Yadkin River in Stanly, Davidson, Montgomery, and Rowan Counties as an instrumentality of intrastate, interstate, and foreign commerce and navigation;
- acquire the Yadkin Project and the associated license issued by the Federal Energy Regulatory Commission (FERC);

- produce, distribute, and sell hydroelectric power from existing or new hydroelectric facilities; and
- issue bonds or notes to finance acquisition and operation of the Project.

In addition to other powers and duties, the bill provides that the Trust would be required to:

- conduct environmental testing on properties owned, or formerly owned by Alcoa or its subsidiaries;
- pursue remediation of contamination at the Badin Works site in Stanly County to levels over and above minimum levels that Alcoa and its subsidiaries would be required to perform under current law to restore contaminated land and water to multiple use purposes;
- install aeration technology to improve water quality in the Yadkin River;
- institute operational changes to retain more water in several lakes, extend recreational seasons at those lakes, and develop new or expanded public recreation facilities across the Yadkin River;
- implement a "Low Inflow Protocol" (comprehensive drought management plan);
- allow the City of Albemarle to increase water withdrawals from the Yadkin River;
- use a portion of the proceeds of power generation to fund a Yadkin River Basin Clean Water Trust Fund, and to acquire and donate land for various conservation purposes;
- apportion a percentage of electrical output from the Project for use by a regional economic development entity; and
- submit a budget for the upcoming fiscal year and a report regarding its operation and transactions for the preceding fiscal year to the Joint Legislative Commission on Governmental Operations, the Joint Legislative Utility Review Committee, and the House and Senate Committees on Appropriations on or before July 1 each year.

The bill provides that the property of the Trust would be exempt from taxation. The Trust would be required to make payments in lieu of taxes to affected counties, municipalities, and school districts after payments for necessary operating expenses, annual debt requirements, and discharge annual obligations from finance agreements.

BACKGROUND[1]:

The Yadkin Project is comprised of four hydroelectric stations, dams, and reservoirs located along a 38-mile stretch of the Yadkin River in Davidson, Davie, Montgomery, Rowan, and Stanly counties. The Project has an installed capacity of 215 megawatts. In 1958, the Federal Power Commission, predecessor to FERC, issued a 50 year license to Carolina Aluminum Company (a wholly-owned subsidiary of Alcoa, Inc.) to operate and maintain the Yadkin Project. Alcoa Power

[1] Additional background on the Project and FERC proceedings is available at:

- http://www.ferc.gov/industries/hydropower/enviro/eis/2008/04-18-08.asp#skipnavsub, and
- at the ERC website -- http://www.ncleg.net/gascripts/DocumentSites/browseDocSite.asp?nID=12&sFolderName=\Alcoa%20-%20Stanley%20County%20-%20FERC%20Re-licensing

Generating Inc (APGI, a wholly-owned subsidiary of Alcoa) filed a license application with FERC for the Yadkin Project on April 25, 2006, and filed a Relicensing Settlement Agreement with FERC on May 7, 2007.

Under the authority of the Federal Power Act, FERC has the exclusive authority to license most nonfederal hydropower projects located on navigable waterways or federal lands, or connected to the interstate electric grid. FERC may issue an original license for up to 50 years for constructing, operating, and maintaining jurisdictional projects. At the end of a stated term of an original license, a licensee must undertake the relicensing process. In response, FERC can issue a new license (relicense) to either the existing licensee or a new licensee for a period of 30 to 50 years, the federal government can take over a project, or a project may be decommissioned.[2]

With regard to federal takeover of a project, 16 USC § 807 provides that the United States, upon or after the expiration of any license may take over, maintain, and operate any project, or may take over upon mutual agreement with the licensee all property owned and held by the licensee. The section further provides that the United States shall pay the net investment of the licensee in the project taken, not to exceed its fair value, plus such reasonable damages, if any, to property of the licensee – such value to be determined by FERC. Under the section, the right of the United States or any State or municipality to take over, maintain, and operate any project licensed under the chapter at any time by condemnation proceedings upon payment of just compensation is expressly reserved.
(Jennifer McGinnis, Research Division)

ASSUMPTIONS AND METHODOLOGY:

Expenditures
Section 1 of the bill creates the Yadkin River Trust as a "body politic and corporate" "to benefit the people of the State." Further, the bill is permissive as to the Yadkin Trust acquiring the Yadkin Project; new G.S. 77-123 states that "The Yadkin River Trust *may acquire* the Yadkin Project." If the Trust were to not acquire the Project, then there would be no potential costs nor revenue.

Revenues, after all other obligations are fulfilled, are directed to the State General Fund. As the bill is written, it is not clear that the State would incur any costs related to this legislation However, in recognition of the potential for the Trust to acquire the Project, Fiscal Research offers the following estimates. **It should be noted that these estimates are provided with the qualification that Fiscal Research does not have the staff resources to conduct a thorough, independent analysis of the costs at this time. Thus, Fiscal Research has relied on data from the various parties involved in these proceedings (mainly Alcoa/APGI and Stanly County) to form a range of estimates.**

Cost of Acquiring the Yadkin Project
There is some dispute as to what basis should be used to determine the value of the Yadkin Project were the Yadkin Trust to attempt to acquire it. The FERC relicensing guidelines allow for federal

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[2] *Handbook for Hydroelectric Project Licensing and 5 Mw Exemptions From Licensing*, Federal Energy Regulatory Commission, Washington, DC, April 2004. See http://www.ferc.gov/industries/hydropower/gen-info/handbooks/licensing_handbook.pdf

takeover of a project and stipulate that the value of such a takeover would be determined as "net investment...not to exceed the fair value of the property taken, plus such reasonable damages, if any."[3] Fiscal Research notes that this section also states that FERC would ultimately determine this value. Per Alcoa's 2006 License Application, the "net investment" amount is $24,158,903 (2005 dollars).[4] Lobbyists for Stanly County contend that $24.2 million is thus the fair value and further contend that reasonable severance damages would be minimal, if any.

Lobbyists for Alcoa contend that severance damages would be "hundreds of millions of dollars" including the costs of replacing the assets in Alcoa's energy portfolio as well as compensation to shareholders for loss of assets and associated revenue stream. However, Stanly County contends that future potential revenues beyond the original 1958 license term should not be included in the calculation of severance damages.

Additionally, Alcoa states that it has invested approximately $67 million in the Yadkin Project since the license application was submitted in 2006. Alcoa contends that its "net investment" is now closer to $91.2 million. A breakout and/or supporting documentation for the $67 million in additional investments was not provided to Fiscal Research.

Setting aside the issue of "net investment," Alcoa contends that Federal recapture of the license is no longer possible, and thus the only way for the Yadkin Trust to acquire the project would be through direct purchase from Alcoa or condemnation. Under either of these scenarios (although it should be noted that Alcoa has stated that it does not wish to sell the Yadkin Project), "fair market value" could be used to determine the purchase price. Alcoa acknowledges that it has not had an independent appraisal conducted, but it estimates the fair market value to be in excess of $500 million. Proponents of the Yadkin River Trust refute the notion that recapture is not possible.

Based on the assessed values reported by the five counties in which the Yadkin River Project is located, the total tax value is $140.5 million. The assessed value is divided by the sales assessment ratio for each county to determine the estimated market value. The sales assessment ratio is an estimate of how close assessed values are to market values. The estimated market value for the Yadkin River Project based on these calculations is $176 million.

Compiling all of these data, Fiscal Research anticipates that the cost of acquiring the Yadkin Project would fall somewhere within the range of $24.2 million to over $500 million, with the most likely estimate being something closer to the estimated market value of $176 million which is based on the tax values provided below.

County	**Tax Value of Alcoa Property**	**Sales Assessment Ratio**	**Estimated Market Value**
Stanly	$49,122,910	0.82	$59,905,988
Montgomery	$62,929,298	0.72	$87,401,803
Davidson	$26,567,135	0.99	$26,835,490
Davie	$1,472,349	0.91	$1,617,966

[3] Federal Power Act, 16 U.S.C § 807(a)
[4] Alcoa, *Yadkin Hydroelectric Project FERC No.2197 Application for License*, Volume 1, Exhibit D, 2006. Available online at http://www.alcoa.com/yadkin/en/relicensing/FERC_application.asp.

Rowan	$495,697	0.97	$511,028
Total	$140,587,389		$176,272,274
Note: Tax values are based on all property owned by Alcoa in each county, some of which may not be included in the Yadkin Project.			

Cost of Assuming the FERC License

The bill stipulates that if the Yadkin Trust acquires the Yadkin Project, it shall pursue transfer of the license. It is not clear if transfer of the license would require a completely new application for the license or if materials prepared by Alcoa could simply be modified. Alcoa spent five years working on the license application and the relicensing settlement agreement. They had 23 environmental technical studies conducted and held meetings with various stakeholder groups. In its 2006 License Application, Alcoa stated that preparation of the license application cost approximately $20 million.

Cost of Capital and Other Improvements to the Yadkin Project

Alcoa contends that extensive capital improvements are needed at the Yadkin Project to insure compliance with the Relicensing Settlement Agreement. As of April 24, 2009, Alcoa estimates that such improvements will cost $194.5 million and asserts that these costs would need to be assumed by whomever operates the Project. In the original License Application, Alcoa stated that $130.5 million (2005 dollars) and $1.5 million in annual costs were needed for capital investments.

Lobbyists for Stanly County agree that "major maintenance" may be necessary. They cite an estimate by Dr. Steve Scroggin, a visiting assistant professor of economics at Virginia Tech, that new enhancements may cost $1.5 million annually with $4 million in one-time costs.

New G.S. 77-124(c) requires that the Yadkin River Trust conduct a variety of activities if it acquires the Yadkin Project. These activities include

- conducting environmental testing and assessments,
- remediating contamination,
- establishing a remediation fund,
- installing aeration technology to increase dissolved oxygen levels,
- instituting operational changes that will retain more water in High Rock Lake and Badin Lake,
- extending the recreation season at High Rock Lake and Badin Lake,
- implementing a comprehensive drought management plan,
- developing and maintaining public recreation facilities,
- allowing the city of Albemarle to increase water withdrawals,
- creating a Yadkin River Basin Clean Water Trust fund to acquire land and other activities,
- apportioning a percentage of electricity to a regional economic development entity, and
- using proceeds from power generation to
  - acquire and donate land to Badin for a public park,
  - acquire and donate land to Rowan County for the Eagle Point Nature Preserve,
  - acquire other land for conservation purposes, and
  - make a $40,000 donation to the Yadkin-Pee Dee River Trail Fund.

Some of the listed powers and duties overlap with costs Alcoa has described under its capital improvements estimate, including $2.6 million one-time and $480,000 annually to meet dissolved oxygen requirements. However, Fiscal Research does not have an estimate for the cost of all of these activities. Expenditures are likely to be substantial. For example, the first two items of conducting environmental testing and remediating contamination could cost millions of dollars depending on the extent of remediation needed.

The range for capital improvement costs provided by the two parties is quite broad - $4 million in one-time costs and $1.5 million in annual costs compared to $194.5 million one-time and $1.5 million annually – and is most likely not an apples-to-apples comparison. Moreover, it is not clear how much these estimates correspond to the requirements specified in the bill. Further study and independent analysis would be needed for Fiscal Research to be able to provide an estimate of these costs.

Cost of Operating the Yadkin Project

New G.S. 77-124(a) describes the powers and duties of the Yadkin River Trust including producing, distributing, and selling hydroelectric power.

Alcoa asserts that annual expenses, including salaries and benefits for 32 employees, and depreciation costs are approximately $28.3 million. A breakdown of these expenses is provided by Alcoa as Table D.4-1 in its License Application and is as follows:

Cost of Capital (equity and debt)	$8,615,579
Property Taxes	$849,043
Depreciation	$9,083,141
Operation & Maintenance	$9,296,093
FERC Administrative Fee	$466,241

The Yadkin Trust, as an entity operated by and for the people of the State would most likely be exempt from taxes, and thus would not incur the tax expenses that Alcoa currently pays of $5.3 million (State and Federal combined). The bill provides a specific exemption and payment-in-lieu for property taxes. See the "Tax Analysis" section of this memo for additional information.

Stanly County in its brief to ERC estimated operating expenses to be $2.5 million annually with an additional $1.5 million annually for enhancements and capital improvements.

Cost of Issuing Debt

The Trust is authorized to incur debt to purchase, construct, renovate, and equip facilities for the purpose of generating hydroelectric power, as well as, acquire land. The Trust may issue revenue bonds, as a municipality, under Article 5 and other provisions of Chapter 159 of the General Statutes. All authorized debt would require approval by the Local Government Commission.

Any revenue bonds issued by the Trust would not carry a pledge of the full faith and credit of the State. Revenue bonds would not be secured by any other sources of revenue besides revenue generated by the project financed or by the revenue-generating entity, the hydroelectric operation.

To the extent that revenues fall short of the debt service payments and the Trust is in risk of defaulting on any revenue bonds, the bond holders can seek remedies through rate setting and other operational changes as determined by special covenants of the bonds. The bond holders would have no expectation that other State revenues would be obligated to repay debt.

Aside from revenues generated by the Trust, no impact is anticipated to State debt or the State's debt service requirement.

<u>Revenues</u>
On the revenue side, the bill stipulates that the Trust shall first use revenues to:

(1) Operate the Yadkin Project;
(2) Pay the debt service on any revenue bonds, notes, or other evidences of indebtedness or obligation;
(3) Fulfill the local responsibilities under G.S. 77-126; and
(4) Make payments to taxing units under G.S. 77-129.

After these obligations are paid remaining revenue is to be remitted to the State General Fund, any or all of which can be used for the replacement of the Yadkin River Bridge.

According to Alcoa, the Yadkin Project has a total generating capacity of 215 megawatts of electricity.[5] Alcoa claims that average annual revenue is approximately $43.6 million. Alcoa asserts that annual expenses and depreciation costs are approximately $28.3 million. Additionally, the annual costs associated with the new license would be $1.6 million. Thus, profits before taxes would be approximately $13.7 million.

Lobbyists for Stanly County contend that profits could be $35 million, or more, annually. In its brief to ERC, Stanly County stated that they estimated the Yadkin Project gross annual revenues to be at least $40 million with annual costs of about $2.5 million and new enhancements of $1.5 million annually.

Thus, Fiscal Research estimates that annual revenues for the Trust would be between $13.7 million and $35 million. As to revenues being remitted to the State General Fund, Fiscal Research estimates that such disbursements would most likely be minimal in the first five years of the project. The Trust would first need to pay all operating expenses, all debt service, all obligations under G.S. 77-124(b), and all payments-in-lieu as specified under G.S. 77-129. Many of the duties under G.S. 77-124(b) could be quite costly, and the bill does not stipulate the amounts (neither absolute dollars nor percentages) that should go towards these activities. For example, the remediation fund described under G.S. 77-124(b)(3) and the Yadkin River Clean Water Trust Fund described under G.S. 77-124(b)(10) could require extensive revenues.

[5] Alcoa website, accessed April 25, 2009, http://www.alcoa.com/yadkin/en/info_page/hydropower.asp.

Tax Analysis

Property Tax Exemption (77-129)
The bill provides that the Yadkin River Trust will be exempt from property taxes as a governmental entity. In lieu of taxes, the Trust will make payments to the local government districts in which it owns property. The amount of the payments will be based on the amount paid annually at the time of the acquisition. These payments will be made after other debts to pay operating expenses, debt service and other obligations resulting from federal financing agreements have been paid. Because the payments in lieu will be based on the amount of tax paid at the time of acquisition, local governments will experience a fiscal impact to the extent that this amount differs from the actual amount of tax that would have been owed in any particular year. The amount of property taxes paid for the Yadkin River Project in 2008 was $1,307,885.

SOURCES OF DATA: Stanly County Assessor's Office; Davie County Assessor's Office; Davidson County Assessor's Office; Montgomery County Assessor's Office; Lobbyists for Alcoa and APGI; Lobbyists for Stanly County; Documents prepared by Stanly County for the Environmental Review Commission and Documents prepared by APGI for the Environmental Review Commission available online at http://www.ncleg.net/gascripts/DocumentSites/browseDocSite.asp?nID=12&sFolderName=\Alcoa%20-%20Stanley%20County%20-%20FERC%20Re-licensing; Alcoa Licensing and Relicensing Documents available online at http://www.alcoa.com/yadkin/en/info_page/relicensing_overview.asp.

TECHNICAL CONSIDERATIONS: none

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