

# spotlight

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## SMOKES, BOOZE ... AND ELECTRICITY?

A new sin tax on electricity could be on its way

**S U M M A R Y :** The North Carolina Public Utilities Commission is considering charging an extra fee, separate from existing rates, to electric utility customers. This extra charge will help support what is called a “public benefits fund.” The fund would support programs that have nothing to do with the supply of electricity. Consumers would be required to pay the “fee” if they want to receive electricity, and the more electricity they use, the higher their fee will become. To environmental extremists and other proponents of this extra fee, the use of electricity, which allows us to warm our homes and function in modern society, is a “sin” and needs to be reduced. This extra fee is no different than any other sin tax. If that’s not bad enough, the Public Staff—which is supposed to be the government’s advocate for electricity consumers—is actually the office pushing the sin tax. Proponents of the sin tax try to disguise its true nature by giving it an innocent-sounding name like “energy efficiency charge.” Even worse, some proponents would like to get around the legislature altogether and simply let the Utilities Commission create this new tax. Besides being unethical, such a move would likely be illegal.

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**t**he North Carolina Public Utilities Commission (Commission), a body appointed by the governor and confirmed by the General Assembly,<sup>1</sup> is considering charging an additional fee to electric utility customers.<sup>2</sup> This additional fee would be calculated based on the amount of electricity an individual or business consumes.<sup>3</sup> In other words, it is a tax for the “sin” of using electricity. If North Carolina is going to have an electricity sin tax, the public should know about it. However, as is the case in other states that have instituted similar taxes, the true nature of this “fee” would be hidden from the public.

This electricity sin tax would finance a “public benefits fund” that would be used for a variety of purposes, such as developing what are known as demand-side management (DSM) programs. There is no bright-line definition of what constitutes a DSM program, but in general terms, these programs are designed to reduce demand for electricity. Examples of such programs include providing subsidies for installing energy-efficient appliances, differential pricing schemes during peak hours, and education programs on electricity conservation.

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This *Spotlight* examines the proposed electricity sin tax, discusses how its true nature is being hidden, and provides recommendations that will ensure consumer interests and open government are protected.

## **Background**

The Commission is responsible for setting the rates that utility providers can charge their customers. Traditionally, rates have been calculated based on the costs associated with providing electricity to consumers, along with a reasonable profit provided to the utilities. However, beginning in the 1980s, rates no longer were solely based on the actual supply costs. Consumers had to pay for programs that had nothing to do with the costs of supplying electricity. Specifically, they had to pay for programs that were supposed to reduce demand for electricity. In a Cato Institute report that discusses DSM programs across the country, Matthew Hoffman argues: “But as the 1980s progressed, utilities were prodded by environmentalists who wished to reduce energy use, and state regulators to use DSM.”<sup>4</sup>

### *DSM in North Carolina*

North Carolina electric utilities have had DSM programs since the 1980s.<sup>5</sup> These programs have included incentives paid to consumers to install energy-conserving equipment, such as residential high-efficiency heat pumps.<sup>6</sup> The North Carolina State Energy Plan, a report developed by the State Energy Office, states, “To motivate customers to implement these options, utilities have offered financial incentives such as reduced electrical rates, rebates on the customers’ bills, rebates for purchase and installation, and low-interest loans.”<sup>7</sup>

The costs of these subsidies are paid by all consumers and are buried in the rates. They are similar to gasoline taxes, wherein the taxes have been included in the price of the gas (currently, the total gasoline tax in North Carolina is 48.6 cents/gallon; this includes a federal tax of 18.4 cents/gallon and a North Carolina state tax of 30.2 cents/gallon).<sup>8</sup> Just as consumers often are unaware of the taxes included in the price for gasoline, they are likely just as unaware of the electricity taxes they are being charged to support DSM programs.

### *The Proposed Electricity Sin Tax*

Now, the Commission is considering charging consumers an extra fee that would support what is euphemistically called a public benefits fund. According to the State Energy Plan, a public benefits fund could cost utility consumers, using the average national rate, \$181 million annually.<sup>9</sup> The fee that would support the public benefits fund would show up on utility bills as a separate charge, apart from the rate.<sup>10</sup> This additional charge would be based on the amount of electricity used, with higher rates of consumption incurring a higher charge. Clearly, this “fee” is a tax. In order to receive electricity, consumers would be required to pay a charge that has nothing to do with the actual cost of producing electricity. Indeed, the separation of this charge from the rate structure explicitly signals that this charge is not based on the actual cost of producing electricity.

Environmental groups and the Public Staff want to reduce demand at least in part to avoid the need for new power plants. They view the construction of new power plants as a “problem” and, correspondingly, view demand for electricity as a “sin.” Similar to other sin taxes, like those on cigarettes or alcohol products, the energy sin tax will also have the effect of discouraging the sinful activity. In this case, the “electricity sin” would include lighting our houses and keeping ourselves warm in the winter and cool in the summer. This “horrible” sin is the difference between living in the 19th century and the 21st century.

The programs that a North Carolina public benefits fund would support are unknown because they have not, as yet, been formally proposed. However, other states that have public benefits funds divert money from these funds to other uses than just DSM programs. They often are used to help subsidize the costs of electricity for low-income individuals, finance research and development in renewable sources of energy, and pay utilities for the costs of implementing a renewable portfolio standard.<sup>11</sup> A renewable portfolio standard, which is concurrently being considered by the North Carolina Utilities Commission,<sup>12</sup> requires that utilities provide a certain percentage of electricity through alternative sources of energy, regardless of the additional costs imposed on consumers.

## **The Public Staff Is Recommending the Electricity Sin Tax**

The North Carolina Public Staff is the agency responsible for representing the interests of consumers before the Commission. Funded through rates,<sup>13</sup> it was created in 1977<sup>14</sup> under the Public Utilities Act.<sup>15</sup> The specific language that created the Public Staff states that the agency is supposed “to represent the using and consuming public” and be independent, which is why the Public Staff is not “subject to the supervision, direction, or control of the Commission, the chairman, or members of the Commission.”<sup>16</sup> It is generally expected that a consumer advocate such as the Public Staff would be responsible for fighting against the proposed sin tax. Unfortunately for North Carolinians, the Public Staff has failed to fulfill its mission. Instead, it is actually the agency that recommended the new sin tax.

## **The Commission Lacks Authority to Implement the Sin Tax**

The Public Utilities Act outlines in detail how the Commission must calculate the prices paid by consumers.<sup>17</sup> There is nothing in the law that gives the Commission the power to charge a separate tax that falls outside of the rate-making process. The Commission has used the statute’s declaration of policy to justify creating programs that appear to be beyond their authority.<sup>18</sup> However, declarations of policy are merely broad statements at the outset of a law that serve to provide context, particularly if there is any confusion when interpreting the law. Broad declarations do not supplant more detailed provisions that address specific issues, such as the means by which consumers can be charged for electricity. Furthermore, there is nothing in the declaration of policy that supports anything other than a rate system to offset costs.<sup>19</sup>

## **Rationale for the Sin Tax**

Utility companies are operating fewer DSM programs than they used to for a variety of reasons. First, DSM programs have not been as successful as hoped in reducing peak demand.<sup>20</sup> Second, according to the State Energy Plan, “the cost of peak power plants, such as gas turbines, has become so low that they are less expensive than reductions in peak demand from DSM programs.”<sup>21</sup> Third, utilities have a disincentive to reduce demand as they transition into a more competitive marketplace.<sup>22</sup> The Public Staff and environmental groups claim that a public benefits fund should be created and administered by a third party in order to overcome these disincentives.<sup>23</sup> A major problem with this solution is that a private, third-party administrator could have sole discretion without public accountability in how taxpayer money is spent.<sup>24</sup>

## **Disguising the Sin Tax: Name Games**

Advocates of the sin tax have developed numerous euphemisms in order to disguise the nature of the tax. Those include such names as “system benefits charge,”<sup>25</sup> “cost recovery mechanism,”<sup>26</sup> and “surcharge.”<sup>27</sup> However, none of those euphemisms can hide the fact that what they refer to is an electricity sin tax. Ironically, the dictionary definition of “surcharge” includes “an overcharge, especially when unlawful,” and “an additional or excessive burden; an overload.”<sup>28</sup>

Other states with public benefits funds have tried to disguise their hidden tax by referring to it in misleading ways on electricity bills. The Public Staff has discussed the public benefits funds of Vermont and Wisconsin as potential models.<sup>29</sup> The Vermont program, Efficiency Vermont, calls its sin tax an “energy efficiency charge.”<sup>30</sup> The Wisconsin program, Focus on Energy, calls its tax a “non-taxable fixed charge.”<sup>31</sup> As is seen with both of these programs, states want to disguise the fact they are charging a tax.

## **Hiding the Sin Tax by Going Around the Legislature**

If it were not for consumer advocacy groups such as the Carolina Utility Customers Association (CUCA) arguing that the legislature is responsible for enacting such a tax,<sup>32</sup> the Commission might get away with creating the tax in absence of authorizing legislation. Since most people likely are unaware of what occurs at Commission meetings, it would be easy for the Commission to enact such a tax without consumers knowing about it.

Fortunately, in response to the concerns voiced by CUCA and others, the Public Staff has been forced to recognize

“that there is a legitimate question as to whether the Commission has the statutory authority to approve a cost recovery mechanism [tax] to collect for DSM program costs.”<sup>33</sup> On the other hand, this statement reflects a belief that the tax still *could* be passed by the Commission without legislation.

Some in the legislature could try to pass off this new “fee” as something other than a tax. Instead of calling the tax a tax, and having it go through the process required for a new tax, the legislature may simply enact new legislation that would grant the Commission the power to charge the “fee.” Such a deference of power would insulate legislators from their constituents’ backlash while granting an independent third party autonomy in how it spends the \$181 million in new taxes. Legislators in favor of a public benefits fund would certainly consider it more politically feasible to force constituents to pay \$181 million in new taxes if it is disguised as a utility “fee.” If the legislature does pass this massive tax, it should be enacted through the required means necessary to pass a tax, as outlined in the North Carolina Constitution.<sup>34</sup>

Deferring to the Commission or the third-party administrator also means the legislature never would have to allocate money from the General Fund for programs that would have little public support. In Vermont and Wisconsin, the respective Utilities Commissions contract with one or more private firms to administer DSM programs.<sup>35</sup> If the legislature permitted the Commission to create a public benefits fund in North Carolina, proponents of these programs could simply avoid the legislature and elicit support for these programs from the third-party administrator. Moreover, there would be limited accountability as third-party administrators are neither elected nor even appointed by elected officials.

## **Recommendations to Protect Consumers**

*The Legislature and Commission Should Be Honest About the Electricity Sin Tax.* The legislature, not the Commission, should debate this new sin tax. Before any decision on the new sin tax is made, the specific programs which the tax would fund should be spelled out in detail. Furthermore, the Commission should not allow a sin tax to be called by some misleading name such as a “non-taxable fixed charge” in order to deceive North Carolinians. In the event North Carolina does institute a public benefits fund administered by a third party, an open process should be used to determine who this third party should be. The citizens of North Carolina need to be especially concerned that a public benefits fund does not evolve into a slush fund for the implementation of pet policies being advocated by special interest environmental groups.

*Public Staff Should Remember Its Mission.* The utilities companies have argued that the best interest of consumers should be considered in evaluating DSM programs and not external factors that are unrelated to costs.<sup>36</sup> Environmental groups disagree and have argued that DSM programs should consider societal costs and the larger public interest.<sup>37</sup> The Public Staff has taken the side of environmental groups, favoring policies that would impose higher costs on consumers.<sup>38</sup>

The Public Staff has clearly strayed from its founding principles of representing consumers. In fact, the purpose of the Public Staff is solely to protect consumers and not environmental groups, utilities, or even the general public. The Public Staff exists because there are many competing interests. Consumers, at least in theory, need a state agency to protect their interests before the Commission, such as ensuring that there are no hidden taxes. The Public Staff needs to adhere to its important mission. If the Public Staff is not going to perform this role, consumers should not have to pay for the pretense that their interests are being protected. When utilities have become more consumer-friendly than the state-created consumer advocate, there is a real problem.

## **Conclusion**

Consumers should only have to pay for the actual costs of supplying electricity, along with a reasonable profit for utility providers. Instead of protecting consumer interests, the Public Staff and environmental groups are trying to impose hidden taxes on consumers. If a tax is going to be imposed, consumers have the right to know what they are paying and what their money will help subsidize. If a public benefits fund supports worthy programs, then there should be no need for deception. The potential costs and benefits of these programs should be weighed against other taxpayer

priorities by considering them as possible expenditure items in the General Fund. This would allow a more open public debate to develop about the merits of these programs and would promote honest government in North Carolina.

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## Notes

1. North Carolina Utilities Commission web page entitled "Description" at [www.ncuc.commerce.state.nc.us/overview/ucdesc.htm](http://www.ncuc.commerce.state.nc.us/overview/ucdesc.htm).
2. Robert Gruber, Public Staff Executive Director, "Comments to the Legislative Commission on Global Climate Change Regarding Demand-Side Management Cost Recovery," October 3, 2006, at p. 5.
3. "Public Staff's Report on July 27, 2006 Workgroup Meeting," North Carolina Utilities Commission, Docket No. E-100 Sub 103, p. 20, at [ncuc.commerce.state.nc.us/cgi-bin/webview/senddoc.pgm?dispfmt=&itype=Q&authorization=&parm2=8AAAAA44260B](http://ncuc.commerce.state.nc.us/cgi-bin/webview/senddoc.pgm?dispfmt=&itype=Q&authorization=&parm2=8AAAAA44260B).
4. Matthew C. Hoffman, "The Future Of Electricity Provisions," *Regulation: The Cato Review of Business & Government*, Vol. 17, No. 3, Summer 1998, Cato Institute, [www.cato.org/pubs/regulation/regv17n3/reg17n3-hoffman.html](http://www.cato.org/pubs/regulation/regv17n3/reg17n3-hoffman.html).
5. "North Carolina State Energy Plan," North Carolina State Energy Office, p. 23, at [www.energync.net/sep/docs/sep\\_12-04.pdf](http://www.energync.net/sep/docs/sep_12-04.pdf).
6. *Ibid.*
7. *Ibid.*
8. "North Carolina Gas Prices" web page at [www.northcarolinagasprices.com/tax\\_info.aspx](http://www.northcarolinagasprices.com/tax_info.aspx).
9. *Op. cit.* note 5, at p. 75.
10. For example, see a sample Wisconsin utility bill at [www.uwsp.edu/cnr/wcee/keep/Mod1/Unitall/bill.asp](http://www.uwsp.edu/cnr/wcee/keep/Mod1/Unitall/bill.asp).
11. California is an example of a state that uses a public benefits fund to help subsidize energy providers for meeting a renewable portfolio standard. See the California Public Utilities Commission web page at [www.cpuc.ca.gov/static/energy/electric/renewableenergy/index.htm](http://www.cpuc.ca.gov/static/energy/electric/renewableenergy/index.htm).
12. *Op. cit.*, note 3, at pp. 17-21.
13. The Public Staff is funded by the utilities who contribute 0.12% of revenues to the operation of the Public Staff and the Commission. Utilities can recuperate these costs through the rate structure. Personal conversation with Robert Gruber, Executive Director of the Public Staff, October 2006.
14. North Carolina Public Staff website at [www.pubstaff.commerce.state.nc.us/psabout.htm](http://www.pubstaff.commerce.state.nc.us/psabout.htm).
15. See N.C. Gen. Stat. § 62 *et seq.*, [www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/ByChapter/Chapter\\_62.html](http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/ByChapter/Chapter_62.html).
16. N.C. Gen. Stat. § 62-15(b), [www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_62/GS\\_62-15.html](http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_62/GS_62-15.html).
17. N.C. Gen. Stat. § 62-133, [www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_62/GS\\_62-133.html](http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_62/GS_62-133.html).
18. "Order Authorizing the Establishment and Funding of a North Carolina Alternative Energy Corporation", North Carolina Utilities Commission, Docket No. E-100, Sub 37 (1980), pp. 12-13, at [ncuc.commerce.state.nc.us/cgi-bin/webview/senddoc.pgm?dispfmt=&itype=Q&authorization=&parm2=VAAAAA98210B](http://ncuc.commerce.state.nc.us/cgi-bin/webview/senddoc.pgm?dispfmt=&itype=Q&authorization=&parm2=VAAAAA98210B).
19. N.C. Gen. Stat. § 62-2, [www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_62/GS\\_62-2.html](http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_62/GS_62-2.html).
20. *Op. cit.*, note 5, at p. 24.
21. *Ibid.*
22. *Ibid.*
23. *Op. cit.*, note 3, at pp. 26-27.
24. Wisconsin is an example of a state that gives discretion to the third party administrator in allocating funds. See this discussion of public benefits programs, including the Wisconsin program, that was developed for the state of Kansas: Energy Programs Consortium, 2003, "Options for Developing a Public Benefits Program For the State of Kansas," p. 16, at [www.kansasenergy.org/KEC/KsPubBenFundStudy2004.pdf](http://www.kansasenergy.org/KEC/KsPubBenFundStudy2004.pdf).
25. *Op. cit.*, note 5, at p. 75.
26. *Op. cit.*, note 3, at p. 26.
27. *Ibid.*, at p. 23.
28. *The American Heritage Dictionary of the English Language*, Fourth Edition, Boston: Houghton Mifflin Company, viewable online at [www.yourdictionary.com/ahd/s/s0911800.html](http://www.yourdictionary.com/ahd/s/s0911800.html).
29. *Op. cit.*, note 2, at p. 5 and note 3, at pp. 18-19.
30. See Efficiency Vermont web page entitled "About Us" at [efficiencyvermont.com/pages/Common/AboutUs](http://efficiencyvermont.com/pages/Common/AboutUs).
31. "Focus on Energy Recommended Call Center Q & A Resource Guide, Topic: Utility Public Benefits Charge," *Focus on Energy*, 2002, p. 1, at [www.focusonenergy.com/data/common/pageBuilderFiles/Public%20Benefits%20QA.pdf](http://www.focusonenergy.com/data/common/pageBuilderFiles/Public%20Benefits%20QA.pdf).
32. *Op. cit.*, note 3, at pp. 18, 23.
33. *Op. cit.*, note 2, at p. 5.
34. North Carolina Constitution, Article II § 23, [www.ncga.state.nc.us/Legislation/constitution/article2.html](http://www.ncga.state.nc.us/Legislation/constitution/article2.html).
35. *Op. cit.*, note 24, at pp. 16-17.
36. *Op. cit.*, note 3, at p. 5.
37. *Ibid.* at pp. 5-7.
38. *Ibid.* at p. 7.