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Guest Commentary



Expand California's MIC to Include Independent Energy Producers

By Chris Micheli, Juan G. Rodriguez and Mohammed S. Alrai

"MIC" and "SIC" are acronyms that are crucial to growth of the California economy, particularly their roles in a proposed tax incentive designed to help provide dependable electricity for the state's expanding high-tech industries.

Under current California law, there is a 6 percent tax credit for the purchase of certain machinery and equipment used by manufacturers (the manufacturers investment tax credit, commonly called the MIC). To qualify for this tax credit, a taxpayer must be engaged in an activity described in Standard Industrial Classification (SIC) Codes 2011 to 3999, according to a manual issued in 1987 by the U.S. Office of Management and Budget.

Unfortunately, independent energy producers fall under SIC Code 4911. California should expand the MIC to include this important industry. In 1997, the North American Industry Classification System (NAICS) Manual was issued that provides a six-digit classification system (rather than the SIC Manual's four-digit classification). Proposed legislation this year (AB 2596, Corbett) would have added NAICS Code 221112 to the statute, thereby extending the MIC to include this group of energy producers.

While five states do not impose a sales/use tax, over 40 of the remaining states provide a partial sales/use tax exemption for the purchase of manufacturing equipment. A number of states,



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including Texas and Arizona, include electric generation plants under the "manufacturing" definition for tax incentive purposes.

These statutes in competing states often define facilities that produce electricity for sale as "manufacturers" because electric generation is the process of converting raw materials (natural gas, coal or steam) into a finished product - electricity. The activities of distribution and transmission of electricity are usually not included in the definition of manufacturing.

California imports a significant amount of electricity (nearly one-quarter of its needs) and increasing economic expansion will require even more sources of electric generation. California's electric power fleet is aging and is a major source of industrial air pollution. Nearly half of the power plants operating today are 25 years or older, and a major power plant in this state has not been built in the last decade.

Competition in the electric generation industry is encouraging new technologies that protect our planet's natural resources, while lowering the cost of electricity for consumers. California should encourage the replacement of antiquated, inefficient plants with clean, modern facilities.

Independent energy producers are concentrating their efforts on the development and operation of gas-fired, turbine-powered facilities. They also recognize the environmental and long-term economic advantages of geothermal energy. These clean-burning power plants generate electricity 40 percent more efficiently than the average gas-fired power plant in operation today; and they incorporate the most stringent environmental control technology available, setting a new national standard for environmental excellence.

California must improve its infrastructure to maintain and expand its thriving economy, including power generation facilities, not just roads and water supply systems. This infrastructure is sorely lacking in California. No major generation facility (over 50 megawatts of power) has been built in the San Francisco Bay Area since 1972. California needs this new generation of power producers to rebuild California's electric power infrastructure to meet the state's growing population demands and the needs of "New Economy" industries.



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As a result of limited generating capacity in this state, there are serious concerns in the Silicon Valley and Southern California of brownouts and rolling power outages. The lack of sufficient supply to meet the needs of these growing sectors of the economy has resulted in the need to purchase electricity, at much greater cost, from out-of-state producers.

This fact has resulted in a number of companies generating power in other states, where they can build power plants at a lower cost, and transmitting their power to California for sale to consumers. Many independent power producers have facilities in Oregon, Arizona, and Nevada, and "wheel" that electricity into this state.

Ultimately, expanding the MIC would help lower costs for consumers by lowering the costs of construction of new power facilities (historically borne by the ratepayer) and creating needed supply and competition.

Population growth, a booming economy, and the voracious use of electricity by the Internet are straining our nation's power infrastructure. Costly power shortages have already occurred in California and elsewhere. The Information Age is increasing power demand. Computers now consume more than 13 percent of the total power generated in the United States, and this demand will likely grow to 50 percent over the next decade.

The state needs sufficient and reliable energy sources in-state, rather than increasing its reliance on out-of-state generators of electricity.

The Internet is responsible for 40 percent of the U.S. load growth over the past 10 years. Experts predict that "half of all electricity within the next decade will be devoted to computers and the Internet." Power disruptions caused by system overload are intolerable to Internet-dependent organizations, as well as to the ever-growing number of Internet service providers (ISPs), whose gateways to the Internet must be powered 24 hours a day, seven days a week. The only solution is the construction of new, modern energy facilities.

According to *Megawatt Daily* (February 24, 2000), "California may have power blackouts this summer because of its thin generation reserve margin." William Keese, chair of the California Energy Commission, said: "The problem is not transmission, but generation capacity. There is no near-term fix for generation shortfall. Plants being built now will not come online until at least 2001."

According to the *San Jose Business Journal* (February 25, 2000), "Silicon Valley must produce a lot more of its own power if it is to protect its position as the world's foremost technology Mecca. Right now, about half our power is imported, mostly from the Northwest, where growing metropolises will use up more of that power in the future. That's just one trend that threatens the reliability of our imported energy supply."

From the California Energy Commission's "Heat Storm Report" (July 1999): "As each year goes by without an increase in new generation capacity in California, the probability of Stage II alerts during the summer peak demand period will increase. Without significant amounts of new generation capacity being built in California, reserve margin levels will remain low, increasing the likelihood that interruptible load customers will be asked to curtail consumption during the summer peak demand season."

Expanding the MIC recognizes that a key problem for California is an inadequate supply of power plants. The state needs sufficient and reliable energy sources in-state, rather than increasing its reliance on out-of-state generators of electricity. Expanding the MIC would create a modest, but valuable, economic incentive to energy producers. The Assembly Appropriations Committee's analysis estimated the value of the MIC expansion at \$2 million in the first year, \$3 million in the second year and \$4 million in the third year.

It is a similar tax incentive that California's competitor states provide to independent energy producers. The proposal is narrowly crafted (i.e., it only applies to power plants that use natural gas). This will encourage the building of more efficient, environmentally friendly power plants in the state.

The companies making profits this past summer are mainly out-of-state businesses selling electricity into California. They are not likely to build power plants in California. The proposed legislation would benefit only those companies that invest in the state's infrastructure. It would not benefit many of those "out-of-state profiteers."

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creation of new jobs in the state. On average, it takes 18 months to build a new 300 megawatt plant, which would employ between 200 and 250 persons during the construction phase, as well as create 30 high-skill, high-wage jobs to run the facility.

Assembly Bill 2596 was approved by the Assembly Revenue and Taxation Committee without a dissenting vote, but died in the Appropriations Committee, where it did not come up for a vote. This MIC expansion proposal also was included in early drafts of an unsuccessful tax-relief package that surfaced in the final days of the legislative session in August.

Similar legislation is expected to be introduced in the new session that begins in December.