UTILITY REPLACEMENT TAX TASK FORCE

REPORT TO THE IOWA LEGISLATURE

December 15, 2014

Task Force Members

David Roederer, Co-Chair, Director of the Department of Management
Courtney Kay-Decker, Co-chair, Director of the Iowa Department of Revenue
Tim Coonan, Iowa Association of Electric Cooperatives
Steve Evans, Vice President Taxation, MidAmerican Energy Company
Jim Henter, President, Iowa Retail Federation
Alan Kemp, Executive Director, Iowa League of Cities
Bill Peterson, Executive Director, Iowa State Association of Counties
Julie Smith, General Counsel, Iowa Association of Municipal Utilities
Michael Rubino, Manager of State and Local Taxes, Deere & Company

Background

During the 1998 legislative session, the Iowa General Assembly passed and the Governor signed Senate File 2146, the Property Tax Replacement and Statewide Property Tax Act. The bill replaced the property taxes paid by electric and natural gas utilities on their property with an excise tax associated with the distribution of electricity and natural gas. The bill also created a "statewide property tax" on the real property associated with the electric and natural gas utility companies.

The bill required the Department of Management, in consultation with the Department of Revenue, to initiate and coordinate the establishment of a task force. It was the intent of the General Assembly that the task force include representatives of the Department of Management, Department of Revenue, electric companies, natural gas companies, municipal utilities, electric cooperatives, counties, cities, school boards, and industrial, commercial, and residential consumer, and other appropriate stakeholders.

The purpose of the Replacement Tax Task Force ("Task Force") is to study the effect of the Replacement Tax on local taxing districts, consumers, and taxpayers. If the Task Force recommends modifications to the Replacement Tax that will further the purposes of tax neutrality for local taxing authorities, local taxing districts, taxpayers, and consumers, the Department of Management is tasked with transmitting those recommendations to the General Assembly.

2014 Legislative Activity

In March of 2014 the Task Force convened to discuss Senate File 2329 proposed by Senator Amanda Ragan. The bill proposed phasing in a Replacement Tax exemption for companies delivering 60 million therms or less of natural gas. The loss in local property tax revenue would be backfilled by appropriations from the State's General Fund. There was speculation that the bill may have stemmed from the District Court decision in the Little Sioux Corn Processors case, hereinafter "the Little Sioux Litigation."

At that time the Task Force decided to submit a letter commenting on the legislation in advance of a March 20, 2014 subcommittee meeting to be held on the bill. In essence the Task Force was concerned that the legislation may be contrary to its three guiding principles:

- Tax Neutrality
- Competitive Tax Equity
- Ease of Administration

Ultimately the bill did not move forward.

In June of 2014 Task Force member Tim Coonan was contacted by Senator Ragan asking if the Task Force could convene to hear her constituent, Walter Wendland of Golden Grain Energy, explain his position on the previously proposed legislation. In the process of looking at dates and times to meet, the Task Force received the request described below.

The Request

On July 14, 2014 Directors Courtney Kay-Decker and David Roederer, as co-chair of the Task Force, received the information request below, which was jointly signed by Speaker of the House Kraig Paulsen and Senate Majority Leader Mike Gronstal:

> *We request the Utility Replacement Tax Task Force established under Iowa Code section 437A.15, subsection 7, gather information relating to the tax imposed on natural gas (the "tax") under Iowa Code section 437A.5, subsection 2, analyze the information and submit recommendations to the General Assembly by December 15, 2014, in order for the legislature to have the necessary information needed to potentially address the concern regarding inequitable application of the tax during the 86th General Assembly. The information requested should include, but not be limited to, the following:*
>
> 1. *The number and types of taxpayers who currently pay the tax.*
> 2. *The amount of tax being paid by each taxpayer, or if this information is confidential, the amount of tax paid in each competitive service area.*
> 3. *The amount of natural gas consumed by the five grandfathered taxpayers who are exempt from the tax.*
> 4. *The amount of property taxes that would be paid by each taxpayer identified in 1 above if the taxpayer paid locally assessed property taxes at current rates in the respective counties*
> 5. *The allocation and amount of the revenue generated by the tax revenue to local governments and other local taxing districts.*
>
> *The analysis should consider the effects of the tax on local governments and other local taxing districts, consumers, and taxpayers. As you collect and analyze this information we urge you to consult with the department of management, the department of revenue, the Iowa utilities division, taxpayers that are subject to the tax, representatives of the local governments and other local taxing districts that receive revenue collected from the tax, and all other parties impacted by the tax.*

In response, the Task Force convened on August 21, 2014 to discuss the request and also to hear from Mr. Wendland. An agenda and transcript for the meeting are included as Appendix "A."

The Task Force requested formal comments as directed in the request and asked to receive those comments by October 17, 2014. A second Task Force meeting was scheduled for November 12, 2014. The comments received are included as appendices and have been grouped as follows:

Comments from Task Force Members - Appendix "B"
Comments from the Iowa Renewable Fuels Association – Appendix "C"
Comments from the Davis Brown Law Firm, representing Bypass Companies – Appendix "D"

An agenda and transcript of that meeting are included as Appendix "E."

Questions and Responses

1. **[Provide] the number and types of taxpayers who currently pay the tax [under Iowa Code section 437A.5(2)].**

   Iowa Code section 437A.5(2) describes a specific subset of Replacement Taxpayers that are consumers of natural gas that do not otherwise pay the Replacement tax on the delivery of the natural gas. In other words, this subset of taxpayers "bypasses" the natural gas distributor designated for a given service area and instead receive natural gas directly by connecting directly to an interstate pipeline through what is referred to as a "lateral" pipe that branches off from the interstate pipeline. These companies shall hereinafter be referred to as "the Bypass Companies."

Name	Type/Industry	County
1. Valero-Albert City	Renewable Fuel/Biorefinery	Buena Vista
2. Otter Creek Ethanol (Poet Biorefining)	Ethanol/Biorefining	Osceola
3. Poet Biorefinery -- Jewell	Ethanol/Biorefining	Hamilton
4. Flint Hills Resources – Menlo	Ethanol	Guthrie
5. Little Sioux Corn Processors	Ethanol	Cherokee
6. Plymouth Energy, LLC	Ethanol	Plymouth
7. Valero—Charles City	Ethanol/Biorefining	Buena Vista
8. AGP Algona	Biodiesel	Kossuth
9. Southwest Iowa Renewable Energy	Grain Processing/Ethanol	Pottawattamie
10. Flint Hills Resources – Shell Rock	Ethanol	Butler
11. Green Plains Holdings II, LLC	Ethanol/Biodiesel	Kossuth
12. Absolute Energy	Ethanol	Mitchell
13. Iowa Ethanol (Poet Biorefining)	Ethanol	Worth
14. Homeland Energy Solutions	Ethanol	Chickasaw
15. Green Plains Superior, LLC	Ethanol	Dickinson
16. Poet Biorefining – Gowrie	Ethanol	Webster
17. Louis Dreyfus Commodities	Ethanol	Greene
18. Corn, LP	Ethanol	Wright
19. Quad County Corn Processors	Ethanol	Ida
20. Central Iowa Power Cooperative	Generation & Transmission Power Cooperative	Linn

2. [Provide] the amount of tax being paid by each taxpayer, or if this information is confidential, the amount of tax paid in each competitive service area.

Technically the amount of the Replacement Tax paid by each Bypass Company is not confidential. What is confidential is information reported on the Replacement Tax Return, including the number of therms of natural gas delivered. Replacement Tax rates are specific to the "Competitive Service Area" (CSA) in which the gas is being delivered. Many CSAs have a small number of consumers; some only have one consumer. The Replacement Tax rates are public information so theoretically, if the Department revealed the amount of Replacement Tax paid in a CSA, one could take the Replacement Tax rate in the CSA and calculate the number of therms delivered in that CSA. Ultimately, this would violate the Department's confidentiality obligations under the law.

3. [Provide] the amount of natural gas consumed by the five grandfathered taxpayers who are exempt from the tax.

There are five companies that connect directly to interstate pipelines that were in existence prior to the implementation of the Replacement Tax. In creating the bill authorizing and implementing the Replacement Tax, the Iowa Legislature deliberately excluded these five companies because these companies were not centrally assessed as utility property by the Department and they were few in number. These companies became known as the "Grandfathered Companies," and according to an expert witness report prepared for the Little Sioux Litigation (refer to Appendix D), they are:

Name	**Type/Industry**	**County**
1. AGP	Renewable Fuel/Biorefinery	Cerro Gordo
2. CF Industries	Fertilizer	Woodbury
3. Bunge Soybean Plan	Biorefinery	Mills
4. KOCH Industries	Nitrogen Production	Webster
5. Grain Processing Corporation (GPC)	Grain Processing	Muscatine

Because the Grandfathered Companies were specifically excluded from the Replacement Tax legislation, the Department does not receive information on the amount of natural gas these companies consume.

In response to this question, the Davis Brown Law Firm, which represents several ethanol companies, speculates as to the number of therms utilized by two of the Grandfathered Companies, but neither the Task Force nor the Department is able to verify the accuracy of those amounts (refer to Appendix D).

4. **[Provide] the amount of property taxes that would be paid by each taxpayer identified in 1 above if the taxpayer paid locally assessed property taxes at current rates in the respective counties.**

   In order to determine the amount of property tax that would be paid by the Grandfathered Companies if their transmission property was locally assessed the Department of Revenue would need to know the fair market value of those companies' pipeline facilities. This information is unknown to the Task Force and to the Department.

   A report prepared by the Stradley Group for this study estimates that one of the Bypass Companies pays approximately forty-five times more in Replacement Tax than it would pay in locally assessed property tax if assessed on its own assets (refer to Appendix D).

   The Task Force refutes this assertion for several reasons. First, a comparison between locally assessed property tax and Replacement Tax is invalid because the taxes are unrelated and use a different basis. Property assessment at the local level is based upon the fair market value of real property. The Replacement tax is based upon the number of therms being delivered or consumed, not upon the value of a company's property or even the value of the natural gas itself. Local property tax is an ad valorem tax; Replacement Tax is an excise tax. In essence, it is an apples-to-oranges comparison.

   Second, the Stradley Group's analysis contemplates that both the locally assessed property tax and the Replacement Tax revenues are static. In actuality, because the Replacement Tax is based solely upon the number of therms of natural gas consumed or delivered to the consumer, in the event of a plant shutdown or slowdown, there would either be no Replacement Tax due or a reduced amount of Replacement Tax due. Locally assessed property taxes would be due regardless of the plant's operating activities.

   Finally, the Stradley Group also reports that the "transmission property" of the three Grandfathered Companies it sampled is not being locally assessed and seems to imply that it should be. If those Grandfathered Companies owned the lateral pipelines, that property would be locally assessed. But the fact is those lateral pipelines are owned by Interstate Pipeline companies. As a result, the lateral pipeline property of those three companies is centrally assessed by the Department. The Department centrally assesses Interstate Pipelines using the three approaches to value as a going concern based upon the value of the company, both in and outside of Iowa. In contrast to the laterals utilized by the three Grandfathered Companies, pipeline owned by a Bypass Company today is subject to the Statewide Property Tax that is part of the Replacement Tax system. The Statewide Property Tax is based upon the cost of the lateral pipeline and is calculated and assessed by the Department at a rate of three cents per thousand dollars. So the assertion that Bypass Companies should be valued and assessed locally upon their own assets does not create equity; rather, it introduces a brand new methodology for valuing pipeline into the mix. The irony of this proposition is that local assessment of pipeline using this methodology would result in a substantially higher *property* tax on the pipeline than the existing Statewide Property Tax under the Replacement Tax system.

The Task Force's final point on the Grandfathered Companies is that the Legislature was fully aware of the existing Bypass Companies at the time the Replacement Tax legislation was passed. Leaving the Grandfathered Companies, which were NOT centrally assessed utility properties, under their existing property tax regime furthered the Replacement Tax's principle of revenue neutrality for local governments. In fact, it was fully contemplated that bypass companies coming into existence subsequent to the implementation of the Replacement Tax should be treated as described in section 437A.5(2). Specifically, it was not the Legislature's intent to exempt large Bypass Companies from the Replacement Tax because that would create a clear competitive advantage. The Replacement Tax and the rate itself are based on the total amount of deliveries of natural gas in each service area. If natural gas deliveries are reduced from one year to the next a "threshold adjustment" may be triggered. By law, the total tax in a service area cannot be more or less than 2% of the previous year's tax. If that is the case, the rate has to be adjusted either up or down so that the total tax amount is within 2% of the previous year's amount. By allowing such companies to purchase their natural gas free from the Replacement Tax, it would create an incentive for other companies to bypass the Local Distribution Carrier (LDC) in a given service area, therefore reducing the overall tax base for the local government due to the loss of large customers. Not only would the natural gas costs for the LDCs be shifted to other residential and business customers that were too small to bypass, but because of the threshold adjustment, as the number of therms of natural gas delivered into a service area decreases, the tax rate for existing customers would increase. One of the goals of the Replacement Tax was stability. The disruption that would be caused by Bypass customers moving in and out of service areas would fly in the face of that concept.

5. [Provide] the allocation and amount of the revenue generated by the tax revenue to local governments and other local taxing districts.

Listing payment amounts by taxing jurisdiction produces a report that is roughly 400 pages long. For the purposes of this report, the Department of Management has aggregated statewide amounts by type of taxing authority for the 2013 Assessment year (Replacement Tax payments made in September of 2014 and March of 2015). The results are shown below:

Levy Authority Type	**Statewide Replacement Tax Amount**
School	$ 67,968,460
County	$ 38,551,407
City	$ 37,323,560
Community College	$ 4,216,579
County Hospital	$ 3,187,224
County Assessor	$ 1,549,581
Township	$ 1,188,238
Ag Extension	$ 668,115
Miscellaneous Districts	$ 372,644

City Assessor	$ 282,955
Benefited Fire District	$ 82,679
Sanitary Sewer	$ 47,523
State Brucellosis/TB Eradication	$ 15,367
Township City Cemetery	$ 12,574
Benefited Lighting	$ 84
Water District	$ 15
Rural Improvement Zone	$ 0
STATEWIDE TOTALS:	**$155,467,005**

Finally, the Task Force was asked to **"consider the effects of the tax on local governments and other local taxing districts, consumers, and taxpayers with input from DOM, IUB, Taxpayers, Local Governments and others, and all other parties."**

In response to this question, the Task Force held two public meetings to solicit feedback from interested parties as well as calling for written comments.

- **Local governments and other local taxing districts.** The local government representatives providing comments to the Task Force indicated their primary concerns about changes to the Replacement Tax system involved shifting the tax burden and reduction of existing tax revenues. Historically, however, we know that one of the motivating factors in the creation of the Replacement Tax system was to create a tax that was more predictable. Prior to the Replacement Tax, a utility's property was centrally assessed using one or more of the three approaches to value: income, cost, and stock and debt. The amount of tax revenue generated from year to year could fluctuate materially depending upon the utility's financial performance and other external events. The Replacement Tax system is based upon the number of therms each taxpayer reports were delivered or consumed. Replacement Taxpayers provide an estimate of their delivery or consumption and that estimate has proven to be accurate within a very small margin of error. This allows local governments to budget with confidence for this particular revenue source. In addition, the Replacement Tax system calls for a "threshold adjustment" based upon the number of therms of natural gas delivered in a service area. The threshold adjustment also helps contribute to the stability of Replacement Tax revenue.

- **Taxpayers.** The Task Force received comments from businesses and business organizations that represent "taxpayers" as the term is used generally. The commenters seem to believe that a compelling case for change in the existing Replacement Tax system has not been made. They also echoed the concerns of the local government representatives that a change may merely shift the tax burden elsewhere.

- **Consumers.** The Task Force also received comments from Bypass Companies. These companies are in the ethanol and biofuel industries. The primary issue these companies have is that they believe they are similarly situated to the Grandfathered Companies, which by statute do not pay Replacement Tax, and therefore they posit that it is inequitable that they do pay the Replacement Tax.

  Much could be said about this topic. However, this is precisely the crux of the Little Sioux Litigation, which is currently before the Iowa Supreme Court. In fact, the case has been set for Oral Argument on January 21, 2015 at 10:00 a.m. All the publicly available documents related to the Little Sioux Litigation are included with this report in Appendix "F." It would be inappropriate for the Task Force or the Department to discuss any case that is actively being litigated and as such, this report does not explore the issues that are central to the Little Sioux Litigation.

Conclusions

As evidenced by the attached comments, the vast majority of respondents believe the Replacement Tax system accomplishes what it was intended to accomplish. The system works smoothly. In fact, since the inception of the Replacement Tax, prior to the Little Sioux litigation, no utility company had protested or appealed its tax assessment. Prior to the Replacement Tax, the Department was tied up in informal negotiations and formal contested case proceedings every year with multiple utility companies.

The ethanol and biofuel industries have concerns about the tax they pay. They say they want to pay a fair tax to their counties based upon their own assets. However, this is not what the other companies subject to the Replacement Tax are paying. Replacement Taxpayers pay their counties an excise tax based upon the delivery or consumption of natural gas and pay the State of Iowa a "property tax" of three cents per thousand dollars of the actual cost of the pipeline.

As to the concerns about inequity, as stated previously, this issue is being litigated. It has long been the practice of the Iowa Legislature not to make law around areas under litigation. The Task Force recommends this practice be exercised in this case: let the Court decide the questions of equity amongst Replacement Taxpayers.

Index of Appendices

Appendix A Agenda and Transcript of August 21, 2014 Task Force Meeting

Appendix B Comments Responsive to October 2014 Request – Task Force Members

Appendix C Comments Responsive to October 2014 Request – Iowa Renewable Fuels Association

Appendix D Comments Responsive to October 2014 Request – Davis Brown Law Firm

Appendix E Agenda and Transcript of November 12, 2014 Task Force Meeting

Appendix F LSCP, LLP, Petitioner, v. COURTNEY M. KAY-DECKER, DIRECTOR, IOWA DEPARTMENT OF REVENUE, Respondent.

UTILITY REPLACEMENT TAX TASK FORCE

AGENDA FOR AUGUST 21, 2014 MEETING
11:00 a.m.
Room 7, A Level, Hoover State Office Building

Members

Courtney Kay-Decker, Co-chair, Director of the Iowa Department of Revenue
David Roederer, Co-Chair, Director of the Department of Management
Tim Coonan, Iowa Association of Electric Cooperatives
Steve Evans, Vice President Taxation, MidAmerican Energy Company
Jim Henter, President, Iowa Retail Federation
Alan Kemp, Executive Director, Iowa League of Cities
Bill Peterson, Executive Director, Iowa State Association of Counties
Julie Smith, General Counsel, Iowa Association of Municipal Utilities
Michael Rubino, Manager of State and Local Taxes, Deere & Company

I. **Call meeting to order and roll call/introductions**

II. **Approve minutes from March 12, 2014**

III. **Walter Wendland, Golden Grain Energy**

IV. **Legislative request**

V. **Questions**

VI. **Schedule next meeting**

VII. **Adjourn**

UTILITY REPLACEMENT TAX TASK FORCE MEETING

MINUTES
August 21, 2014

The Utility Replacement Tax Task Force met at 11:00 a.m. on August 21, 2014 in Room 7 on the A Level of the Hoover state office building, Des Moines, Iowa. The meeting concluded at 12:00 p.m. A quorum was present.

COURTNEY KAY-DECKER (CKD): Thank you for all coming today to our meeting of the Utility Replacement Tax Task Force. I'm Courtney Kay-Decker, Director of Revenue and I have with me Dave Roederer, Director of the Department of Management and co-chair and we are going to go around start off with by introducing everyone on who's here. If you state your name for the record and who you represent that would be great. There will be a signup sheet coming around. Just so we have a good record of the meeting, because we have a lot of stuff to discuss. We are recording it and we have our transcriptionist here as well to take minutes for us.

Victoria Daniels, Iowa Department of Revenue, Legislative Liaison

Donn Stanley, Iowa Attorney General's Office.

JJ Severson, Attorney with the Department of Revenue

Roland Simmons, Department of Revenue - Property Tax Section

Julie Roisen, Department of Revenue - Property Tax

Alan Kemp, Executive Director of the Iowa League of Cities

Carrie Johnson, Department of Management, Local Government

Julie Smith, Iowa Association of Municipal Utilities

Tim Coonan, Iowa Association of Electric Cooperatives

Bill Peterson, Iowa State Association of Counties

Steve Evans, MidAmerican Energy representing Investor-owned Utilities

Christina Downing, Iowa Department of Revenue

Jon Wolfe, Assisting the Director of the Iowa Department of Revenue

Monte Shaw, Iowa Renewable Fuels Association

Erin Mullenix, Iowa League of Cities

Ray Chiquette, representing the EGP

J.D. Davis, MidAmerican Energy

Terry Harrmann, Alliant Energy

Mark Douglas, Iowa Utility Association

Dick Stradley, The Stradley Group
Bill Hanigan, Davis Brown Law Firm
Walter Wendland, Homeland Energy Solutions
Tom Stanberry, Davis Brown Law Firm
Brian Cahill, Southwest Iowa Renewable Energy
Gary Grotjohn, Little Sioux Corn Processors
Jace Mikels, Senate Democratic Caucus Staff
Brent Mackie, Iowa Renewable Fuels Association
Bob Malloy, Representing Corn LP
Matt Caswell, AGP
Mike Rubino (phone), John Deere

CKD: So then our next item on the Agenda is approval of the minutes from our March 12th meeting. Any Task Force members have questions or comments with regard to those minutes. Hopefully you had an opportunity to review them. And your emails from earlier this week. I would take a Motion to Approve the Minutes. I'll Move-Tim Coonan; 2nd-Bill Peterson-; All in favor- Aye? (Aye) Anyone oppose?-None

CKD: All right let's move onto the business of the day. Mr. Wendland, you have a presentation for us. My hope is that perhaps you take 15 minutes or so for your presentation and then if there's any questions or comments.

WALTER WENDLAND (WW), President and CEO of Homeland Energy Solutions, an Ethanol Plant located in Northeast Iowa. We are a large stakeholder in the Iowa Replacement Tax and I would like to address the tax inequities of this tax. Those inequities can affect the jobs of our employees. The markets for our area farmers and our local shareholders. And we would like to see some attention paid to correcting the tax that has become inequitable to the ethanol industry. And I want to make it clear that we are only talking about the replacement tax for natural gas. And no impact on electricity or water. The thing is I was also founder and CEO for Golden Grain Energy in Mason City since 2002, so I actually have been able to be on both sides of this issue. We negotiated an agreement with Alliant Energy and to provide gas services to that facility and we have paid no replacement tax since the plant started up in 2004. In 2008 when my services were shared with Homeland Energy Solutions, I became acquainted with that facility and at that time they did not have any utility that was willing to bring natural gas service to their facility and so a lot of people would like to say that we chose to bypass. They had no choice but to put in the line all by themselves. And we located it in an area that where we

had an REC that doesn't participate in any natural gas, so we didn't get the same relationship that we had with Alliant that can provide electricity and natural gas and be able to use that natural gas as an economic incentive. We paid full price to put the pipeline, plus then we paid approximately $250,000-$300,000 a year in replacement tax on top of the 4 million dollars we had to pay to put the pipeline in, so we think that we are not being unreasonable when we ask that...It's our understanding according to the minutes of the letter that was sent to [Senator] Amanda Ragan that when this bill was originally presented as an alternative to deregulation and being able to keep it fair for in-state and out-of-state companies due to deregulation that the intent of the law was keep it revenue neutral to let the property tax burden would be on those assets. And that seems to not be the way that this has gone lately and we think that we have ways that we could fix the inequities, but we would be also open to the committee's suggestion on how these inequities may be approached. So the ethanol industry has its ups and downs and these inequities, this tax can change from year to year where for the utilities it's more stable. So if we could pay a property tax rate, then there would be a more stable type of income for the utilities and for the ethanol plant as well, so I think that like I say that I am thankful that I can be represented on the committee. Our ethanol industry--we have about 16 plants out of the 43 plants in Iowa that pay a replacement tax and that's caused great disparity and the equities of the tax equities in each of these plants, so when you have about half of them that pay and half of them that don't, it puts us at a competitive disadvantage to a lot of the other industries in the ethanol business. And that's why we are kind of here to address and talk about. So are there any questions? I don't have a whole lot of comments other than...I think everybody's aware of the situation that has happened in the ethanol industry. We basically was developed after this tax was put into place and seemed to be the only taxpayers for this replacement tax, but the heart of the problem seems to be that the bill was designed to be revenue neutral with property tax and that neutrality doesn't seem to exist anymore. We need to try to figure out a fix.

CKD: Do you have any data on that you could share with us?

WW: We are willing to do...if the committee's willing to do to listen to our arguments we are willing to get assessors to assess the pipelines that were put in by the fifteen rate payers and be able to have...

CKD: Have they already been assessed in some way?

WW: Not to my knowledge. I called Chickasaw County Tax Assessor on the way down here today and they have no record of any assessment. And that's what I thought if I could see what the pipeline was assessed at then we

could have that comparison and you can see that the in-neutrality that has been created. It was supposed to exist in legislation.

ROLAND SIMMONS (RS): The pipeline that's associated with replacement tax would be based on the cost of the pipeline installed, so the local assessor wouldn't have an assessed value on it because that pipeline would be a part of the replacement tax. And that's the value that you are paying 3 cents per $1,000 on; that pipe that you install.

WW: The pipeline to go to Homeland cost four million dollars.

RS: And your property taxes associated with that pipeline were 3 cents per $1,000.

WW: So we are paying property tax and replacement tax?

RS: For the pipeline that's associated with that, yes you are paying 3 cents per $1,000 of property tax.

RS: That's if everyone else bypassed.

WW: The rate that we pay is considerably higher than the rate the utilities pay with their bypass situation also. And there's inequity in that as well.

CKD: Do you have documentation to that effect? We like numbers.

WW: Mmm hmm...

CKD: Does anyone have any documentation on that?

WW: The inequities between what the ethanol plants pay versus the utility plants for natural gas.

BILL HANIGAN (BH): The utility customers.... There's an expert witness report that's in the litigation, so again we can provide that. Which defines how the amount of replacement tax paid by the customers of the not bypassed pipelines. And that would be customers of all the RECs, so yes.

CKD: And I think that it's worthwhile, thank you for raising that, to note for purposes of the Task Force and for the record that the State is in litigation with respect to this precise issue. Or this is one of many issues, but the discussion of certain constitutionality issues, and Donn can certainly explain better, is the subject of litigation at the moment. So that makes certain discussions more difficult, at least with the Department of Revenue, because we're a party to that lawsuit, so I think information gathering is very helpful, and the more information that you can share with this Task Force is helpful, but at least from my perspective, I'm not interested in having a discussion of something that's being currently litigated in court and is before the Iowa Supreme Court in a briefing stage at this point. So I guess that is all I want to make sure that everyone in the room was aware that that was going on. Yes Bill?

BILL PETERSEN (BP): May I ask a question?

CKD: Absolutely.

BP: Okay, the replacement tax system process eliminated the property tax system, that works traditionally for other types of property, for utilities and associated things related to electricity and natural gas. So are you saying that your enterprise was paying both a replacement tax and a property tax? Because the utilities would only pay a replacement tax, which replaces the property taxes that they would have paid under the old system where either the Department of Revenue or the county assessor or city assessor, so applicable, would have gone out and put an assessment value on that property, against which a tax rate determined by the local taxing entity, would have been applied towards that value. So I guess my question is, are you saying that you are paying both a traditional property tax and a replacement tax or are you paying one or the other?

WW: We are paying some kind of property tax according to this year's statement.

RS: The statewide property tax amount, which is part of this whole overall replacement tax system.

CKD: But that's not the same as the local property tax and I think Bill's question is are you paying a local property tax on top of the replacement tax and all of its components?

WW: We are paying a type of property tax and we are paying a replacement tax, but not a local property tax.

CKD: Can you tell me, though, that none of the counties have an assessment for you? So you are not paying the local property tax. And whatever property tax is being paid is a component of the replacement tax. Is that accurate?

WW: Yes.

CKD: Okay.

WW: The other point is that you made the comment that this replaced property tax for natural gas and it did not. There was a grandfather clause that kept many of...the majority of the users paying a property tax on their assets. Only new customers, which was primarily only the ethanol industry, since this went into effect they have been caught in this taxpayer inequity or in-neutrality. And it wasn't intended to be that way; the bill does not intend that there is an in-neutrality going forward with that bill.

CKD: Can someone who was here originally on the Tax Task Force explain what the neutrality standard is?

BP: Well Steve Evans could probably do that better than I could, but from a tax collector's standpoint what neutrality meant was that at the time the replacement tax system was adopted that we tried to have an equivalent amount of revenue over an average of several years be the benchmark. It didn't mean...to me, it didn't mean that that was the point we were going to be stuck at going forward and I think that the statistics would show that the... there has been growth in the replacement tax over the years within specific windows that are calculated, but Steve is really the expert on this. The details...he could probably give you a better explanation of that.

STEVE EVANS (SE): I don't know, Bill...I think that you have summarized it quite well. The counties, cities and schools were used to receiving funds at a certain level from these large taxpayers and the legislation was designed to make sure those funds are still coming in and probably with some small growth over time and that's what you witnessed whether you were a city or school or county--you received increased taxes, not markedly so, but the energy use hasn't really grown in anything more than 1-3 percent a year and that's pretty much as predicted. You're getting more money than you used to be and you should be, but it was an intent, as much as

possible mathematically, to preserve the revenues for the local governments and schools. And it seems to have done some good.

CKD: Now are you talking about the same type of neutrality or do you have some...

WW: Since the bill was called a replacement tax to property tax, you know, the assumption would be that that neutrality would always exist between the property tax and the tax you are trying to raise in the surtax/surcharge.

SE: Well, I think you're misunderstanding the term "replacement," in my view. Because to me, "replacement" meant that we replaced the traditional assessment system that generally applies to tax...things that our property tax is applied to, which is assessed valuation and taxable valuation; we replaced it with a system that tax based upon different components; what, transmission, distribution, and generation? Those are the key factors in the system that replaced the old traditional property tax system. So I guess my question is: are you asking to go back and be taxed under the old assessment model? Is that what...I'm not clear what you are asking...

WW: Legislation that we proposed in the last session did exactly that. We want to pay either...you know, this was brought into place because of the anticipated deregulation of utilities in the state of Iowa. How many people sitting around the room think that we're going to see deregulation of utilities in Iowa? Raise your hands.

SE: Well, yeah, right it was one of the factors that....I think there were two factors. First of all, if you took a look at the tax revenues generated under the old approach with utilities, which I recall involved stock prices and debt and other things, it was a widely fluctuating system that was, you know, complained about both by the utilities and by the local governments because it did not provide a consistent system of taxation. So that was one aspect of it. Secondly, I think there were a whole series of litigation pieces between the Department of Revenue and probably local assessors and utility companies over what the taxes should be and would be, which was problematic, because I think there were times that we had multiple rebates that we have to get based upon the outcome of court decisions, but there was also an intent to, I think, you know, put Iowa utilities in a position to be competitive if there was general deregulation across the nation. And obviously that didn't turn out, but it was based upon the experience and observations, it has been a successful replacement tax from several...it addresses several of those problems in the system. I can't really address what your challenges are in the ethanol

industry, but I guess I'm unclear as to actually what tax impacts...because I don't really have any numbers or statistics in front of me, what the tax impacts are that seem inequitable to you?

WW: Well the fact that if we paid property taxes on the assessed value of our pipe, it would probably be somewhere between $25,000 to $50,000 per year. Instead of the $250,000-$300,000 we pay now. That's a huge inequity. Of what the intent of the replacement tax was supposed to be. And maybe I indicated if there's anybody here that thinks this would be in place today if deregulation wasn't contemplated I'd like to hear it. So we truly, I think, everybody understands the fact that this was an unintended consequence of a bill that was brought out about through the intent to deregulate the utility business that never happened and probably never will. And needs to be...we need to figure out a fix from the natural gas standpoint. Not from the utility standpoint. This is...seems to be only us that have been impacted by this and the way that we have been impacted. You'll put this at a competitive disadvantage to the rest of the industry. We are willing to work with the replacement tax whatever...

CKD: Could you provide some data as to why it provides the disadvantage?

WW: Golden Grain pays 0 cents replacement tax in Mason City and Homeland pays $250,000.

SE: Could I point something out? The provider of that gas to Golden Grain, Alliant Energy, pays the full boat load of replacement tax. Every therm delivered in this state to an ultimate customer is taxed under this 437A section of the law and in the case of it's a local distribution company like Alliant providing to the other ethanol plant, Alliant is paying that tax and maybe it's a penny a therm, I don't know what it is, but it's something in that range. They're writing checks to the counties and everything because of that tax in the full amount. Now there's another piece of that and that's the regulatory setup. Whether that is included in full or the tariffs that are charged ultimately to the recipient of that gas; that's a matter not part of this code section; it's not a matter of the Task Force, but there is a tax paid regardless of who the party is. If there is a therm delivered within a competitive service area in the state of Iowa-- and they blanket Iowa-- then anybody delivering a therm of gas is required to pay the tax. If there is a party that's for other reasons not paying that tax, then the recipient, which must be the case of your other ethanol facility, pays the tax. But it doesn't matter who you are, if you're in that competitive service area there is a price of a penny a therm or whatever the decimals that you guys publish are, then that's exactly the tax that's going to be paid by anybody and everybody who's delivering a therm in that competitive service area. The difference I think... so there's not 0 tax in one place; there is a full tax, but it's not

necessarily a check written by the ethanol facility; it's check written by the local distribution company that brought that gas to that ethanol facility. The same tax is paid. And then you get into the matters of regulatory rate design and other things, which are beyond this group. I just wanted to clarify: if there's a therm in Iowa delivered, it's taxed.

CKD: Would you like to respond to that?

WW: I do not want to get down into the weeds about it to be honest with you. I never bothered...

CKD: What is get into the weeds?

WW: I have never found where replacement tax is being paid in Cerro Gordo County by Alliant Energy, so if I can find that, that would be helpful. And I say alls (sic) we are interested in doing is bringing the tax back to tax neutrality like it was designed to be and... or eliminate replacement tax. I know our industry and we want to work together with the legislative fix. I mean it's not something that this committee can fix or we can fix. But we need to work together to come up with a solution that's equitable and get this tax back to tax neutrality. Like it was intended to be in the first place. I do...I mean there was a concern about the legal aspect, so I need to kind of clarify that, you know, Homeland Energy is seeking a prospective legislative relief and I spoke at the Ways and Means Committee at the legislative session this spring about that relief. You know the refund case that's involving Little Sioux Corn Processors is about the refund historically paid, so there has been, you know, a big difference between what we are talking about now and the case that is about the historic taxes that are paid. So in my opinion I think that's to help understand that we can't have this conversation.

CKD: Does anyone else have any questions? Or yes go ahead...

MONTE SHAW (MS): Are we allowed to ask questions?

CKD: Absolutely, we're free-for-all here.

MS: All right well thank you.

CKD: And state your name for the record again so when there is something...

MS: Monte Shaw. Steve brought up a couple of interesting points and [unintelligible]. Since you are the experts, I guess I will direct it to you. Whoever knows the answer. It says every therm is taxed, but we know that the bill was initially enacted, any existing bypass customers at that time would receive an exemption...were "grandfathered" out of the system, so they're not paying the tax on those therms? Or am I misunderstanding?

BP: No, that's correct; there is grandfather clause. If there was a bypass customer, I think there were only 4 or 5. There were a handful in place on 12/31/1998. They were locally assessed; they remain locally assessed, so thank you that is a clarification of that...

MS: Another thing that I have been interested in, that I haven't been able to dig into, that you said that a local service provider pays the tax and if there are bypass customers, a new one, they pay the tax. So every therm is taxed, but then you said however, it may not go to a tariff, that goes to a specific end-user like for example Golden Grain. And you mentioned that the regulatory rate structure goes is beyond this legislation and this committee. Okay I don't know, but as you are in the industry then it's certainly not beyond some legislation and some oversight by the state because somebody is regulating the tariffs and where would we look into that? Because it's pretty interesting to me that Homeland has to pay this full rate of this replacement tax and Mason City's ethanol plant may not necessarily. Now someone might be paying it, but it may not be the ethanol plant. I would like to dig. It seems to me that that right there raises some inequity questions.

BP: I might add that in the initial development of the legislation, and if you look at this, there was a provision. The Utilities Board and maybe customers were very much involved in trying to understand that and making sure the tax did not disturb ratemaking. And so when I say it may or may not...maybe the full therm is passed on and maybe it's something else, I don't know. That is part of the regulatory read out and that was fully considered. The Utilities Board weighed in heavily when this legislation was enacted and they actually had another task force which was set up to make sure there were not inequities or disturbances, I guess, whatever the legislative language is that addresses that with respect to regulation and so that remains in the purview of the Utilities Board. They weighed in on drafting the language heavily that exists today and they get represented here on this Task Force, as well, through large customers and other participants. That other Task Force I think had one or two meetings and it was determined it was not necessary at this time.

CKD: Any other questions from the crowd? Julie, looks like you have a question?

JULIE SMITH (JS): No.

DONN STANLEY (DS): At the last meeting we talked about the fact that the case from Little Sioux Corn Processors, with the Department of Revenue, challenging the replacement tax on a number of constitutional issues had just...there had just been a judicial review decision by the District Court and, as was expected, that decision was appealed to the Supreme Court. Little Sioux has submitted their first brief and the Department's response brief is due on Tuesday and then there'll be a reply brief filed in September. And then the Supreme Court will decide whether to retain the case or assign it to the Court of Appeals and probably set it for Oral Argument. And it's unclear whether there would be a Supreme Court Argument in this term, which was just starting in September and will end in April, it could get pushed to the next term based on how long other appeals will take. So after that we're probably looking at least 6 months from the Oral Argument until we get a decision. That's our expectation. Bill's [Hanigan] on the case so if he certainly has a different take on it, but rather than discuss, you know, any of...you know, it's kind of policy in our office, we don't discuss the merits of litigation outside the pleadings. We are happy to make any of the public filings and public decisions that have been issued at the Administrative level and the District Court level...we are happy to make anything available to the committee and anyone else who would like to see in terms of characterizing any of the arguments, we prefer just to let the pleadings speak for themselves. But I wanted to just provide an update of the timing of it as we did at the last Replacement Tax Task Force meeting.

CKD: Umm...

WW: I have one more comment about the inequities. You know there is an ethanol plant in Iowa that was built after this went into place that pays 0 replacement tax as well. So because of a loophole that's in the law. And I think there's a lot of...

CKD: Which one is that?

WW: It's the Poet plant. Evidently.....

CKD: Okay, do you have any data on that?

WW: I'm sure it's in the case. And it's....

DS: It's in that area...is that the one in the Emmetsburg Municipal District?

BH: Right, it's a bypass customer in the Municipal District.

WW: Pays no tax

RS: And it's a 0 service area though. There's 52 natural gas service areas in the State of Iowa. Just so happens that one happens to be a 0 service area rate, because they never had a property tax when we started the replacement tax system.

WW: So each district is to negotiate what their rate is?

RS: No, it was all based on the property taxes that were paid back in '98. There was a five-year average done to calculate what type of rate would be used. And it just so happens, Emmetsburg didn't have a property tax at that time, so no rate was developed. So they're in a "zero" service area.

WW: Sounds like a pretty sweet deal compared to what I pay.

JS: Well if you go back, one of the goals of the initial legislation was to bring in all of the different utilities and recognize that there are different ways that you can get the community to impose the tax. So municipal utilities in Emmetsburg didn't pay the tax, because it was a city utility to begin with, so it's a reflection of what historically was happening and it was an intent to bring all of the utilities together and impose one tax...you may not think it sounds logical, but it was logical to do it that way. Because it actually replaced what was there in the first place. So...

WW: Sounds like an inequity to me.

JS: Well...

SE: It replaced whatever rates were out there. They got a good deal--what can I say, but there was no intent to increase taxes by that legislation; it was to replace prior tax levels and they happened to be at 0.

WW: That was exactly the comment that I wanted to hear. There was no intent in the law to increase revenue.

SE: There was no intent to increase taxes on the existing taxpayers in the State of Iowa.

WW: So let's be unfair with new businesses coming into the State.

SE: We will put them under the same tax regime that all the other existing taxpayers have...

WW: We are not all under that same tax regime. They all got grandfathered in.

CKD: Do you have data to reflect that?

WW: It's all in that legal document.

CKD: Well right now we are talking about the litigation.

JS: We are talking about the heart of the litigation.

CKD: I think we should put off this conversation.

WW: I have no problem, I just think that this committee should look at the in-neutrality that was originally intended by the law and work together and come up with a solution to fix the situation and do the job that this committee was intended to do and that was to monitor that neutrality and keep it neutral to property taxes.

CKD: I just want to make a little point that, being the people who provide fiscal estimates to the legislature, the Department of Revenue provides our analysis and then LSA uses the tax information that we provide from our confidential tax records to help inform their decisions on what their inquiries are. A fiscal estimate and revenue neutrality is as of a moment in time. Revenue neutrality does not exist into perpetuity. It's as of the date the bill was passed, because we cannot have neutrality in the world and have that work mathematically into infinity.

So to me, and maybe yours is a different understanding from the others, but when I think of revenue neutrality, it is as of a moment of time, so...

WW: It just seems unusual that they call a bill a "replacement tax" and then completely disconnect from that.

CKD: It's replacing a system; it's not replacing a dollar amount.

RYAN CAHILL (RC): I guess on the data...this is more of a question and I don't know the answer, but the utilities that charge for the therms of natural gas...is that a line item that this committee has, to see how much revenue is collected during the year versus the prior property taxes that were there?

CKD: In 1998?

RC: No, as of today. Because I have heard that it reads that the ones that aren't on bypass...

CKD: We can tell you the ones that were in '98, because that's the most accurate.

RC: No, I am asking today--do the utilities take that money and then pay it to local property tax. As their...

CKD: The replacement tax is paid to the local government.

RC: So is that number available per therm or an aggregate number?

CKD: Is it available per therm or just in an aggregate number?

RS: An aggregate number, because some of that stuff might be used, you know...

CKD: Confidential taxpayer information?

RS: Right.

SE: I might add to that. I'm sensing Mr. Cahill maybe one of the points of your concerns is that...is this matching up with what the old property taxes were. And that was very much a charge for a period of three years. The Legislature enacted kind of a testing evaluation period to see if it worked. Is it lining up or, I don't know, watching out for local governments and schools. Money was still coming in and for a period of three years, there was a mechanism that was kind of complicated and [the Departments of] Management and Revenue had to run this thing where the replacement tax was determined based on the therms and then there was what they called the "general property tax equivalent" computation to see "well, how is this matching up with what the property tax may have been?" With some assumptions, but how would it have been. So for a period of three years there was actually a "true-up." If the replacement tax came in at ninety-five bucks and the equivalent was one hundred dollars, then that extra five dollars kicked in. On the other hand, if replacement tax came in at one hundred-five dollars and the expected property tax equivalent was one hundred dollars, then it went back down to the one hundred dollars. So for a period of three years we had frequent meetings. [We had] extensive data to evaluate "was the thing working or not?" and the records would show both in the minutes from this organization, as well as the old data that we looked at, that they actually did. They came within 1 or 2 percent of what the expectations were, high or low, and so it was maintaining that tax revenue neutrality. I think that was your question. Is it producing the kind of tax that...

MS: ...in the alternative...and that was probably done before there was collection of new tax on ethanol plants.

SE: This would have probably been tax year '99-2000 or 2001.

MS: So there wouldn't have been ...

SE: It was to meet...the question was, "is the system doing what it was intended to do" as a replacement system. Here is a brand new way of getting the taxes from the folks and getting them to the right people in the state. Is it doing that? And it did; it showed. This Task Force met frequently to evaluate that. [The Departments of] Revenue and Management worked those things all the time. Did it pull in the revenues that they were expecting to get? And it did; it basically said we are now comfortable this system works and the legislatively-enacted three-year test period sunsetted and it served its purpose. This system continues to work. As Bill noted earlier, the taxes are a lot more predictable and they have grown over time as one would expect.

WW: So with the onset of a huge biofuels industry that helped the whole state...you don't think that it's pertinent to revisit that to see how close you are now since that clearly was the intent of the law, to see how to put that relationship...

CKD: Why don't we wait until the litigation is done?

SE: We're in the weeds here, but there is another piece of the legislation that basically said concerns by those seeking revenues...what if somebody new shows up, what if somebody leaves, we still want fairly predictable revenues. We still want the money to run schools and cities and so on and counties. And so there is a mechanism that works today. If you have big spikes or valleys there is kind of a threshold where the rate gets reset to ensure fairly constant mathematical growth in the tax revenues. So yes, there was some anticipation of very large new additions or departures of receivers of natural gas. That was factored into the mathematics which continue to exist today and [the Departments of] Revenue and Management re-tweak the rates to make sure that that mitigates those swings. So yes, there was anticipation of major growth or major departure of taxpayers—both--and it functions today in the math that's setting the rate per therm.

CKD: Anyone else have a question?

MS: I would like to make a couple of comments.

CKD: And we are starting to run out of time.

MS: I'll be brief...couple of things; you might know this from a county level. Emmetsburg has a county property tax. Okay, so if Poet builds a plant under the old system, it would have in fact paid taxes, because it would have been taxed on the real property of the bypass pipe. In the new system, because it was then tied to the rate in the municipality, which was 0, because that was a different type of tax, it doesn't get it. So there are some things that are under litigation; a couple of things. There are facts in the litigation which are separate; they were used in the litigation, but they are facts. So we provide a lot of those facts to you guys, so there is nothing to do with the litigation and constitutional questions that were raised. In terms of how the system's running, I don't think anyone here...it sounds like it almost became a debate over the efficacy of the replacement tax. Speaking on behalf of Iowa Renewable Fuels Association, my board has not directed me to question the efficacy of using the replacement tax systems versus the old system. But they have raised questions and I'll get some, I think,

some fairly definitive direction at our next board meeting, September 4th, if I'm reading the tea leaves right, that while this may be, you know, achieving the goals at that 50,000-foot level, when you get down closer and look at the bypass customer and the rate that they are paying in lieu of the old property tax for these pipes, a lot of whom we were forced to build, then we are seeing some inequities. That's not a constitutional question. That is...

CKD: You know what, I hate to interrupt you. We are running out of time and I have to be somewhere. You segued so nicely into our next topic which is the request we received from the Legislature. Hopefully you all saw this in the information that we sent out with the minutes. There are a number of questions that were posed to us as the Task Force, some of which we can respond to as a group as we work through the information that we have, at the Department of Revenue in supporting the Task Force, some of which we'll need help from Cari and Dave from the Department of Management. The thing that I think, where Monte is right on point is that one of the questions posed is asking us to consult with DOM, Revenue, Utilities Division, taxpayers subject to the tax, representatives of local government, etc., etc. and others impacted by the tax. So what I would propose for the Task Force's consideration is that we form some sort of subcommittee or working group that allows us to invite those folks to some meeting that doesn't become unwieldy to start talking about these issues and perhaps have folks submit to us their written comments so that we all have time to digest them. It's very hard to be talking in these high-level concepts and then jumping down into the weeds and understand in the level of detail that we all need to understand to make sure that this is a living, breathing, law that has evolved as it needs to evolve for the times. So I would be interested in feedback from the task force as to whether that's something that you would be interested in doing. I do note that we have a deadline of replying to this correspondence by December 15th of this year. So do you all want to do that in a subcommittee format or do you want to all participate? Thoughts?

DAVE ROEDERER (DR): Subcommittee.

CKD: Thank you, Dave. And how best do you want to select yourselves for the committee? Do you want Dave and me to appoint you? Or would you like to volunteer? I would say we probably need...

DR: Is anybody on the Task Force that is not here?

CKD: Mike Rubino is on the phone, so I think we should make him be on the committee...

MIKE TROMBINO (MT): I heard that.

BP: I would be happy to serve on the committee.

CKD: Thank you, Bill.

SE: I can, as well.

DR: I think Cari will serve on, as well.

CARRIE JOHNSON (CJ): I will.

CKD: Excellent.

DR: Is that what you wanted, Cari?

CJ: Absolutely.

CKD: That's why you came!

JS: I would like to be on it, as well, since we seem to be the subject of much of this discussion. Some of it, anyway.

TIM COONAN (TC): All right, then now I have to be on it.

CKD: Alan, do you not want to participate?

ALAN KEMP (AK): I am happy to be on it, if everyone else is in.

CKD: I guess I would ask the rest of you who are in the room, if you have information that you would like to provide to us in writing, please do that. And I think perhaps we'll want to set some timelines for submission of

data and if you wouldn't mind giving me a few minutes to think about what those timelines should be and we will share with you. We do have all of your email addresses, I hope. Did we ask for that in our list? We will pass the list around one more time, so we can get your email addresses on so we can make sure to communicate with you, and depending on the volume of comments, that will probably dictate when we need to have the next meeting and we will of course notice that, all of those sorts of things as we normally do. And depending upon the written comments, we may ask for additional testimony to come and speak to us and further clarify the written document.

TC: Can I say something real quick?

CKD: Yes.

TC: [The RECs] are in an interesting position; we serve the bulk of the ethanol industry and yet we have no natural gas, so they are very important customers/members of ours. The local REC that serves Walt's plant is supportive of any change that helps their business, but my Association does not have a position, but we are interested in finding the bottom of this and if there is other information that keeps being alluded to. I think Monte had a great suggestion that there is no reason that information can't be recreated outside of the paradigm of litigation.

DS: I totally agree with what Monte said and also, like I said, we can give all the public filings on both sides of litigation that, not surprisingly, include fact sections in the brief, so any, I'm not saying that any, even the arguments that are made I'm just saying what the AG's office will provide are all of the public filings because this is...any proposed legislation isn't for us to take a position on anyway. We just have to...we're charged with defending the laws and that's what we are doing.

TC: I think there would be value in respecting that, respecting a role instead of hitting that brick wall every time it comes up. I think there would be value in recreating, even though it's recreating work that's out there, making that part of the record then we can discuss it. And so I think that's a good suggestion so that's all I have. So thank you for keeping us right on track.

CKD: Anyone else want to make a comment here in the last five minutes?

JW (JON WOLFE): I'm sending a list around. If you would like to put your email address on this if you want to be contacted about submissions of comments and data for this discussion. We can get in touch with you.

CKD: Anyone else? I would take a motion to adjourn?

AP: So moved.

TC: Second.

CKD: All in favor? Everyone said "Aye;" We are adjourned. Thank you so much for coming.

Daniels, Victoria [IDR]

From: Rubino Michael C <RubinoMichaelC@JohnDeere.com>
Sent: Friday, October 03, 2014 11:05 AM
To: Daniels, Victoria [IDR]
Subject: FW: Replacement Tax Task Force Request -- Sent on Behalf of Co-Chairs Kay-Decker and Roederer

Thank you for the opportunity to comment. I want to make it clear that my comments below are as a member of the task force and are not reflective of John Deere. As I look at this issue and all of the other issues that have come before the Task Force, I have to go back to the Iowa Code Section 437A.2 which talks about the purpose of the Replacement Tax and lays out the three guiding principles that the Task Force is charged with. These are:

- Revenue neutrality and debt capacity for local governments and taxpayers
- Neutrality in the allocation and cost impact of any replacement tax among and upon consumers of electricity and natural gas
- Provide a system of taxation which reduces existing administrative burdens on state government

As I thought about the issue, my first thought was similar to ADM issue in Clinton, Iowa that we addressed several years ago. When a company decides to locate a facility or make an investment in a particular location, the taxation of that operations needs to be analyzed as part of the decision process. It is my understanding that the replacement tax has not changed since the decisions were made to locate any ethanol plants in Iowa. Based on this, the location analysis should have included these costs in the decision process.

The other issue about granting an exemption for one type of taxpayer such as ethanol plant seems to create an inequality between other kinds of manufacturers who have to pay the tax. It certainly does not meet the second criteria of neutrality amount consumers.

At first glance, the issue of backfilling the new exemption from the state general fund appears to assist the local government in keeping them revenue neutral. The question here is whether this is a sound budgeting commitment by the state to fund this exemption in the long term. If it is, what prevents other taxpayers from coming to the state and asking for similar treatment. If an exemption is desired, the taxpayer should go to the local taxing jurisdiction and request some of type of contractual relief outside of the tax code, rather than go to the state legislature for special tax relief within the tax code.

The final criteria of easing the administrative burden on the state is not satisfied because a new exemption does not ease any administrative costs.

In summary, the Replacement Tax has been in place for about fourteen years. The tax has created a consistently increasing source of revenue for local governments that is stable and predictable. The legislation has done what it was intended to do and should only be changed or modified when absolutely necessary. At this time, I do not think a case has been made for any change.

Regards,

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Friday, October 10, 2014

Victoria L. Daniels
Public Information Officer & Legislative Liaison
Iowa Department of Revenue
Hoover Building
Des Moines, Iowa 50319

Dear Victoria:

On behalf of Iowa's investor-owned utility companies I represent as a member of the Utility Replacement Tax Task Force, I offer the following comments in response to your September 11, 2014 e-mail request asking, "... for your individual comments and response to the *[July 14, 2014]* request we received from Speaker Paulsen and Senator Gronstal."

By way of background, as you are aware, our industry participated in the development of the Iowa Utility Replacement Tax in 1996, 1997 and through its enactment in 1998. The three principles that guided the development of the new property replacement tax were:

1. **Tax Revenue Neutrality** – for local taxing authorities, utility taxpayers, other payers of property tax, and for customers of the utilities.
2. **Competitive Tax Equity** – for all utility taxpayers in Iowa (IOU's, Muni's, and REC's), regardless of whether or not based in Iowa.
3. **Ease of Administration** – a tax easily calculated and administered by taxpayers and by state and local governments.

Since the law's enactment, our industry and other task force stakeholders have measured any replacement tax issues brought before the task force against those three foundational principles. We strongly urge this long-held, successful task force practice continue.

The requested information from the legislative leaders and my responses are as follows:

*1. **The number and types of taxpayers who currently pay the tax.***

Response: This information is contained in the records of the Iowa Department of Revenue and the Iowa Department of Management.

*2. **The amount of tax being paid by each taxpayer, or if this information is confidential, the amount of tax paid in each competitive service area.***

Response: This information is contained in the records of the Iowa Department of Revenue and the Iowa Department of Management.

3. ***The amount of natural gas consumed by the five grandfathered taxpayers who are exempt from the tax.***

Response: This information should be obtained from those referenced taxpayers.

4. ***The amount of property taxes that would be paid by each taxpayer identified in 1 above if the taxpayer paid locally assessed property taxes at current rates in the respective counties.***

Response: Unknown. Any answer would be purely hypothetical since the local property assessments do not exist and are therefore unknown.

5. ***The allocation and amount of the revenue generated by the tax revenue to local governments and other local taxing districts.***

Response: This information is contained in the records of the Iowa Department of Management.

If you have questions concerning my responses or need further information please don't hesitate to contact me. I look forward to further task force discussion of this issue.

Sincerely,

Steven R. Evans

Steven R. Evans,
Senior Vice President, Taxation
MidAmerican Energy Company

Member, Utility Replacement Task Force
Representing Investor-Owned Utility Companies

IOWA
ASSOCIATION OF MUNICIPAL
UTILITIES

Victoria Daniels
Iowa Department of Revenue

Monday, October 13, 2014

Dear Victoria:

Thanks for the opportunity to provide comments in response to Speaker Paulsen and Majority Leader Gronstal's request for information. I represent the Iowa Association of Municipal Utilities (IAMU) on the Replacement Tax Task Force. IAMU has 52 natural gas utility and 136 electric utility members who are impacted by the utility replacement tax.

IAMU participated in the discussions that led to the development of this legislation. The legislative intent language found at 1998 Iowa Acts, chapter 1194, section 1 and the statement of purpose contained in Iowa Code section 437A.2 both discuss three main principles that guided policy development and consideration for adoption by the 1998 General Assembly. Proposed changes to the replacement tax system should be consistent with these principles of tax revenue neutrality, competitive tax equity and ease of administration. The Replacement Tax Task Force was created in the initial legislation and has been extended over the years. Iowa Code Section 473.15 subsection 7 limits any recommendations put forward by the Task Force to those modifications to chapter 473 that will "further the purposes of tax neutrality for local taxing authorities, local taxing districts, taxpayers and consumers, consistent with the stated purposes of the chapter."

IAMU does not have any of the specific information requested by Legislative Leaders. Information in relation to questions 1, 2 and 5 would perhaps best be provided by the Department of Revenue. It would seem that the amount of natural gas consumed by the five grandfathered bypass customers must come from the grandfathered entities. IAMU is unclear how the appropriate information to answer question 4 would be gathered.

Respectfully,
Julie A. Smith
IAMU Legislative and Regulatory Counsel
Member, Utility Replacement Tax Task Force

IOWA RETAIL FEDERATION

The Voice of Retailing in Iowa

October 15, 2014

Victoria L. Daniels
Public Information Officer & Legislative Liaison
Iowa Department of Revenue
Hoover Building
Des Moines, Iowa 50319

Dear Victoria:

On behalf of the retail customers of Iowa's utility companies I represent as a member of the Utility Replacement Tax Task Force, I offer the following comments in response to your September 11, 2014 e-mail seeking task force member responses and comments to the July 14, 2014 letter the Department received from Speaker Paulsen and Senator Gronstal.

The companies I represent on the task force are themselves significant payers of property taxes, as well as customers of utilities. The primary concerns of these commercial taxpayers with respect to granting any potential property replacement tax breaks for certain industries are:

1. Providing tax breaks for other parties currently subject to utility property replacement taxes (which are treated for all intents and purposes as property tax revenues) creates a very real risk that the property tax burden will then shift to other taxpayers such as owners of commercial properties. Counties, cities and schools will seek to secure needed revenues from those who remain subject to taxation.

2. Even if the shift of taxation is somehow limited only to other parties which are subject to the replacement tax, such as utilities, the increased costs on those parties could indirectly lead, through the regulatory process, to higher costs for gas and electricity consumed by customers of the utilities, including commercial businesses.

Either way, tax breaks for a few merely result in tax cost shifts to others.

Having served on the Utility Replacement Tax Force since it was established by the Legislature, I am aware that the task force is charged with evaluating any proposed changes to the utility property replacement tax statute in accordance with three solid principles:

10555 New York Ave. | Suite 102 | Urbandale, IA 50322-3748 | 515 270-1729 | 800 795-1729 | 515 270-2903 fax | info@iaretail.org | www.iaretail.org

1. Tax revenue neutrality for taxing authorities, utility taxpayers, other payers of property taxes (e.g., commercial property owners) and for customers of utilities (e.g., commercial property owners).

2. Competitive tax equity for all utility taxpayers in Iowa.

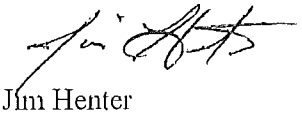
3. Ease of administration for governments and for taxpayers.

It would seem that any proposal seeking a property replacement tax break for existing taxpayers would likely not satisfy these guiding principles and would create the concerns I described above for other taxpayers. If the state of Iowa decides to extend economic assistance to large natural gas users such as ethanol plants, I recommend this assistance instead be instituted outside of the replacement tax system - in a manner which does not adversely impact other taxpayers within existing tax revenue sources.

As to the request for specific information, I would think the Department of Revenue and Department of Management would be best for data requested in items 1, 2 and 5. Information for item 3 I believe would have to come from the entities themselves. I have no suggestions for how to gather information to address item 4.

Thank you for the opportunity to share these comments.

Sincerely,



Jim Henter
President, Iowa Retail Federation
Member, Utility Replacement Task Force

October 15, 2014

Victoria L. Daniels
Public Information Officer & Legislative Liaison
Iowa Department of Revenue
Hoover Building
Des Moines, IA 50319

Dear Victoria:

On behalf of Iowa's electric cooperatives and as a member of the Utility Replacement Tax Task Force, I am pleased to offer the following comments in response to your September 11, 2014 e-mail request asking for our individual comments in response to the July 14, 2014 request the Iowa Department of Revenue received from Speaker Paulsen and Senator Gronstal.

As you are aware we participated in the development of the Iowa Utility Replacement Tax in 1996, 1997 and through its enactment in 1998. There were three basic principles that guided the development of the new property replacement tax as follows:

1. **Tax Revenue Neutrality** - for local taxing authorities, utility taxpayers, other payers of property tax, and for customers of the utilities.

2. **Competitive Tax Equity** - for all utility taxpayers in Iowa (IOU's, Muni's, and electric cooperatives), regardless of whether or not based in Iowa.

3. **Ease of Administration** - a tax easily calculated and administered by taxpayers and by state and local governments."

Electric cooperatives provide service to much of the renewable fuels industry so we are very sensitive to their concerns. However, any proposed changes to the replacement tax system must be measured against the above-listed principles.

"The requested information from the legislative leaders and our responses are as follows:

1. ***The number and types of taxpayers who currently pay the tax.***

Response: We assume this information is contained in the records of the Iowa Department of Revenue and the Iowa Department of Management.

8525 Douglas, Suite 48 Des Moines, Iowa 50322-2992 phone: 515.276.5350 fax: 515.276.7946 www.iowarec.org

Iowa Association of
Electric Cooperatives
A Touchstone Energy® Cooperative

2. ***The amount of tax being paid by each taxpayer, or if this information is confidential, the amount of tax paid in each competitive service area.***

Response: We assume this information is contained in the records of the Iowa Department of Revenue and the Iowa Department of Management.

3. ***The amount of natural gas consumed by the grandfathered taxpayers who are exempt from the tax.***

Response: This information should be obtained from those referenced taxpayers.

4. ***The amount of property taxes that would be paid by each taxpayer identified in 1 above if the taxpayer paid locally assessed property taxes at current rates in the respective counties.***

Response: Unknown. Any answer would be purely hypothetical since the local property assessments do not exist and are therefore unknown.

5. ***The allocation and amount of the revenue generated by the tax revenue to local governments and other local taxing districts.***

Response: This information is not available to us but should be contained in the records of the Iowa Department of Management or other Iowa governmental records."

Please do not hesitate to contact me should you have any question concerning this matter. I look forward to participating in future Task Force discussions.

Sincerely,

Tim Coonan
Director, Government Relations
Iowa Association of Electric Cooperatives
8525 Douglas Avenue, Suite 48
Des Moines, IA 50322-2992

5500 Westown Parkway, Suite 190
West Des Moines, IA 50266
PHONE: 515.244.7181
FAX: 515.244.6397
www.iowacounties.org

ISAC
Iowa State Association of Counties

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October 15, 2014

Victoria L. Daniels
Public Information Officer & Legislative Liaison
Iowa Department of Revenue - Hoover Building
Des Moines, Iowa 50319

Re: Utility Replacement Tax Task Force Information Request by Legislative Leadership

Dear Victoria:

As a long-time member of the Replacement Tax Task Force, I want to thank you for sharing the information request from Speaker Paulsen and Senate Majority Leader Gronstal relating to the tax imposed on natural gas. I am hoping the Department can develop the requested information and look forward as a member to reviewing the information prior to it being sent to Legislative Leadership. Our association does not have the capacity to generate the information or to provide the sort of data being requested.

I would like to comment on the Utility Replacement Tax and the Task Force's role in the administration of the Replacement Tax since its enactment in 1998. As the association's executive director during the period when the replacement tax system was developed, I was directly engaged in extensive discussions with taxpayers and other stakeholders over a two year period about the tax system proposal prior to adoption. There were three fundamental principles that were at the core of these discussions – tax revenue neutrality, competitive tax equity and ease of administration. Subsequent to enactment and implementation, as a Task Force member, we have reviewed and recommended changes to the tax system from time to time, using those same principles to guide recommendations to the Legislature and Governor. The Task Force members represent a broad array of constituencies from taxing authorities to tax paying entities. I have observed a rare sense of cooperative purpose among this group – considering the topic deals with the imposition and payment of a tax.

It is my understanding that the information was requested because of a concern about whether there has been an "inequitable application" of the tax related to natural gas. As mentioned above, I am interested as a Task Force member to see whether the information requested would provide evidence of this concern. I have confidence that the Task Force is capable of reviewing and making a recommendation based on that evidence. Absent any evidence of such an inequity in my view, a change in the system would likely result in a shift in the tax burden from one taxpayer to another.

Sincerely,

William R. Peterson
Executive Director

500 SW 7th Street, Suite 101
Des Moines, IA 50309-4506
www.iowaleague.org

IOWA LEAGUE of CITIES

October 16, 2014

Victoria L. Daniels
Legislative Liaison
Iowa Department of Revenue
Hoover State Office Building
1305 East Walnut Street
Des Moines, IA 50319

Dear Ms. Daniels:

The Iowa League of Cities offers this response to your recent request for comments regarding Iowa's utility replacement tax and a recent request for information by Senator Gronstal and Speaker Paulsen. As you are aware, the League was heavily involved in the development of the Utility Replacement Tax System in the late 1990s and someone from the organization has always served on the Utility Replacement Tax Task Force. This group was developed under Iowa Code section 437A.15, subsection 7, to address legislation and issues related to the utility replacement tax in Iowa.

My goals as a Utility Replacement Task Force member are to address this issue in terms of "furthering the purposes of tax neutrality for local taxing authorities, local taxing districts, taxpayers and consumers, consistent with the state purposes of the chapter," seeking competitive tax equity for all utility taxpayers in Iowa, and supporting the ease of administration for governments and taxpayers." The Task Force and the Iowa League of Cities should continue to be concerned about and avoid reduction of tax revenues to local governments, and in shifting tax burdens to others.

Although the League is more than willing to help out with related requests, and appreciates the opportunity to do so, the information requested in the July 14, 2014 letter is not data that the Iowa League of Cities currently has available. The Department of Revenue in conjunction with the Iowa Department of Management may be the best sources from which to gather the information necessary. The Legislature as well as the Task Force may be better able to analyze the information upon its compilation.

Thank you for the opportunity to respond and apologies for not being of more assistance. But, we look forward to analyzing information that would come before the Task Force. Please let me know if you have any questions or concerns.

Sincerely,

Alan W. Kemp

Alan W. Kemp
Executive Director

Iowa Renewable Fuels Association
5505 NW 88th Street #100 · Johnston, IA USA 50131-2948 · 515-252-6249 FAX 515-225-0781

October 17, 2014

Victoria L. Daniels
Legislative Liaison
Iowa Department of Revenue
Hoover State Office Building
1305 East Walnut Street
Des Moines, IA 50319

Dear Ms. Daniels:

As the state's largest trade association representing Iowa's ethanol and biodiesel producers, the Iowa Renewable Fuels Association (IRFA) appreciates the opportunity to respond to the recent request for information by Senator Mike Gronstal and Speaker Kraig Paulsen, as well as the subsequent request for comments by the Utility Replacement Tax Task Force, regarding Iowa's utility replacement tax.

In the past, the Utility Replacement Tax Task Force has reviewed Iowa's utility replacement tax from a "50,000 foot level," determining the policy to be working just fine. While that may be true at the highest level, a review nearer to the ground, specifically of individual natural gas consumers which directly connect to interstate pipelines (hereafter referred to as "bypass customers"), clearly demonstrates vast inequities that no one can defend as fair and reasonable. IRFA is deeply troubled by the competitive disadvantages and inequitable taxation caused by the application of Iowa Code section 437A.5, subsection 2 (hereafter referred to as 437A.5(2))—results which were never envisioned at the outset of the law and serve no public policy justification.

Specifically, IRFA has identified the following concerns regarding 437A.5(2) as it applies to bypass customers:

1. While nearly all other utility replacement taxpayers' rates are based on the value of their own assets, under 437A.5(2), bypass customers are subject to a rate of taxation that is completely divorced from the value of their own assets. Because their replacement tax rates are unconnected to any of their activities and the value of their assets, bypass customers are generally unable to impact their replacement tax rates in one way or another. Bypass customers should have the opportunity to pay a replacement tax rate that is based on the value of their own assets.

2. 437A.5(2) is discriminatory in that it causes similarly situated bypass customers to pay significantly different replacement tax rates based solely on their location. For example, some bypass customers pay replacement tax rates that are four times higher than other bypass customers. In other municipal locations, the rate for a bypass customer could be zero. Similarly situated bypass customers should be subject to similar replacement tax rates, regardless of location.

October 17, 2014

3. Certain bypass customers are subject to unreasonably and unjustifiably high rates of taxation due to 437A.5(2). For example, at least one bypass customer pays an effective tax rate of over 100% when compared to the value of its pipeline (as pointed out in #1 above, the actual replacement tax rates for bypass customers have no connection to the value of their assets, and this example is illustrative of this major flaw in 437.A5(2)). Similarly, a bypass customer may pay up to 295% more per unit for natural gas than the amount that is allocated by the large general service class for the same local distribution company. Finally, the tax impact on certain bypass customers may be up to 17 times higher than it would be under a traditional property tax structure. Bypass customers should not be burdened with unreasonable and unjustifiable over-taxation.

4. As a result of 437A.5(2), certain bypass customers are not subject to the replacement tax based solely on the date their facilities began operation. Rather than paying the replacement tax, these bypass customers pay locally assessed property taxes based on the value of their assets. All bypass customers should have the opportunity to pay a locally assessed property tax on their assets, regardless of the date their facilities went into service.

Thank you for your consideration of these comments. IRFA stands ready to work with the Utility Replacement Tax Task Force on resolving any of the issues identified in these comments, and we would welcome the opportunity to meet with you to discuss any of these concerns. If you have any questions, please contact me at (515) 252-6249 or mshaw@iowarfa.org.

Sincerely,

Monte Shaw

Monte Shaw
Executive Director

DAVISBROWN LAW FIRM

REPLY TO DES MOINES OFFICE

October 17, 2014

Iowa Utility Replacement Tax Task Force
c/o Victoria L. Daniels
Legislative Liaison
Iowa Department of Revenue
Hoover State Office Building
1305 East Walnut Street
Des Moines, IA 50319

Re: The Bypass Replacement Tax

Dear Utility Replacement Tax Task Force Members:

We respectfully submit this document on behalf of our clients in response to your September 17, 2014 request to provide information regarding the Iowa replacement tax applied to Iowa bypass natural gas consumers under Iowa Code § 437A.5(2). We call this tax the Bypass Replacement Tax. Your request originates from the request of Legislative Leaders Senator Gronstal and Representative Paulsen pursuant to their letter dated July 14, 2014. Our clients include nine of the eighteen Bypass Replacement Taxpayers known to us. This includes eight fuel ethanol manufacturing plants and one biodiesel manufacturing plant. The remaining Bypass Replacement Taxpayers known to us are also renewable fuels manufacturing companies.

Requested Facts

Senator Gronstal and Representative Paulsen have asked that you provide the following information, which we respectfully submit.

1. *The number and types of taxpayers who currently pay the tax.*

Attached as Exhibit A is the list of the eighteen present Bypass Replacement Taxpayers of which we are presently aware.

2. *The amount the tax being paid by each taxpayer, or if this information is confidential, the amount of tax paid in each competitive service area.*

Attached as Exhibit B is the list of six of our clients who have consented to allow us to provide their replacement tax payments to the Task Force. We have limited this information to the taxes paid during the last three years.

PHONE 515.288.2500 FIRM FAX 515.243.0654
WEB WWW.DAVISBROWNLAW.COM
THE DAVIS BROWN TOWER
215 10TH STREET, STE. 1300
DES MOINES, IA 50309
THE HIGHLAND BUILDING
4201 WESTOWN PKWY, STE. 300
WEST DES MOINES, IA 50266
THE AMES OFFICE
2005 NORTHRIDGE PKWY, STE. 101
AMES, IA 50010

3. *The amount of natural gas consumed by the five grandfathered taxpayers who are exempt from the tax.*

We are not presently aware of any state or federal regulatory agency which collects and publishes the natural gas consumption data of the five grandfathered companies. The replacement taxpayers are required to report this information to the Department of Revenue on Replacement Tax Return Form B. In lieu of the public availability of information, ethanol plants such as Grain Processing Corporation in Muscatine are known to utilize between 5,000 and 10,000 mmbtu per day over a 360 day manufacturing year. Accordingly, we believe that Grain Processing Corporation, for example, uses between 1,800,000 mmbtu and 3,600,000 mmbtu annually. Similarly, the CF Industries fertilizer plant near Port Neal is believed to utilize approximately 50,000 mmbtu per day over a 360 day manufacturing year. Accordingly, we believe that CF Industries near Port Neal utilizes approximately 18,000,000 mmbtu annually. For comparison purposes, the Little Sioux Corn Processors ethanol plant near Marcus utilizes approximately 2,822,000 mmbtu per year. Neither Grain Processing Corporation nor CF Industries pay replacement taxes upon their therms nor local property taxes upon their natural gas pipelines. In 2014, Little Sioux Corn Processors paid $300,570.50 in Bypass Replacement Taxes. We believe that this is inequitable, and that Bypass Replacement Taxpayers should be allowed to pay a fair tax based upon their own assets.

4. *The amount of property taxes that would be paid by each taxpayer identified in 1 above if the taxpayer paid locally assessed property taxes at current rates in the respective counties.*

Attached as Exhibit C is the October 14, 2014 report of the Stradley Group. The Stradley Group consists of Richard Stradley and Alan Harding, both of whom previously administered the replacement tax for the Department of Revenue. Their attached report concludes that the subject taxpayer annually pays approximately forty-five (45) times more replacement tax than it would pay property tax if locally assessed upon its own assets.

5. *The allocation and amount of the revenue generated by the tax revenue to local governments and other local taxing districts.*

Although complete information about Bypass Replacement Tax payments to all counties is not readily available to us, the counties receiving Bypass Replacement Tax proceeds are listed at Exhibit A. Although there are eighteen listed Bypass Replacement Taxpayers, there are only seventeen listed counties. Kossuth County has two Bypass Replacement Taxpayers.

Exhibit B lists the Bypass Replacement Tax proceeds received by the 6 counties listed in this Exhibit, including the proceeds received by Kossuth County from one of its two Bypass Replacement Taxpayers.

Analysis

The information requested by the Legislative Leaders yields two ready conclusions. First, the fact that the Bypass Replacement Taxpayer pays forty-five times more replacement taxes than it would pay property taxed is grossly unfair. On the date seventeen years ago that Chapter 437A was enacted, five taxpayers were grandfathered and exempt, and 52 taxpayers including the investor

owned utilities and municipal utilities were given a replacement tax based upon their own taxable assets. Taxing the Bypass Replacement Taxpayers based upon the taxable assets of the local investor owned utilities yields this queer and inequitable forty-five times result.

Second, the seventeen counties having Bypass Replacement Taxpayers have a competitive advantage over the other 82 counties. These seventeen counties, all other things being equal, enjoy forty-five times more tax revenue from their Bypass Replacement Taxpayers than they would otherwise have. This provides surplus revenue for community and economic development within these counties as compared to the other counties also seeking to attract both residents and businesses.

Iowa Code Chapter 437A places other inequities upon the Bypass Replacement Taxpayers all of which happen to be renewable fuels companies located in rural areas. With respect to natural gas consuming renewable fuels companies, there are four types of replacement taxpayers: 1) thirty-three customers of Local Distribution Companies, 2) one bypass consumer exempt from the tax because it is within two-miles of the municipal utility in Emmetsburg, Iowa, 3) one grandfathered bypass consumer located in Muscatine, and 4) eighteen Bypass Replacement Taxpayers.

Customers of Investor Owned Utilities

The large general service (industrial) natural gas customers of IOUs, including other renewable fuels producers, pay substantially less replacement taxes than do the Bypass Replacement Taxpayers. Attached as Exhibit D is the Supplemental Expert Witness Report of Casey Whelan of US Energy Services. Little Sioux Corn Processors utilized this report in the 2012 evidentiary hearing in its tax appeal. Little Sioux Corn Processors is in the MidAmerican Energy competitive service area. Mr. Whelan, who is an expert in the area, reviewed the tariff application of MidAmerican Energy and concluded that the rate of replacement tax paid by Little Sioux Corn Processors is 295% greater than that of other large general service customers of the investor owned utility. This result from the Iowa Utilities Bureau granting a tariff that allows the IOU to shift a portion of the replacement tax away from its industrial customers and toward its residential customers. The tariff also allows the IOU flexibility to discount its distribution tariff rate to below its replacement tax rate. This is set forth in the attached Exhibit E (Q#14) which is the original expert witness report of Casey Whelan.[1] In such event, the replacement tax would be zero. Although the General Assembly probably did not intend these competitive disadvantages for the Bypass Replacement Taxpayers, none of which existed when Chapter 437A was enacted in 1997, Iowa Code § 437A requires amendment in light of these facts.

The Muni Halo Replacement Tax Exempt Plant

Chapter 437A provides a strange although complete exemption for one large general service natural gas consumer which is an ethanol plant. The statute applies the replacement tax rate of Emmetsburg Municipal Utilities to Poet Bio-Refining Emmetsburg. This ethanol plant is not a customer of Emmetsburg Municipal Utilities; it collects its natural gas off of the interstate pipeline via its own lateral pipeline, exactly as do the Bypass Replacement Taxpayers. However, because of a quirk in Chapter 437A, this taxpayer is completely exempt from the replacement tax. It is exempt because it

[1] Mr. Whelan's *Expert Report on the Economic and Competitive Effects of the Iowa Replacement Tax,* dated April 27, 2012, at Exhibit E is a good general primer on the Bypass Replacement Tax inequities.

happens to be within the two-mile halo of the Emmetsburg City limits. Because Emmetsburg Municipal Utilities is city owned, and cities do not pay property taxes, there was no property tax of the municipality to replace by Chapter 437A. Accordingly, the replacement tax rate for the EMU competitive service area is zero. A zero rate yields zero tax. Also, because this large general service consumer is technically subject to the replacement tax, it is not also subject to locally assessed property taxes on its natural gas pipeline. It therefore enjoys a double exemption. Alternatively, the Bypass Replacement Taxpayers pay tremendous taxes, many multiples of their fair property tax rates, based upon their own assets.

Grandfathered Large General Service Natural Gas Consumer:
Grain Processing Corporation, Muscatine, Iowa

Because Grain Processing Corporation existed prior to the replacement tax, it was grandfathered at the time that Chapter 437A was adopted. That is, it continues to be subject to local assessment, although The Stradley Group found that it is not assessed property taxes based upon its natural gas pipeline asset as discussed in Exhibit C. Grain Processing Corporation is listed as a grandfathered and therefore exempt large general service natural gas consumer on the expert witness report of Casey Whelan at Exhibit E. Like Poet Bio-Refining Emmetsburg, Grain Processing Corporation has a de facto double exemption. The Bypass Replacement Taxpayers do not seek an exemption. They merely want a fair tax based upon their own assets.

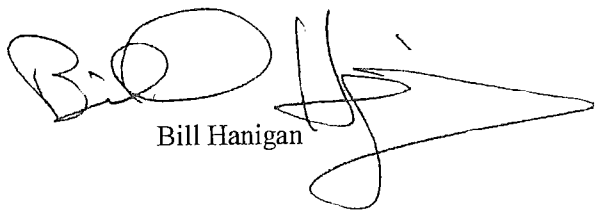
Conclusion

Our clients do not seek a tax exemption, and they do not want to become customers of local distribution companies. Instead they want the same deal that the other 52 replacement taxpayers received. They want to pay a fair tax to their counties based upon their own assets.

Thank you for this opportunity to provide information. Our clients, our consulting experts, and we are available to answer any questions and provide additional documents and information.

Respectfully,

DAVIS, BROWN, KOEHN, SHORS & ROBERTS, P.C.



Bill Hanigan

Attachments

EXHIBIT A

	Name	Address	County of Taxable Activity
1.	Valero-Albert City	2356 510th Street Albert City, IA 50510	Buena Vista
2.	Otter Creek Ethanol	4970 260th Street Ashton, IA 51232	Osceola
3.	Poet Biorefinery – Jewell	2601 320th Street Jewell, IA 50130	Hamilton
4.	Flint Hills Resources – Menlo	3363 Talon Avenue Menlo, IA 50164	Guthrie
5.	Little Sioux Corn Processors	4808 F Avenue Marcus, IA 51035	Cherokee
6.	Plymouth Energy, LLC	22234 K-42 Merrill, IA 51038	Plymouth
7.	Valero-Charles City	1787 Quarry Road Charles City, IA 50616	Buena Vista
8.	AGP Algona	2108 140th Avenue Algona, IA 50511	Kossuth
9.	Southwest Iowa Renewable Energy	10868 189th Street Council Bluffs, IA 51503	Pottawattamie
10.	Flint Hills Resources – Shell Rock	30750 212th Street Shell Rock, IA 50670	Butler
11.	Green Plains Holdings II, LLC	1660 428th Street Lakota, IA 50451	Kossuth
12.	Absolute Energy	1372 Slate Line Road St. Ansgar, IA 50472	Mitchell
13.	Iowa Ethanol	3638 First Avenue Hanlontown, IA 50444	Worth
14.	Homeland Energy Solutions	2779 Hwy 24 Lawler, IA 52154	Chickasaw
15.	Green Plains Superior, LLC	1495 320th Avenue Superior, IA 51363	Dickinson
16.	Poet Biorefining – Gowrie	1562 320th Street Gowrie, IA 50543	Webster
17.	Louis Dreyfus Commodities	1149 U Avenue Grand Junction, IA 50107	Greene
18.	Corn, LP	1303 Hwy 3 East Goldfield, IA 50542	Wright

#2520385

EXHIBIT B

1. LSCP, LLLP — Cherokee County

Tax Period	March	September	Total
2012	$ 157,534.00	$ 157,668.50	$ 315,202.50
2013	$ 157,668.50	$ 159,166.00	$ 316,834.50
2014	$ 159,166.00	$ 141,404.50	$ 300,570.50
Total			$ 932,607.50

2. Plymouth Energy — Plymouth County

Tax Period	March	September	Total
2012	$ 79,633.00	$ 85,649.50	$ 165,282.50
2013	$ 85,649.50	$ 73,317.50	$ 158,967.00
2014	$ 73,317.50	$ 66,749.50	$ 140,067.00
Total			$ 464,316.50

3. Ag Processing Inc a cooperative — Kossuth County

Tax Period	March	September	Total
2012		$ 3,631.50	$ 3,631.50
2013	$ 3,631.50	$ 7,715.50	$ 11,347.00
2014	$ 7,715.50	$ 8,655.00	$ 16,370.50
Total			$ 31,349.00

4. Southwest Iowa Renewable Energy — Pottawattamie County

Tax Period	March	September	Total
2012	$ 34,576.50	$ 30,243.50	$ 64,820.00
2013	$ 30,243.50	$ 128,095.50	$ 158,339.00
2014	$ 128,095.50	$ 51,051.00	$ 179,146.50
Total			$ 402,305.50

#2520451

5. Louis Dreyfus Commodities LLC Greene County

Tax Period	March	September	Total
2012	$ 105,626.50	$ 107,583.00	$ 213,209.50
2013	$ 107,583.00	$ 114,977.50	$ 222,560.50
2014	$ 114,977.50	$ 110,970.50	$ 225,948.00
Total			$ 661,718.00

6. Corn, LP Wright County

Tax Period	March	September	Total
2014	$ -	$ 30,724.00	$ 30,724.00
Total			$ 30,724.00

EXHIBIT C

Utility Replacement Tax Compared to Locally Assessed Connection Pipeline

October, 2014

Prepared by

Richard Stradley
Alan Harding

THE
STRADLEY GROUP

A Property Tax Consultant and Litigation Support Service

Utility Replacement Tax Compared to Locally Assessed Connection Pipeline

The Stradley Group appreciates the opportunity to serve the Davis Brown Law Firm as your property tax consultant. Richard Stradley and Alan Harding will be responsible for providing this service. Attached at the end of this report is the credentials of the experts. Both Stradley and Harding while employed by the State of Iowa conducted commercial, industrial, public utility and railroad appraisals. Both Stradley and Harding administered the Utility Replacement Tax Program during their careers with the state.

The scope of the project is to compare what a taxpayer currently pays under the replacement tax system vs what a taxpayer would pay in property taxes if locally assessed. This analysis made a comparison of the estimated locally assessed property tax liability to the current replacement tax liability for each taxpayer within the selected sample.

Locally Assessed Valuation Method

The local assessor is charged with the responsibility to assess all real property at fair market value. Market value of a property is an estimate of the probable price it would sell for on the open market, with a "willing buyer and willing seller."

The standard appraisal process generally uses three approaches to value: The market approach, income approach, and the cost approach.

In this analysis, the cost approach (replacement cost less depreciation) was the only relevant approach used to value the selected sample of property in this report.

The market approach cannot be calculated because valid sales of bypass pipelines do not exist. The income approach also cannot be calculated because no economic rent data is available for bypass pipelines. Therefore, the cost approach method must be utilized in the appraisal process for this analysis.

Replacement Tax

Iowa Code Chapter 437A was developed to replace property taxes with a tax based to preserve revenue neutrality for local governments and taxpayers. The tax is imposed on electric and natural gas companies in the state. Replacement tax means the tax imposed on the generation, transmission, delivery, consumption, or use of electricity or natural gas.

Local Review

For this study, a random sample was utilized to determine three (3) companies to review as to determine the assessed value of the connection pipeline of properties grand-fathered into the replacement tax, in other words they were attached to an interstate pipeline on January 1, 1999.

The three selected are as follows:

1. Mills County, Bunge Soybean Plant, Bunge North American, Inc.
2. Webster County, KOCH Industries, KOCH Nitrogen Company, LLC
3. Muscatine County, Grain Processing Corporation (GPC)

These properties are engaged in agricultural processing and the direct connection to the interstate pipeline took place prior to when the replacement tax was enacted and were to be assessed locally.

We obtained property records from three assessing jurisdictions that had bypass pipeline facilities already in existence as of January 1, 1999. These facilities were not subject to the replacement tax pursuant to section 437A.5(7) of the Code of Iowa.

During this analysis, we reviewed a facility in Mills County, where we obtained and reviewed the most recent property record cards for Bunge North American, Inc. This plant owns an interconnect facility or bypass pipeline that is connected to Northern Natural Gas Company. There was no indication in the reports that the bypass pipeline property for this company is being assessed. The assessor was questioned if the bypass pipeline was being valued in the appraisal report and they replied no. We asked if the assessor was valuing any natural gas pipeline property in their jurisdiction and again their answer was no. It is clear after reviewing the property records of Bunge North American, Inc. in Mills County that the assessor is not assessing the bypass pipeline facility for this company.

We visited Webster County and obtained the current property record cards and Vanguard Appraisal report completed in 1999 for KOCH Nitrogen Company, LLC. This facility has a bypass pipeline that is connected to Northern Natural Gas Company. Again after reviewing these records, there is no indication that the bypass pipeline facility for this company is being assessed. The assessor stated that they are not assessing this bypass pipeline nor are they assessing any natural gas pipeline property in Webster County.

The last county we made a review in was Muscatine County where we obtained the property record cards and 2005 Vanguard Appraisal report for Grain Processing Corporation (GPC). GPC has a bypass pipeline that interconnects with Natural Gas Pipeline of America. The bypass pipeline for this facility is not contained in the assessment reports and the assessor acknowledged this fact and stated that he is not assessing any natural gas pipeline property in Muscatine County.

In each case, these bypass pipeline facilities are not subject to the replacement tax but are subject to local assessment of the bypass pipeline. However, after our review, it is apparent that none of the facilities are being locally assessed and the taxpayers are not paying any property taxes on these bypass facilities.

Locally Assessed Example of Bypass Pipeline

Based on actual cost data obtained and a review of Iowa Real Property Appraisal Manual, we were able to calculate an example for an assessment of a connection pipeline if it was locally assessed. We also calculated a comparable replacement tax based on actual (confidential) data to make a comparison. The example, based on actual data, depicts the difference between being locally assessed as compared to the current utility replacement tax for this taxpayer. The example below shows the current replacement tax of a taxpayer who owns a bypass pipeline facility as $300,570. The estimated property tax is $6,493. The difference between these taxes in this comparison is substantial, $294,077.

Actual Cost Adjusted For Time	Depreciation	Assessed Value	Tax Rate $0.39	2014 Replacement Tax	RT Difference
$ 320,176	$ 153,684	$ 166,492	$ 6,493	$ 300,570	$ 294,077

The actual installed cost along with public data was used to determine the replacement cost. The calculation of depreciation was based on the Iowa Real Property Appraisal Manual and data observed from Internet based information. The tax rate was based on information gathered from the assessors during the field review of properties. The tax rate sample average was $39 per thousand and the median was $40 per thousand. We used $39 per thousand, the lower of the averages. The replacement tax paid was based on actual confidential data.

Final Conclusion

The Iowa Utility Replacement Tax was implemented in 1999 by the Iowa Department of Revenue and the Iowa Department of Management along with input from utility stakeholders. This tax replaced the property tax system for natural gas and electric distribution utility companies with a tax on generation, delivery of natural gas and electricity to consumers, and a tax on transmission lines. This study deals with the impact of natural gas deliveries to consumers, who have built bypass pipeline facilities that interconnect with the interstate pipelines. These bypass consumers are responsible for paying the replacement tax on the deliveries of natural gas to their facility pursuant to section 437A.5(2).

The study also reviews the property tax liability of three taxpayers that owned bypass pipeline facilities that were attached to interstate pipelines on January 1, 1999 and are not subject to the replacement tax pursuant to section 437A.5(7).

The three locally assessed companies that were reviewed which had bypass facilities attached on January 1, 1999 are industrial facilities and are assessed locally on a going concern value. These companies are not utility companies or natural gas pipeline companies whose primary business is delivering natural gas to consumers; they are industrial plants. The connecting bypass pipeline is a part of the industrial plant and would be included in any sale of an industrial facility. It is clear that the replacement tax was calculated from utility companies' prior property taxes and these bypass facilities are not utility companies. There is no equal comparison to the functions or tax liabilities of a gas utility company as compared to an industrial bypass pipeline. In fact the property tax data used to calculate the replacement tax was based on the utility companies assessed value, which would include property that would not be assessed or taxable for locally assessed property. It must be noted that industrial property is assessed locally under Iowa Code Chapter 441 and not assessed as a utility company under any chapter in the Code of Iowa that is assessing utility companies, including chapter 437A. After the review of several documents in the assessing jurisdiction where these three facilities were located, that the assessor was found to not be valuing the bypass pipeline. The assessed value was $ - 0 – and the property tax liability was $ - 0 -.

This study does not intend to dictate how bypass pipelines should be assessed that was attached as of January 1, 1999. This study is being utilized to compare the property tax liability that would exist for bypass pipelines as compared to the current replacement tax for those same bypass facilities attached after January 1, 1999.

Final Conclusion (Continued)

We reviewed the estimated property tax vs current replacement tax for a taxpayer who pays the replacement tax as a consumer on deliveries of natural gas through their bypass pipeline facility. As stated earlier when calculating a replacement tax for taxpayers that are not utility companies, which is the case for this company, the comparison of replacement tax to property tax is substantially different in tax liability. The delivery tax rates that were calculated for all service areas were calculated from prior year property taxes of utility companies, and the replacement tax was revenue neutral in tax dollars allocated to local taxing jurisdictions. That determination is not true when you review the tax comparisons for bypass facilities; there is no revenue neutrality here because the estimated property tax is substantially less than the replacement tax for these taxpayers. Some of this discrepancy can be attributed to the fact that the bypass facility is part of the industrial facility that is locally assessed and the replacement tax calculations are more equal to prior utility property taxes. These are two separate classes of taxpayers and the mix and match of property taxes and replacement taxes is not equivalent in this comparison.

After reviewing all the information gathered for this report, we find that the initial replacement tax did not address the concerns of the large consumers of natural gas through bypass pipeline facilities. The replacement tax liability for these companies far exceeds what would be paid in property taxes on the bypass pipeline.

We conclude that a review of the current method of taxation on bypass pipelines needs to be addressed after the results of this report.

THE STRADLEY GROUP

A Property Tax Consultant and Litigation Support Service

The Stradley Group provides expert advice in property tax and assessment methods to assist our clients in an effort to arrive at tax fairness.

About Richard Stradley

Richard Stradley is The Stradley Group's owner with over 39 years of experience in property tax. He most recently served as the Chair of the statewide Property Assessment Appeal Board. Prior to his time with the Board, Stradley was with the Iowa Department of Revenue for 33 years. During that time, he served as the Administrator of Property Tax.

He received his degree in economics and has been an economics instructor at Grand View College, testified in state and federal court as an expert in property tax valuation and tax policy, and written and published articles regarding property tax issues.

He has served on state, national, and international committees and boards relating to property tax and has obtained several professional designations dealing with appraisal theory. He is a member of the Iowa Association of Administrative Law Judges and the National Association of Administrative Law Judiciary.

The Stradley Group Services

Litigation Support

Legal services include consulting and analysis regarding expert testimony assistance, discovery and trial strategy. We offer comprehensive services to help customers manage and mitigate property taxes to achieve tax savings.

Property Tax Consultant Support

We offer support in developing methods to help improve and reform the property tax system. We offer assistance to various tax advisory groups in amending and creating tax legislation.

The Stradley Group is committed to achieving quality results for our clients exceeding their expectations.

THE STRADLEY GROUP

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About Alan Harding

Alan Harding is an associate of The Stradley Group with over 32 years of experience in property tax. He worked for the Iowa Department of Revenue from 1978-2010 with an emphasis on utility and railroad valuations as the Chief Utility Appraiser in the Property Tax Division. In 1999, he became responsible for the implementation and administrative duties of the utility replacement tax.

He received a Bachelor of Science Degree in business administration from William Jewell College in 1974. During his employment with the Iowa Department of Revenue, he testified in numerous state and federal court cases on utility and railroad valuation issues. He also has written and published articles regarding utility valuation matters.

He received the Certified Assessment Evaluator professional designation from the International Association of Assessing Officers in 1987 and received the Iowa Certified Assessor designation from the Institute of Iowa Certified Assessors in 1980.

EXHIBIT D

SUPPLEMENTAL EXPERT REPORT OF CASEY D. WHELAN

Purpose of the Supplemental Expert Report. The Export Report I initially submitted discussed the origin and application of the Iowa Replacement Tax (IRT) generally, and specifically the impact on LSCP, LLC (LSCP). I also discussed the tariff rates of MidAmerican Energy Company (MidAm). The purpose of the Supplemental Expert Report is to clarify how MidAm recovers the IRT in retail rates.

Questions:

Q. Does MidAm recover the same IRT unit revenues from Large General Service (LGS) customers (which would include companies such as Little Sioux and other ethanol plants) as LSCP pays as a direct connect customer taking service in the MidAm Competitive Service Area (CSA)?

A. No. It appears LSCP pays a unit rate roughly three times higher than the recovery factor included in retail rates for the rate class under which LSCP would take service if they were a MidAm retail customer.

Q. Please explain how you came to this conclusion?

A. As previously discussed LSCP currently pays an IRT rate of $.01057 for each therm received by LSCP. The rate can change each year and has ranged $.01018 to $.01103 per therm over the past five (5) years. In order to compute the IRT amount included in MidAm retail rates I reviewed MidAm's last general rate case which was filed March 15th, 2002. A Settlement in the case was filed July 15th, 2002 and a final order issued November 8th, 2002. (MidAmerican Energy Company Request for Natural Gas Rate Increase Docket No. RPU-02-2) MidAm included a test year Property Tax liability equal to $11,857,987 and test year throughput equal to 1,171,736,901 therms. The Property Tax rate per therm is $.01012 using the numbers included in the MidAm filing, which is fairly close to current and historic IRT rates.

Q. Did MidAm equally apply the $.01012/therm unit rate to all rate classes?

A. No. MidAm allocated different unit amounts to each customer class. LGS customers were allocated much less per unit that other classes.

Q. Explain how that happened?

A. There was a multiple step process used to allocate Property Taxes to customer classes. First, Property Taxes were assigned to functional categories based on Gross Plant for each functional category. Second, each functional cost allocation was further allocated to customer classes. A variety of allocators were used to allocate functional costs to customer classes. For example, "Services" functional costs were allocated based on Weighted Number of Customers while "Mains (peaking)" functional costs were allocated on Design Day. Once the functional costs are allocated to specific customer classes, the unit cost allocation can be estimated by dividing the sum of Property Taxes allocated to the LGS class ($618,283) by LGS throughput (180,102,172 therms). The allocated unit rate is $.00343/therm, roughly 1/3 the unit rate LSCP pays ($00343/$.01057 = .3245). Put another way, LSCP pays a rate three (3) times higher than the rate included in MidAm's LGS rate based on information included in their rate application. More detail, as well as documentation and references, can be found on Table 1 and 2 attached.

Q. During the discussion above you refer to the IRT as a Property Tax in the context of the MidAm rate case. Can you explain why you are using that term?

A. Yes. I am using the same terms used by MidAm in their rate application. In all places I found discussion or reference to the IRT, MidAm used the term Property Tax. For example, in the direct testimony of Naomi G. Czachura it is stated that "Property Taxes" "are allocated based on gross plant" (Page 8).

Iowa Replacement Tax Case
Review of MidAm Rate Case

TABLE 1

	Test Year Property Tax	$ 11,857,987	wpr. NGC-2	Allocator	LGS Allocator	Allocation
	Peak Facilities	$ 445,431	"	Share of Design Day	0.1031426	$ 45,942.91
	Mains (throughput)	$ 542,152	"	Total Annual Throughput	0.153705	$ 83,331.64
	Mains (Peaking)	$ 4,063,782	"	Design Day	0.1031426	$ 419,149.04
	Mains (Customer)	$ 1,461,014	"	Number of Customers	0.000098	$ 143.18
	Services	$ 3,211,291	"	Weighted Number of Customers	0.0003992	$ 1,281.95
	Meters	$ 1,459,495	"	Weighted Number of Customers	0.009469	$ 13,819.96
	Regulators	$ 246,736	"	Weighted Number of Customers	0.0065735	$ 1,621.92
	Industrial Meters	$ 62,303	"	Weighted Number of Customers In Class	0.7939018	$ 49,462.46
	Customer Service	$ 307,128	"	Weighted Number of Customers	0.0063264	$ 1,943.01
	Transport Admin	$ 13,368	"	Number of Transportation Customers	0.1187648	$ 1,587.65
	COG	$ 45,287	"		0	$ -
	Total	$ 11,857,987	"		**Total Allocation**	**$ 618,283.72**
					LGS Throughput (therms)	**180,102,172**
					Allocated Unit Rate	**$ 0.0034330**
					Total Property Tax	**$ 11,857,987**
					Total Throughput (therms)	**1,171,736,901**
					Average Unit Rate	**$ 0.0101200**
					Difference	**295%**

TABLE 2

	Therms	Allocation Factor
Total Throughput	1,171,736,901	100%
Residential	536,655,383	46%
General Service	447,600,450	38%
Large General Service	180,102,172	15%
Seasonal	7,378,779	1%

A Direct Connect Customer is charged a Replacement Tax Unit rate 295% higher than the allocated Property Tax Unit rate for an LGS customer taking service from MidAm.

Notes:
1. C5: Total Property Tax expense included in Rate Case Filing (Workpaper NGC-2 and Workpaper RRT/C Pages 1-3.)
2. C6-C16: Allocation of Property Tax expense to Function based on "Gross Plant". (See Czachura testimony Pg. 8. and Workpapers NGC-2 Page 13-15.)
3. E6-E16: Allocation approach used to allocate Functional costs to Rate Classifications. (See Czachura testimony Pg. 15-18.)
4. F6-F16: Allocator used to Allocate costs to Large General Service rate class. (See Exhibit NGC-2 pages 1-2.)
5. G6-G16: Property Taxes allocated to Large General Service (LGS) rate class. (Column C x Column F)
6. G17: Sum of Allocated Costs. Total Propert Tax Allocated to LGS class.
7. G18: LGS estimated thoughput. Total Throughput (Exhibit GCS-2 page 1 of 4 and NGC-10) x LGS Througput Allocator (Exhibit NGC-1, page 1 of 2)
8. G19: Allocated Unit Rate (G17/G18)
9. G21: Total Property Tax inlcuded in Rate Case Filing (see Note 1)
10. G22: Total Throughput (See Note 7.)
11. G23: G21/G22
12. G25: G23/G19, expressed in percent.

EXHIBIT E

EXPERT REPORT ON THE ECONOMIC AND COMPETITIVE EFFECTS OF THE IOWA REPLACEMENT TAX

Casey D. Whelan

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Part I: Background and Purpose of Report

This following is the Export Report of Casey D. Whelan, dated April 27, 2012, submitted in Case DIA No. 11DORFC046 (LSCP, LLLP vs. Iowa Department of Revenue).

I have been retained by LSCP, LLLP to provide an Expert Report on the application and impact of the Iowa Replacement Tax (IRT) (Iowa Code § 437A) on the competitive natural gas marketplace generally and LSCP, LLLP Inc. (LSCP) specifically.

In 1999, the State of Iowa restructured the computation and application of the property tax system as applied to electric and natural gas utilities. The tax was converted to a unit rate, with utility assets at the foundation of tax computations. The unit rate was also applied on a broader basis to include certain energy consumers who are not utility customers.

LSCP has paid the IRT since the plant began physical operations. LSCP is directly connected to Northern Natural Gas Company and does not receive any services from MidAmerican Energy, the natural gas service provider in the area.

LSCP contends that the tax is unconstitutional on several grounds. I will not address the constitutional questions; instead I will provide factual information regarding the application and impact of the IRT that may be used to address constitutional questions.

I have reviewed the structure of the tax at its inception in 1998 and market impacts related to its application since that time.

This report will discuss the following issues:

1. Does the IRT as applied to LSCP impact its total cost of gas?
2. Does the IRT as applied to LSCP relate to the property assets owned by LSCP, and used by LSCP to receive natural gas service?
3. What is LSCP's effective tax rate?
4. Is there an economic rationale why MidAmerican's natural gas asset values should serve as the basis for a tax applied to LSCP?
5. Is there an explanation as to why this tax structure was implemented?
6. Did electric and natural gas utility restructuring occur as contemplated by the legislature?
7. Does the IRT protect in-state natural gas producers and create a level competitive playing field as contemplated by SF 2416?
8. What is the economic impact of the IRT as applied to consumers who are directly connected to an interstate pipeline?
9. Does the use of a tax constructed using MidAmerican's asset base and deliveries result in a perverse outcome when applied to LSCP?
10. If LSCP were located elsewhere in the State would they pay a different level of IRT, even if their physical circumstances are identical to their current physical circumstance?

11. Are there natural gas consumers in the State of Iowa who are similarly situated who are not subject to the IRT?
12. Are there examples of consumers who are directly connected to interstate pipelines but are not paying the IRT due to the exemption?
13. Is it reasonable from an economic perspective that two similarly situated consumers, both of whom are located in the same Competitive Service Area (CSA), have fundamentally different tax burdens?
14. Do Utilities have the ability to price their natural gas distribution service below the full cost of taking direct service from a Pipeline, thus putting direct service at a competitive disadvantage?
15. Had Iowa's property tax system not been restructured to include the IRT, would LSCP's current cost of gas be higher or lower?

Part II: Background and Credentials of Expert

Casey D. Whelan is currently Vice President, Strategic Initiatives, at U.S. Energy Services, Inc. (U.S. Energy). U.S. Energy provides energy management services nationwide to commercial, industrial and institutional energy consumers.

Mr. Whelan has been employed by U.S. Energy since January, 1996. Over the past 15 years, Mr. Whelan has worked with a variety of large and small energy consumers helping them to structure energy service portfolios that meet their reliability requirements at the least cost.

Mr. Whelan was employed by Northern States Power Company (NSP) (now Xcel) and wholly-owned subsidiaries from 1985 through 1995. Mr. Whelan's first position at NSP was as a Rate Analyst and last position was Vice President, Gas Supply and Transportation at Centerprise.

Mr. Whelan holds a Master of Arts degree in Economics from the University of North Dakota (1985) and a Bachelor of Science degree in Economics from the University of Minnesota (1982). Mr. Whelan's Master's Thesis is entitled "Toward an Incentive Regulation Program: The Measurement of Relative Performance for the Electric Utility Industry"

Mr. Whelan was Honorably Discharged from the U.S. Marine Corps (USMC) in December, 1978 after serving his full commitment.

Mr. Whelan is a recognized expert in natural gas industry. He publishes a monthly "Natural Gas Report" column in the Ethanol Producer Magazine, has addressed numerous conferences/workshops/trade groups over the years regarding natural gas issues and has published topical articles in a variety of publications. Mr. Whelan has previously testified in energy related cases in MN, ND and Wisconsin.

Part III: Resources and Documents Reviewed

1. Senate File 2416 (1998), see attached.
2. Iowa Code § 437A.5 Replacement tax imposed on delivery of natural gas, see attached.
3. DIA Docket No. 11DORFC046, Rev. Docket No. 2011-500-2-0123, Iowa Department of Revenue's Answers to LSCP, LLLP's First Set of Interrogatories, see attached.
4. MidAmerican Energy Company, Gas Tariff No. 1, available at http://www.midamericanenergy.com/include/pdf/rates/gasrates/iagas/ia-gas.pdf.
5. Northern Natural Gas Company and Kinder Morgan NGPL, Location Detail Information Display & Point Catalog, see attached.
6. Iowa Code §479A.2, see attached.
7. Federal Energy Regulatory Commission, eTariff Company List, see attached.
8. Correspondence from Donald Stanley to State Senators Gronstal, Kibbie and Bolkcom, see attached.
9. State of Iowa – Natural Gas Operations Map (prepared by Iowa Utilities Board), see attached.

Part IV: Structure of Natural Gas Industry

The natural gas industry can be functionally divided into three general service components as described below.

Commodity Supply Service – The most significant cost component is commodity supply. Commodity supply is comprised of natural gas that is produced from wells and processed to meet interstate pipeline quality standards. There are numerous commodity supply options, including large and small producers, marketers, aggregators and financial institutions. Commodity supply prices are not regulated, instead they are set based on market dynamics. Generally, there is significant price transparency and liquidity in the commodity supply market. In the State of Iowa, commodity supply comes from many regions within North America, including on and off-shore Gulf of Mexico, the Rockies, Canada and the Midcontinent (i.e. Texas, Oklahoma, Kansas).

Interstate Pipeline Service – Interstate pipelines are large diameter, high pressure pipeline facilities that move gas from production areas to market areas. Natural gas is moved through interstate pipelines using mechanical compression. Interstate pipelines are regulated by the Federal Energy Regulatory Commission (FERC) with respect to prices and service terms and conditions. There are over 100 FERC regulated pipelines across the United States (FERC eTariff Company List) and several located in the State of Iowa. The major interstate pipelines serving Iowa include Northern Natural Gas Company (NNG), Natural Gas Pipeline Company of America (NGPL), ANR and Northern Border Pipeline Company (Northern Border).

Distribution Service – Distribution service, the final service component, includes receipt of gas from interstate pipelines, pressure reduction and delivery to consumers. Generally, distribution service pricing is regulated by state or municipal authorities. In Iowa, Investor Owned Utilities (IOU) are regulated by the Iowa Utility Board (IUB) and municipal utilities are self-regulated. Distribution companies are assigned service territories within which they have the exclusive right to provide distribution services.

Services provided by an IOU are subject to tariffs filed with and approved by the IUB. Rates and service terms and conditions are contained in utility tariffs. Allowed rates typically vary by customer class and size.

Consumers cannot choose between distribution service providers within a service territory. However, a consumer can choose to avoid taking utility service and instead directly connect to an interstate pipeline. This outcome is commonly referred to as "utility bypass". If a consumer directly connects to an Interstate Pipeline, the consumer will incur both capital costs associated with building the direct connection facilities and ongoing operation and maintenance costs.

Part V: Structure of the Iowa Replacement Tax

In 1998, the State of Iowa restructured the application of property taxes as applied to natural gas and electric services within the State. Under the restructured tax system, a "Replacement Tax" is computed as shown below:

"3. Natural gas delivery tax rates shall be calculated by the director for each natural gas competitive service area as follows:

a. The director shall determine the average centrally assessed property tax liability allocated to natural gas service of each taxpayer, other than a municipal utility, principally serving a natural gas competitive service area for the assessment years 1993 through 1997 based on property tax payments made. In the case of a municipal utility, the average centrally assessed property tax liability allocated to natural gas service is the centrally assessed property tax liability of such municipal utility allocated to natural gas service for the 1997 assessment year based on property tax payments made. For purposes of this subsection, taxpayer does not include a pipeline company defined in section 479A.2.

b. The director shall determine for each taxpayer the number of therms of natural gas delivered to consumers which would have been subject to taxation under this section in calendar year 1998 had this section been in effect for calendar year 1998.

c. The director shall determine a natural gas delivery tax rate for each natural gas competitive service area by dividing the average centrally assessed property tax liability allocated to natural gas service of the taxpayer principally serving the natural gas competitive service area by the number of therms of natural gas delivered by such taxpayer to consumers in calendar year 1998 which would have been subject to taxation under this section had such section been in effect for calendar year 1998." (Iowa Code, Taxes on Electricity and Natural Gas Providers §437A.5, Paragraph 3)

The initial Iowa Replacement Tax (IRT) rate (formula below) for each Investor Owned Utility (IOU) was computed by dividing each utility's average property tax liability from the years 1993-1997 by deliveries in 1998. There is a unique and different IRT for each IOU operating within the state. The IRT rate is reviewed each year and can be changed based on changes in deliveries within each IOU.

$$\frac{Average\ Property\ Tax\ Liability\ Per\ Taxpayer\ (1993-1997)}{1998\ Deliveries\ by\ Taxpayer} = 1999\ IRT$$

The process for determining the IRT rate for municipal utilities is different. I will not review the process for developing municipal IRT rates since LSCP is not within a municipal service territory.

Consumers who are directly connected to a pipeline incur a tax liability under the IRT tax structure equal to the initial or revised IRT rate within a Competitive Service Area (CSA)

multiplied by deliveries to their facility. (Iowa Code, Taxes on Electricity and Natural Gas Providers §437A.5, Paragraphs 1 & 2)

In LSCP's case, the IRT operates as follows. The currently effective IRT rate within MidAmerican Energy Company's (MidAmerican) CSA is $.0105/therm.[1] In 2011, LSCP used approximately 28,000,000 therms. LSCP's tax liability in this example is $28{,}000{,}000\ therms\ x\ \$\ (.0105) per\ therm = \$294{,}000.$

Interstate Pipelines, such as NNG and NGPL, are "pipelines" under Section 479A.2 of the Iowa Code. As such, these facilities continue to be taxed under the traditional property tax system which had been applied to electric and natural gas utilities prior to implementation of the IRT.

LSCP's facilities are not considered "pipelines" under Section 479A.2 of the Iowa Code. If LSCP's facilities were considered pipelines under Section 479A.2 of the Iowa Code, LSCP would still be subject to the IRT since the tax is based on deliveries. If a pipeline under Section 479A.2 of the Iowa Code owned all facilities necessary to provide service to LSCP, LSCP would still be subject to the IRT since the tax is based on deliveries.

[1] See Iowa Department of Revenue's Answers to LSCP, LLLP's First Set of Interrogatories - DIA Docket No. 11DORFC046, Rev. Docket No. 2011-500-2-0123.

Part VI: Impact of Iowa Replacement Tax

The intent of Section IV and V was to develop a contextual framework from which to evaluate the impact of the Iowa Replacement Tax. This section will address specific impacts of the Tax within the context of the natural gas industry structure and the structure of the Replacement Tax as applied in the marketplace generally and to LSCP specifically.

1. **Does the IRT as applied to LSCP impact its total cost of gas?**

Yes. LSCP's total cost of gas is higher due to application of the IRT. Absent the IRT, LSCP's total cost of gas would be the sum of Commodity Supply Costs, Interstate Pipeline Charges and costs related to operating LSCP's direct connection pipeline.[2] With the IRT in effect, LSCP's total cost of gas is the sum of Commodity Supply Costs, Interstate Pipeline Charges, costs related to operation LSCP's direct connection pipeline and the IRT. LSCP's cost of gas is greater by the value of the IRT.

2. **Does the IRT as applied to LSCP relate to the property assets owned by LSCP, and used by LSCP to receive natural gas service?**

No. LSCP's asset value associated with the Direct Connection pipeline is $285,000. This value has no bearing on or relationship to LSCP's IRT tax liability.

The IRT applied to LSCP is based on MidAmerican's property tax liability and utility deliveries. It is important to note that MidAmerican's property tax liability is a function of asset values and property tax rates at the time the IRT was computed.

3. **What is LSCP's effective tax rate?**

The effective rate is over 100%. LSCP's 2011 IRT Estimated Tax liability is $294,000. The asset value for facilities used to provide natural gas service to LSCP is $285,000. The effective tax rate, defined as tax liability divided by assets, is 103% ($\frac{\$294,000}{\$285,000} = 103\%$)

The IRT as applied to LSCP is a function of the property assets owned by MidAmerican Energy Company (MidAmerican) which are used to provide service to MidAmerican customers. LSCP's tax liability is tied to actions and activities related to MidAmerican serving their customers, not the actual asset value used by LSCP to provide service to LSCP.

4. **Is there an economic rationale why MidAmerican's natural gas asset values should serve as the basis for a tax applied to LSCP?**

No. There doesn't seem to be any economic rationale to apply a tax to a consumer based on assets, tax liability and delivery volume of a third party, in this case MidAmerican.

5. Is there an explanation as to **why this tax structure was implemented?**

[2] Operating costs include, for example, odorization costs, inspection and compliance costs, and property tax.

During the 1990's there was considerable concern among utilities and regulators regarding the impact related to potential electric marketplace restructuring. Generally, electric restructuring involved "unbundling" electric generation (supply), transmission and distribution service and giving consumers the option to purchase electric supply from alternative suppliers in much the same way the natural gas marketplace operated then and still operates today. Under an unbundled market structure, utility owned generation assets would be required to compete in the marketplace with other utility and non-utility generation assets, both within the state and out of state. Naturally, utilities had an objective of positioning their generation assets as favorably as possible in the marketplace. Restructuring the traditional property tax structure was a move in that direction.

Language from Senate File 2416 (1998) which enabled the IRT illustrates the concern.

> Section 1. LEGISLATIVE FINDINGS. The general assembly finds that with the advent of restructuring of the electric and natural gas utility industry, a competitive environment will replace the current regulated monopoly environment. Currently, utility companies are subject to property taxes which are levied in various amounts with respect to utility property located in areas serviced by the utility companies. If the property tax, as currently levied, continues, the property tax costs in Iowa will become a factor among competitors in the pricing of electricity and natural gas. Moreover, non-Iowa located electricity and natural gas suppliers do not have property in Iowa subject to property tax and to the extent that they are located in a low property tax state, such property tax costs would grant to such non-Iowa suppliers an unfair tax advantage over Iowa-based utility companies.

6. Did electric and natural gas utility restructuring occur as contemplated by the legislature?

No. The electric marketplace was not restructured at all in Iowa. In addition, the natural gas marketplace was already restructured allowing industrial customers access to a variety of supplier options. There have been no substantive regulatory changes related to natural gas transportation since implementation of the IRT.

7. Does the IRT protect in-state natural gas producers and create a level competitive playing field as contemplated by SF 2416?

The natural gas industry is comprised of three functional parts. The first part, commodity supply, was deregulated well before 1999. In addition, all commodity supply comes from

outside Iowa. There is no in-state "supply" to protect so the stated objective of the law makes no sense with respect to natural gas.

The second functional service, interstate pipeline service, continues to be regulated by the FERC in the same manner as before 1999. As such, tax restructuring has had no impact.

The final functional area is distribution service. Implementation of the IRT has had an impact on distribution services. However, instead of creating a level playing field just the opposite has occurred. Consumers choosing to directly connect to a pipeline instead of subscribing to utility distribution service are economically disadvantaged by the IRT.

8. What is the economic impact of the IRT as applied to consumers who are directly connected to an interstate pipeline?

Application of the IRT penalizes gas customers who choose to directly connect to an interstate pipeline because their costs are higher than would be the case without the IRT (see Question #15). It does not create a level competitive playing field for in-state vs. out-of-state suppliers because all supply comes from out-of-state. Instead, the tax creates a competitive advantage for in-state utility distribution services as compared to customers choosing to directly connect to an interstate pipeline.

The IRT materially impacts site selection choices for consumers evaluating construction of new facilities in Iowa. In the past, U.S. Energy has worked with numerous consumers considering building facilities in the state. We include the IRT as a specific cost that is considered in site selection. The total cost of directly connecting to an interstate pipeline is higher because of the IRT. It is possible that service from a utility is chosen instead of directly connecting to a pipeline because of the IRT.

In other cases, it may be necessary to directly connect to the pipeline because delivery pressures from the pipeline are a better operational fit than service from the utility since certain industrial applications require higher pressure natural gas service than is typically available from the utility. Accordingly, the IRT is not avoidable.

9. Does the use of a tax constructed using MidAmerican's asset base and deliveries result in a perverse outcome when applied to LSCP?

As shown in Question #3, LSCP's effective tax rate is 103% which seems excessive.

In addition, LSCP's tax liability can increase significantly even if its natural gas service delivery assets change relatively little. A good example of that outcome occurred in 2008. LSCP increased its plant capacity by 100% in 2008. This resulted in a roughly a doubling in natural gas requirements. The natural gas delivery facilities did not have to be upgraded because they were initially designed to accommodate an expansion. Once the plant expansion was completed and operational, LSCP's tax liability doubled even though its natural gas service assets increased very little. This is an odd outcome, and can impede efforts to improve efficiency by increasing size and output.

LSCP has no control over its tax liability as it relates to the tax rate since the rate is completely a function of MidAmerican's utility operations not LSCP operations. This is an unfortunate circumstance for LSCP who operates in a very competitive industry.

10. If LSCP were located elsewhere in the State would they pay a different level of IRT, even if their physical circumstances are identical to their current physical circumstance?

If LCSP was identically situated in terms of access to an Interstate Pipeline but located in another CSA, the tax level could be dramatically different. The tax could be as low as zero, if the plant was located within one of several Municipal service territories. If the Plant was located in Interstate Power's CSA, the rate would be $.00259/therm, only 25% of the rate applied in MidAmerican's service territory. (see 2011 Natural Delivery Tax Rates by Service Area)

LSCP's 2011 tax liability was approximately $300,000/year based on prevailing rates in MidAmerican's CSA. Had LSCP been located in Interstate Power's CSA, the tax liability would have been roughly $72,000. That is a considerable and meaningful difference.

The table below shows the IRT rate applied to various direct connection facilities throughout the State.

Table 1
Iowa Delivery Tax By Facility

U.S. Energy

Facility Name	Utility Service Territory	Delivery Tax Rate
Valero - Albert City	Interstate Power and Light	$ 0.00258695
Otter Creek Ethanol	Interstate Power and Light	$ 0.00258695
POET Biorefinery - Jewell	Interstate Power and Light	$ 0.00258695
Flint Hills Resources - Menlo	Interstate Power and Light	$ 0.00258695
Green Plains Holdings II - LLC	Interstate Power and Light	$ 0.00258695
Little Sioux Corn Processors	MidAmerican Energy	$ 0.01057313
Plymouth Energy, LLC	MidAmerican Energy	$ 0.01057313
Valero - Charles City	MidAmerican Energy	$ 0.01057313
East Fork Biodiesel	MidAmerican Energy	$ 0.01057313
Flint Hills Resources - Shell Rock	MidAmerican Energy	$ 0.01057313
Southwest Iowa Renewable Energy	Black Hills Energy	$ 0.00682869
Absolute Energy	Black Hills Energy	$ 0.00682869
Iowa Ethanol	Black Hills Energy	$ 0.00682869
Homeland Energy Solutions	Black Hills Energy	$ 0.00682869
Green Plains Superior, LLC	Black Hills Energy	$ 0.00682869
POET Biorefining - Gowrie	Black Hills Energy	$ 0.00682869
Louis Dreyfus Commodities	Black Hills Energy	$ 0.00682869

There is another odd feature related to the tax. If a direct connection customer is located within 2 miles of a municipal service territory they can "adopt" the IRT rate of the municipality. Most municipalities have "0" IRT rates so direct connect customers can avoid the IRT by locating

within two miles of a municipal utility. The biofuel plant near Emmetsburg takes advantage of this provision. (see letter from Don Stanley to Senators Gronstal, Kibbie and Bolkcom)

11. Are there natural gas consumers in the State of Iowa who are similarly situated who are not subject to the IRT?

Yes. Certain direct connection consumers do not pay the IRT, even if the direct connection consumer is located in a CSA with a positive IRT rate. These consumers are able to avoid the tax because the enabling legislation exempts direct connection projects in place before January 1, 1999.

12. Are there examples of consumers who are directly connected to interstate pipelines but are not paying the IRT due to the exemption?

Based on a review of pipeline faculties, we have identified five consumers who appear to be directly connected to an interstate pipeline, but are not listed as paying the IRT. Below is a discussion of each.

Example 1 – AGP (Cerro Gordo County). AGP is listed as the point operator of an interconnect facility with Northern Natural Gas Company. AGP is not listed as paying the IRT.

Example 2 – C.F. Industries – Terra (Woodbury County). Terra International, Inc. is listed as the point operator of an interconnect facility with Northern Natural Gas Company. Terra International is not listed as paying the IRT.

Example 3 – Bunge Soybean Plant (Mills County). Bunge North American, Inc. is listed as the point operator of an interconnect facility with Northern Natural Gas Company. Bunge is not listed as paying the IRT.

Example 4 – KOCH Industries Lehigh TBS #3 (Webster County). KOCH Nitrogen Company, LLC is listed as the point operator of an interconnect facility with Northern Natural Gas Company. KOCH is not listed as paying the IRT.

Example 5 – GPC/NGPL Muscatine (Muscatine County). GPC is listed as the owner of facilities interconnecting with NGPL. GPC is not listed as paying the IRT. (MAP)

The above consumers are engaged in the agricultural processing industry, the same industry as LSCP. But for these projects going into service before 1999, they would also be paying the IRT. The only reason LSCP is paying the IRT is because the direct connection project was built after 1999. Had it been build before 1999, they would be afforded the same economic advantage as the above projects. The above listed consumers pay traditional property taxes, however, as shown in Question #15 below, the economic impact is dramatically less than the IRT.

13. Is it reasonable from an economic perspective that two similarly situated consumers, both of whom are located in the same Competitive Service Area (CSA), have fundamentally different tax burdens?

It is not reasonable that two similarly situated consumers should have such dramatic tax differences. LSCP's tax liability is roughly $300,000/year and an exempt consumer pays nothing. Clearly, it is uneven, inequitable and discriminatory treatment.

14. Do Utilities have the ability to price their natural gas distribution service below the full cost of taking direct service from a Pipeline, thus putting direct service at a competitive disadvantage?

Yes. Utilities can reduce their distribution rate to below the cost of the IRT. For example, under MidAmerican's Competitive Pricing Transportation Service (CPS) tariff, they can reduce their distribution rate to below the IRT rate applicable in MidAmerican's CSA. MidAmerican can set a service price below the cost to directly connect to an interstate pipeline.

Due to the current structure of the natural gas industry all consumers pay the same price for two of the three service functions – commodity supply and interstate transportation service -- at a given location. The determining factor becomes what is the relative cost of directly connecting to an interstate pipeline compared to the cost of utility distribution service. The pricing flexibility MidAmerican has under the CPS tariff, allows them to unfairly compete with a consumers' option to directly connect to an interstate pipeline.

15. Had Iowa's property tax system not been restructured to include the IRT, would LSCP's current cost of gas be higher or lower?

LSCP's total cost of gas is higher because of the IRT. Without the IRT, LSCP would likely pay traditional property taxes in the range of 4%-6% of assets. Using a tax rate on the high end of the range (6%) produces a tax liability of $17,100 for LSCP. LSCP's 2011 tax liability under IRT is $294,000, 17 times higher than under a traditional property tax structure. Converting to the IRT is harmful to LSCP.

Part VII: Conclusions

The Iowa Replacement Tax as currently applied to LSCP, and potentially to other direct connection customers, has several inequitable, unreasonable and discriminatory economic outcomes. Each is summarized below.

1. LSCP is currently paying an effective tax rate of over 100%. LSCP's 2011 tax liability is $294,000 and the asset base associated with using natural gas is somewhat less than the tax liability ($285,000). This is clearly unreasonable.

2. LSCP is currently paying significantly more in taxes than they would if they were located elsewhere is Iowa. For example the IRT in the Interstate Power CSA is ¼ the rate in MidAmerican's CSA. In certain municipal utility locations, LSCP's tax liability would be zero even if its physical circumstances are identical to its current physical circumstances. This is clearly discriminatory.

3. There appear to be several consumers in Iowa who are not subject to the IRT even though they are directly connected to an Interstate Pipeline and are located within a CSA and would otherwise pay the IRT. The exemption is tied *only* to the date facilities were installed. This is clearly discriminatory.

4. LSCP's tax liability is a function of MidAmerican Energy's past property tax liability. The level of tax is completely independent from assets used by LSCP to receive natural gas service. In fact, when LSCP expanded their plant in 2007 very little additional natural gas delivery assets where required. However, once the expansion became operational their IRT liability increased by approximately 100%. This structure does not seem to make logical sense.

5. The rationale for the IRT was concern regarding gas and electric industry restructuring and the impact on in-state suppliers. Restructuring has not happened in Iowa and there is no in-state natural gas supply. With the legislation rationale for the tax structure change rendered meaningless, it seems appropriate to evaluate the tax based on its impact on in state consumers such as LSCP.

6. MidAmerican has the ability to price their distribution service at below the IRT rate. This provides MidAmerican Energy with the ability to unfairly compete with a consumer's option to directly connect to an interstate pipeline.

7. The tax impact on LSCP due to the IRT is likely 17 times higher than under a traditional property tax structure.

UTILITY REPLACEMENT TAX TASK FORCE

AGENDA FOR NOVEMBER 12, 2014 MEETING
1:00 p.m. – 3:00 p.m.
Room 7, A Level, Hoover State Office Building

Members

Courtney Kay-Decker, Co-chair, Director of the Iowa Department of Revenue
David Roederer, Co-Chair, Director of the Department of Management
Tim Coonan, Iowa Association of Electric Cooperatives
Steve Evans, Vice President Taxation, MidAmerican Energy Company
Jim Henter, President, Iowa Retail Federation
Alan Kemp, Executive Director, Iowa League of Cities
Bill Peterson, Executive Director, Iowa State Association of Counties
Julie Smith, General Counsel, Iowa Association of Municipal Utilities
Michael Rubino, Manager of State and Local Taxes, Deere & Company

I. **Call meeting to order and roll call/introductions**

II. **Approve minutes from August 21, 2014**

III. **Comments from those submitting information to the Task Force**

IV. **Comments from the Task Force**

V. **Report assignments and next steps**

VI. **Adjourn**

UTILITY REPLACEMENT TAX TASK FORCE MEETING
MINUTES
November 12, 2014

The Utility Replacement Tax Task Force met at 1:00 p.m. on November 12, 2014 in Room 7 on the A Level of the Hoover state office building, Des Moines, Iowa. The meeting concluded at 2:40 p.m. A quorum was present.

COURTNEY KAY-DECKER (CKD): We will take the Executive Authority to proceed without my co-chair here. Thank you all for coming to today's meeting. There should be a sign-up sheet that's going around, if you haven't signed it yet. Make sure you sign that so we can have an inventory of name spellings, so on and so forth for the record. I have Christina Downing here again who will be recording our proceedings today and what I will ask you to do when if you are up speaking, to come up here and sit in this chair right next to her. So it's easier for her to hear for the transcription purposes. And with that I think we will officially go ahead and get on the record and get under way with the Agenda. Alright very good, so first thing we have on the agenda is roll call and introductions. I think everybody pretty much knows each other, but why don't we go ahead and go around the room.

Present:

Courtney Kay-Decker, Director of the Iowa Department of Revenue and Task Force Co-Chair
Victoria Daniels, Department of Revenue
Mike Rubino, State Tax Director for John Deere
JJ Severson, Department of Revenue
Roland Simmons, Department of Revenue
Julie Roisen, Department of Revenue
Carrie Johnson, Department of Management
John Ward, Rural Electric Cooperatives
Tim Coonan, Iowa Association of Electric Cooperatives
Julie Smith, Municipal Utilities
Steve Evans, Investor Owned Utilities
Christina Downing, Department of Revenue
Jim Miller, Iowa Attorney General's Office
Donn Stanley, Iowa Attorney General's Office
Lori Marchese, Department of Revenue
Grant Meinke, Iowa Renewal Fuels Association
Jace Mikels, Senate Democrat Staff
Erin Mullenix, Iowa League of Cities
Robert Palmer, Iowa League of Cities
Monte Shaw, Iowa Renewable Fuels Association
Terry Harmann, Alliant Energy

Mark Douglas, Iowa Utilities Association
Tom Stanberry, Davis Brown Law Firm
Kate Carlucci, Davis Brown Law Firm
Dick Stradley, The Stradley Group
Alan Harding, The Stradley Group

Absent:
Bill Peterson, Iowa State Association of Counties
Alan Kemp, Iowa League of Cities

CKD: All right we have been around and Dave will be here shortly. So the next item that we have on the agenda is approval of the minutes from our August 21st meeting. We basically just took the transcription and made that the minutes. Does anyone have any corrections or comments on the minutes? And if there are none I'll entertain a motion to approve them.

Julie Smith (JS): I move approval.

CKD: Thank you Julie, do I have a second.

Tim Coonan (TC): I'll second.

CKD: Thanks Tim. Any further discussion? All of those in favor in approving the minutes. Everyone said "Aye". Opposed? None. All right we are done with two items already. That's exciting. So the next step in the process is we are going to ask those who have submitted written comments, if they would like to provide an additional oral presentation. I know that we heard from Mr. Stanberry that you'd like to give a presentation. Are there others who will also want to give presentations, so that we make sure that we allot enough time and divide up the time we have available? Other non-Task Force members? So just Mr. Stanberry?

Tom Stanberry (TS): We are happy to...

CKD: You are happy to present?

TS: We are happy to answer questions and (inaudible)

CKD: Okay; very good, and Mr. Stanley. So we have two presenters then I'll expect that we will have questions from the Task Force for those presenting and also for anyone who has submitted written comments to get clarification in that regard. Does anybody have any questions or suggestions on that procedure before we get started? All right then, Mr. Stanberry. Okay; go ahead and come up.

TS: My name is Tom Stanberry, I am an attorney with the Davis Brown Law Firm and we represent a group of the Natural Gas Replacement Tax Bypass Customers who are currently paying the tax. We have submitted a written submission. I am not going to go over the written submission in detail. I

want to just highlight a couple of items that are in the submission and then certainly answer questions. We have outside consultants as well as two of my partners are here to answer additional questions. I am going to be brief. I didn't realize I was the only one that said that I was going to speak. I still intend to be brief.

I wanted to clear up a couple of misperceptions about the goal of the bypass customers that we represent. Misperceptions come to me from comments that'd we have heard from various people some on the task force or some legislators and others that have been involved in this discussion. First, from our clients' standpoint we are not asking for an exemption. We don't see this as an exemption. We are not suggesting that anyone that does not pay the tax today be subject to the tax. We know that there are grandfathered bypass customers. We are not suggesting that they be subject to the tax. We know that there are municipal utilities that have a zero rate and we are not suggesting that change. What we are really asking for is that the non-grandfathered bypass customers pay a tax based on the value of their assets as opposed to the value of some assets that were in existence in 1998 and that if this tax is to be a true excise replacement tax for property taxes, that the property that these bypass customers that are non-grandfathered are or have be used as a basis for the tax.

We went through our submission and reviewed all the other submissions and we tried to break down some of the comments into the key principles the Task Force uses. And I know that you talk about them in terms of 3 principles when you look at the statute. One of them kind of gets interwoven with each other so I am going to break them down for purposes for today in kind of four basic categories. The first principle that we always hear about from the Task Force is that any change in the replacement taxes needs to preserve revenue neutrality and debt capacity for local governments and taxpayers. We agree. We think that any change that you make to the natural gas replacement tax or any other replacement taxes really needs to maintain the local governments and the same revenue position that they are into today. Taking into account what would be the normal changes in business cycles and knock on wood or knock on Formica everybody who is in business today paying the replacement tax maybe not be in business at some point in the future. Businesses may shrink, businesses may grow. As a result of that, the amount of tax that's going to be collected and the amount of revenue to local governments may change; may go up, may go down, but we don't think that anything that we are suggesting should change that. Chapter 437A has a mechanism in place to change the rate as volumes are adjusted. And if there is a volume change as a result of what we're discussing, you know, that the rate can be changed by that mechanism. We also think that any consumer of natural gas that does not pay the natural gas replacement tax in the future clearly needs to be subject to local assessment of property taxes. So when you start thinking about the fact that there will be property taxes collected on the value of these assets and there should be an adjustment in the rate of taxes, so that collections will eventually near what they are today. There needs to be a temporary substitute for that revenue, so that all those local tax jurisdictions are maintained in their current revenue position. It could come in...the simplest mechanism to us would be a temporary backfill similar what was used in the 2013 legislation with respect to the property tax rollback. I'm sure there are other alternatives that we can think about. That's what came to mind when we first started talking to our clients and they first started talking to us. And we impressed upon them that we didn't think that there should be an impact....negative impact...on the local tax jurisdictions.

One of the reasons we commissioned the study is a part of our submission that compared the replacement taxes being paid by a number of bypass customers with the theoretical property taxes based on local assessment and local mill levies of various counties in which the bypass customers are located. Was so we could just see the disparity and as you can see from the submission and our expert's analysis, it's a wide range. There are actually cases that we were able to document where the replacement taxes that are being paid, are roughly 45 times what that same bypass customer would pay on the property that would be assessed on a local basis. So when you hear us and when you heard one of our clients speak at the last Task Force talk about the tax inequity, that's what he was talking about. He was not talking about the fact he's taxed and his neighbor down the street is not taxed. He was talking about that the fact that you look at similarly situated people paying property taxes versus what his plants are paying in replacement tax; there is a fairly large disparity.

Second principle just toss out real quickly in the Code says preserve neutrality in the allocation of the cost impact of any replacement tax among and upon consumers of electricity and natural gas in the state. We would argue that the current system is not neutral. There are consumers of gas that under the current statute pay a tax rate of zero. So a zero tax rate, regardless of how much is consumed, is going to be zero taxes. We understand the legal and constitutional principles of why they pay that, but just to point out that there is not total neutrality. The grandfathered bypass customers, so those bypass customers in existence in 1998, pay no tax. We also know, because of the way the tariffs are set up for the investor-owned utilities, that a consumer that is a large consumer of gas can end up in a negotiated rate with a rate that they pay is less than a natural gas replacement tax rate. We have no problem with that, but I think we do need to point out that there is lack of neutrality now and the changes that we are proposing will not change that.

Third item that is in the Code says remove tax cost as a factor in a competitive environment. I think if anything, the system that we have in place now actually promotes competition based on the tax. And I will throw a hypothetical situation. If you locate a facility in a site where the tax rate is zero and the site would be exempt from local property taxes because the consumer is under 437A subject to the natural gas replacement tax, that gives that community that has a municipal utility that is a gas consumer that can site the project within a two mile limit a distinct competitive advantage over any other municipality that can't site a project with the same restrictions or same limitations. So I think when you step back and you look at tax costs as a competitive factor one of the things that has to be considered is whether or not the current system actually accomplishes that. And again, there's nothing that we are proposing and we are not here to talk about proposals at this point...there's nothing in our submission and there's nothing we have discussed so far that would change that. So if the neutrality doesn't exist, we are not suggesting there's a way to change it and we're not suggesting that our alternative would actually eliminate that. So I think the summary of that one, you can take the current system and you can use it actually very competitive advantage for certain municipalities.

Last item that's articulated in 437A says provide a system of taxation which reduces existing administrative burdens on State Government. We spent a lot of time since the 2014 session of the Legislature talking to folks in other states, to people in this state, that are experts in either the administration of the natural gas replacement tax or in many cases, are payers of the tax and talking about alternatives to the current system which would either maintain the status quo or certainly not

increase the level of administration that the State has to go through today. And we have multiple attorneys at this point...it'd take a long time to talk about them all, to discuss them all, so I don't think we want to sit here and hash through them. But there are a lot of ways to do that and we understand that is one of the guiding principles and we want to reiterate: we are confident that we can come up with an alternative to the current system that maintains the ease of the administrative burden that this system does from a state government standpoint.

To quickly summarize where I started out, we don't think the right way to solve this problem is a blanket exemption. We think that there are ways to change the system so that the bypass customers are in an equivalent position to what they would be if they were paying locally assessed property taxes. We know that there are consumers that don't pay the tax and we are not suggesting that they do pay the tax. We are not trying to level the volume in the buckets by assessing someone that is not assessed today. We just want to see the non-grandfathered bypass customers taxed on the value of their property as it stands today and that's it. Simple and sweet.

CKD: Thank you Mr. Stanberry.

TS: You are welcome.

CKD: Does anyone from the Task Force have questions. Mr. Stanberry, stay up here if you don't mind.

TS: Oh yeah. I am happy to.

CKD: Task Force -- questions? Questions for....Julie do you have something?

JS: No, not really.

CKD: You look like....

JS: I like the term Muni-halo. I just thought I would throw that out there.

TS: You know I think we would love to take credit for it. I don't think we crafted that one ourselves.

CKD: Is there anyone from the public that has questions? Comments for Mr. Stanberry?

MIKE RUBINO (MR): I might just have a quick question.

CKD: Okay, Mike.

MR: From what I recall there's some language to recalculate the rate when the volume changes in the service area by a certain amount, is that right?

TS: There is. Yes.

MR: Did the rate get recalculated any time during this time period? With...there is so much more usage; did the rate get changed? I just didn't know that...

CHRIS JAMES (CJ): Which CSA?

TS: Yeah, I was going to say it's going to vary from CSA[Competitive Service Area] to CSA, so when you have rates change.

MR: Rates change...

TS: Yes rates have changed.

MR: Dramatically in any of these places to kind of alleviate some of that concern that you had? With the tax being not comparable to the property?

TS: Chris, do you recall the biggest change?

CJ: Yeah, well Roland knows this too, but there has been some significant changes for some aggregations that have occurred earlier on in some CSAs; MidAmerican has been relatively stable, but it does not fluctuate based on the usage of bypass customers; ?They can't use the gas to impact the municipal gas impact the therms any given year, so whether they use a lot or a little does stem from MidAmerican or some other ethanol plants. It probably wouldn't have any impact. They do not use enough gas for the MidAmerican service area. Now in a larger CSA, but a smaller utility base in it maybe a few more could band together and cut the rate, but by in large, (inaudible).

MR: So bypass customers' usage, although it could be substantial, doesn't impact the rate? Is that what you are saying?

CJ: For instance one year...a good example we have is for instance, one year the Little Sioux Corn Processors plant doubled their capacity, doubled their usage in one year, and you would think that if that were to happen the rate would actually go down.

MR: Sure.

CJ: But it didn't; it went up that year. So they don't really have...they just don't use enough therms compared to some energy users. So by and large, they don't really have the ability to affect the rate very much. Collectively, maybe a little bit, but and their therms are factored in, so I wouldn't say it has no impact, but it's very gradual.

TS: It would have to be a small CSA with a lot ethanol plants. There are industrial users that can in fact impact the rate.

CKD: Any other questions for Mr. Stanberry, while he is up here? All right, thank you. Who's next? Is that you Donn? Mr. Stanley?

DS: Good Morning. Afternoon. Again my name is Donn Stanley. Jim Miller and I work for the Attorney General's Office and work with the Replacement Tax Task Force and we are in the Revenue Division, so our main job is litigating cases for the Department of Revenue. So we are working with our old friend and former college Chris James and others in terms of litigating the Little Sioux case that's now before the Supreme Court. I gave a report last time about that; I'm happy to answer any questions you have.

I would like to start by just making clear that that's our role in this...is to try and help with legal issues for the Replacement Tax Task Force and the Department of Revenue. The Attorney General's Office doesn't take a position on this legislation. If that were to happen, it would happen much later and at a much higher level of the Attorney General's Office than you have before you today. General Miller, as most of the people in this room know, has always been a strong supporter of renewable energy, but our job is to defend the statutes as written from this constitutional challenge and if the law changed depending on what the Replacement Tax Task Force recommends, what the legislature does, what the Governor signs; our job would then be to defend whatever statute is in place at that time.

I did just want to comment on some of the issues that were posed by the legislature and some of the comments that had been made in terms of trying to respond to some of that. The first is that the questions that the legislature posed, the numbers and types of taxpayers that currently pay the tax can be provided and the Davis Brown Firm helpfully has provided a list of ethanol users. The question that I think that we would have is are there additional companies that might need to be included in the bypass customer list. We're not aware of that, but those were the ethanol plants that are in that bypass customers. I'll talk a little about the fact that that list might increase over what it is now depending on what kind of legislation would be proposed or enacted.

The amount of tax paid, technically is not confidential just the amount of therms delivered that are disclosed on the return. The problem is that once a tax is revealed for a taxpayer operating in a single service area, the therms delivered can be determined easily by just backing out the number, so that may trigger the confidentiality provisions in terms of that. But the aggregate amount of tax paid by a service area could certainly be provided to the legislature.

CKD: Are you saying that there is a right number of different tax payers...so if they are just paying out of a service area that...

DS: If there is just one service area then you will know how much tax they did, so aggregate. If you have...if the aggregate is more than one, I guess again, which, and the amount of gas, the third question, the amount of gas consumed by the grandfathered companies is not known. There is no requirement that that be reported to anyone. So that amount is not known. The amount of property taxes that would be paid if the transmission property that were subject to local property tax is not known as we did not know the fair market value of the consumer's pipeline facilities. There's a difference between market value and, you know, the cost less depreciation and that may not be the market value and so the tax would be there. Right now the values reported for the statewide property tax is the book value, which is the acquisition cost less depreciation. And as we talked before, that's a

very small amount. I think, again, in the Little Sioux example that Chris was talking about earlier, that statewide property tax was what, about six dollars a year, something like that, so I mean that's not a market value approach and that's what's used right now.

The allocation of the revenue to the local governments generated by these consumers again could be aggregated and provided but not the local parts.

Let me address a few of the issues that were mentioned in some of the comments that were submitted and then talk very briefly about some of the things in the oral presentation. First of all, the local distribution companies and the municipal utilities weren't given a replacement tax rate based upon their own taxable assets. And I think this is really important. The service area in which they were the primary provider was given a rate based on the actual tax paid by the provider, not on the value of their assets. And so when you are talking about going back and having the same thing and having it based on the value of the assets, that's not how this is determined in the first place. This was done to ensure revenue neutrality for both the taxpayer and the local government at the time of the conversion to the replacement tax. And again, I think it's important: it was a snapshot for at that time in terms of revenue neutrality. After the replacement tax went into effect the rate was free to fluctuate depending on the number of therms flowing into the service area, subject only to the threshold adjustment and that was talked about, you know at the end of Mr. Stanberry's presentation. There is a mechanism to keep it from too big of fluctuation. This threshold adjustment. But there was never, I think, any thought that it would be the same for all time and that's what this concept of revenue neutrality is about. Otherwise, and we will talk about this maybe in a minute a little bit more, but revenue neutrality only applies to the parties that are involved when this happens in the first place. Otherwise, just by definition if you have a new business and they weren't part of it, their taxes are going to be the same as when they didn't exist. Because when they didn't exist they didn't have any tax and so that's just not how that concept of tax law applies. And I think a lot of the people here are already aware of that.

The second point is the conclusion that 45 more times, 45 times more replacement tax revenue than property tax revenue is really a fallacy, because the replacement tax revenue is dependent solely on the number of therms flowing to the consumer. It's a tax on the therms; it's not the tax on the property. And so comparing the property tax on a pipeline is apples-to-oranges over comparing the therms, because you can have the same length of pipeline that conveys a different amount of therms. And when the tax is on the therms then it's not going to be the same for those areas of pipeline. You could also have the scenario where a plant could shut down for a year because of some sort of mechanical problem or whatever; you have absolutely nothing flowing through or you wouldn't have a tax based on therms during that time, but you would still have the property there. If it was a property tax, that would be paid whether you were actually running therms through there or not. So the 45 times is not really a comparison because it's based on a different tax on a different item.

Also the Legislature was aware of bypass customers which is why the grandfathered companies were treated the way they were in terms of maintaining neutrality for those customers. That again is what the term revenue neutrality and the tax neutrality has to do with it. It has to do with what customers were existing at the time of the law and that's why they had that. I know Mr. Stanberry mentioned

that he's not advocating that these grandfathered companies pay the replacement tax, but when we first started to litigate the Little Sioux issue one of the issues that I don't think is before the Supreme Court, but was litigated earlier, was the equal protection argument on these companies. And there was one case that was brought up. Most of the time around the country grandfathered provisions have been upheld; exceptions for grandfather provisions. It's not a novel concept in tax. But there was a California case that was brought up and the remedy that the California court used in that case was to impose the same provisions on the grandfathered companies that the other companies were paying. And so certainly one of the things that the court could do or the Legislature could do is to make the 5 grandfathered companies pay the same amount of money. And I recognize that's not the proposal, but that could be true -- both that the grandfathered companies and the municipal companies where the Legislature and the Governor could decide there's going to be some minimum amount of tax. And again, that is something that the Legislature could do and if they did do that, then our position would be, we would, you know, work our hardest to defend the constitutionality of that.

And another thing that was brought up was about the local distribution companies spreading the tariffs and passing the tax on differently to different customers, which is their right under the law to do. Again, that's not really a Replacement Tax Task Force issue, that's a Utilities Board issue. I don't recall if there's somebody from the Utilities Board here today, but again, that's something that's legal under the law, just as it's legal for the bypass customers to pass on a different portion of the tax that's part of their overhead to different customers. They don't have to pass that on exactly the same to every customer just like the utility companies don't have to pass that on to every customer and that gets to the whole concept of where the incidence of the tax lies. There are taxes where the incidence of the tax falls on the final consumer, but in this case, the incidence of the tax falls on the utility companies or in the case of the bypass customers, they are treated like a utility because the tax hasn't been paid by anybody before. And in all those instances, those can be passed on without any sort of regulation as to how much you pass onto each customer. So if people negotiate rates, that's allowable under the law.

In terms of the "municipal halo," which I really like that, too, Julie; but you know a lot of times as the tax prosecutor you don't get the halo thing very often. But in terms of the municipal halo, the legislature could...you know, they had...one thing that I would encourage everybody to look at and that is that a lot of times when we have to defend statutes we have to come up with what the rational basis for these tax statutes were. In this case of the replacement tax and I give credit to the people that were on this task force long before I was involved, but they actually lay this all out in the preamble and they talk about the rationale for all of this and they talk about the rationale for the different rates. And you know why having one rate would be bad -- because it would reduce the cost for some people and increase the cost for others and all of that. But in terms of this being the, you know, the competitive disadvantage, if that's the case, and I'll give you a little example from a newspaper article of some of the negotiation that takes place, but if there was such a massive advantage in the municipal areas, it would seem like we would have more than one plant that was in a municipal area. We only have one in Emmetsburg and I don't think there is any question that from a replacement tax standpoint, that, you know, that's a better deal for them. But it must not be an overwhelming incentive or we would have all or at least a lot of them. We have dozens of these municipal service areas all over the state

and yet there is only one ethanol plant in a municipal service area and just logically, if it was a big advantage, you would have a lot more there.

Again, we talked a little about this: the centrally assessed companies always value far more than just cost-less-depreciation on the pipe. They were assessed under a stock and debt, income, and cost approach as a going concern value based on the value of the entire unit both within and without Iowa. Conducting a similar evaluation methodology on these companies would produce a significantly higher value for the transport and transmission property than the hypothetical used in my good friend Dick's report. Again, we've got the greatest respect for Dick and Al. And I attended a lot of Replacement Tax Task Force Meetings with both of those guys, but that's a different method than what they have in their methodology. Also, if the transport and transmission property is owned by the pipeline up to the bypass customer then the pipeline will be centrally assessed for this property not the bypass customer. And I think that's another important factor is if the pipeline goes almost to the bypass customer's property then the valuation's going to be very small because they just don't have much of the pipeline; the interstate pipeline runs it right to the company. And I think in the grandfathered companies we would need to look at that in terms of making some sort of evaluation.

Let me just tell you...this is from one of our exhibits in the Little Sioux case, but there was an article in the LeMars Daily Centennial when the people from the Little Sioux went to Akron, Iowa to pitch having an ethanol plant there. And we can post this whole thing, but in the article the general manager of Little Sioux who was there with Mr. Grotjohn, who was at our last meeting, says to the Plymouth County Supervisors, "I don't mince words; we're here for some property tax incentives" and then he says later "the plants need zone only line and tax rebates; we need to have paved roads." And asking the local people to pay for the roads...and then this is the interesting part...because that's just what every business is going to try and get the best deal they can to locate somewhere. But then Mr. Roe talked about what benefit this might have for Plymouth County and said, "Iowa does have a pipeline tax that all people that use natural gas have to pay. Adding the taxes and excise tax and says, "As a 55 million gallon plant in Marcus our bill last year was $140,000 that goes direct to the county, that doesn't go through the state," and estimated that Plymouth County could earn in excess of $250,000 annually in pipeline usage tax. And so part of these negotiations, and this might be true in municipal areas and might be true in the other areas, is companies, as they should, and as they have fiduciary duty to do while trying to get the best deal they can, but they also...this gets to the point, and it was really an important point for the court at judicial review...was that unlike the grandfathered customers who were let in on the past ones, those customers made the business decisions they did not knowing about the replacement tax, because that was already...they had already made those decisions before it was in. A point that the District Court Judge made was the difference after the replacement tax for all of the new customers, ethanol or any other new customer, is they already knew the lay of the land. They already knew what the law was and it was clear when they were doing this negotiation, they already knew what the law was in terms of trying to do that.

I think the last thing 'cause I went on longer than I wanted to...is that when you're looking at the impact of the bypass customers leaving the system, I think it's important to look at the fact that if this really is a big incentive, I know we talked about the money being the same, but obviously, if the study is true and the property tax is so low and the replacement tax is higher, the money isn't going to be the

same that people would pay. There would be a tremendous incentive for more customers to become bypass customers. If they were saving money...again it's just...they'd almost have a fiduciary responsibility to try and save their business this money, so again our job at the Attorney General's Office is to defend the statute as it's written. We have tried to do that with the statute that we have now. If there's a new statute then we're going to try our hardest to defend that and if people have any questions I would be happy to try and answer them.

MONTE SHAW (MS): You said something...I might have missed part of it. I'm one of the newer people in this room; I have not been attending these meeting for years. You said the tax rate was based on the tax that had been paid in the competitive service area, not on the value of the assets in the service area at that time (unintelligible). While that may be true on one level, the tax that was being paid at that time was through local county assessments, correct? Of the assets?

DS: Yes.

MS: So it actually was valued...it was based on the assets.

DS: No, it wasn't.

MS: If the tax being paid was a reflection of the county assessed tax from assets and then you're just taking the tax paid and saying, "Well, I'll keep it the same," what it actually derives from is the value of the assets times the county tax rate.

DS: No, well....

MS: (Unintelligible) into a service area.

DS: Well in the municipal areas for instance, there wasn't a collection of the tax. They had this in lieu of transfer and so....

MS: With the exception of the munis then.

DS: Well, I mean that's like saying, you know, with the exception of the days that end in "y." That's such a big part of the situation. Most, by far, most of the districts; most of the service areas are municipal districts.

MS: They had a different tax system before the start. I was actually referring...so for people who paid taxes before.

DS: Well and some of those paid a lower rate, but again, it wasn't based on the value of the assets. Not all of the municipal rates are 0. Some of them are small.

MS: So for the non-municipal rate payers who are here in the old system. What they were paying before this law was enacted was a county assessed property tax?

DS: Yes on the operating property that they had at that time.

ROLAND SIMMONS (RS): State assessed.

VICTORIA DANIELS (VLD): Centrally assessed.

RS: Centrally assessed.

DS: Yes, it wasn't local, it was centrally assessed.

MS: Even before this?

RS: Right

MS: Okay, I have always heard you guys say you liked the system because it was one state assessment instead of 99 counties assessment. I wasn't here so....

VLD: The money goes to the locals, but it is centrally assessed at the Department of Revenue.

MS: And you assess what at that time?

RS: We did the stock and debt, income, and cost approach on of a lot of companies. Some of the real small ones, we just did a cost approach.

MS: And then the other question I had was...actually, I had two more things real quick. You mention the 45 times comparison is a fallacy because there's a tax on therms not a tax on assets, but when we are talking about comparing how the bypass customers are taxed vis a vis the investor owned utilities or the grandfathered plants, the grandfathered plants are still...I don't know if it's a central assessment or county assessment, but they're still assessed on the value of their assets?

DS: They're still all assessed just like they were before.

MS: Okay.

DS: But in terms of...like you were talking about investor-owned utilities, I think it would be hard to say they were taxed 45 times as much as they were before.

MS: So I guess what we were comparing was the treatment of the taxpayer to another taxpayer. Say the grandfathered bypass customer to a non-grandfathered bypass customer.

DS: Right.

MS: It wasn't similarly-situated comparisons. I guess it's not a comparison to everybody; obviously there are different players; there's municipal, investor-owned...

DS: Right and like we said, that cost-less-depreciation, which was the methodology, is not a correct methodology; is not equal. And so if a 45 is based on that, which that's the methodology then that just by definition...

MS: Take away the 45 number...

DS: ...is wrong.

MS: Okay and I'll let you guys who are experts on this argue that. Taking aside the 45, I think the point we were trying to make was an apples to apples comparison with two similarly-situated companies under two different systems. Now it might turn out that that comparison is one to one, it's five to one, it's 45 to one. I won't argue that today (unintelligible).

DS: Sure.

MS: The last question I had was you mentioned that if the Legislature saw fit to change the law and to take all the bypass customers and put them back into the old system, if you will, and some of the grandfathered customers, that that might provide quite an incentive for people to bypass.

DS: If it's true that it's a lot cheaper to do that so...

MS: If it's true that it's a lot cheaper, so under that same theory does the current law not incent companies to not bypass and to go to an investor owned utility for their service?

DS: Well I think it depends on the individual company, just like where you site the company if you bypass or not. Like in Little Sioux, the company that was their advisor advised them to bypass their sister company is the one that did the work. And there, we never got in that one what the real reason for why...they didn't have people still available that could say what the reason why they bypassed or not and then they contrasted that with Valero who got...negotiated a rate, because even the expert witness in that case, Mr. Wehlan, said, you know, one of the things that he tells people is look to see if you can negotiate a rate with the utility company, so it, you know...again there are a lot of factors that might go into that and you know I don't know how big of a role the replacement tax plays in that. Probably would be different for individual companies on why they wanted to bypass and why they wanted to go to the utility. I'm just saying that if it's true that it's so much cheaper then there would be, it seems like, overwhelming reasons to want to bypass.

One of the reasons as I talked about the rationale of the legislation--it's a little like sales and use tax in that if you don't pay; if the sales tax hasn't been paid, then the ultimate consumer is liable for a use tax that equals out the sales tax. There is a subsection one here that imposes this tax on the local distribution companies and then subsection two says if this hasn't been paid before then the consumer is treated like the local distribution company and they pay in the same service area the same rate that

the local distribution company paid for it. And if you take that requirement off and it's a better deal, then it seems like a business that's really on top of things would do whatever is the best business deal for them.

MS: With the exception of the bypass customer had to pay to install a pipeline to maintain the pipeline and eventually, when it ends its useful life, replace the pipeline, so they're paying the same rate without benefiting from someone else having provided the pipeline, but if that's....

DS: No, all of those are, you know, I guess I was going to say, I'm not a, I guess I am, but those would all be deductible expenses.

CJ: Is it your position, Donn, then, that these lateral pipelines that were locally assessed may be subject to a unit value approach?

VLD: Locally assessed or centrally assessed?

CJ: A lateral pipeline from an ethanol plant for instance, is it your opinion that a lateral pipeline would be centrally assessed?

DS: I'm not sure I understand what you are saying. Under what law, I mean?

CJ: Under Iowa law, if these pipeline companies, these ethanol plants, run off line in terms of they were...let's say they were exempted from the replacement tax, right?

DS: That's...so under a change in the law?

CJ: Let's say they are exempted. Would that lateral pipeline now be subject to local assessment?

DS: It would depend on what the Legislature provided. If they said we are going to exempt that from replacement tax and make it subject to local assessment then that's the way it would be. But the Legislature would have to do something.

CJ: It doesn't need that. They just said you are not subject to a replacement tax. They'd be subject to local property tax. For instance the grandfathered company at their level...

DS: But, they said how they're treated.

MS: Let's just say...

DS: If they said that's how they're treated then that's what the Legislature would....

MS: So if the Legislature said we're going to treat all bypass customers today like the grandfathered bypass customers and they made that legislative change, is that the right, am I saying that right? How is that a central or county assessment and then what was the other term?

DS: No, if the Legislature provided for that, then that would be what the law is.

CJ: If they were locally assessed, then they wouldn't be subject to a unified approach right?

DS: They would be subject to a market value approach.

CJ: Right, that wouldn't be stock and debt at the local level, right?

DS: Well it would be however they would get to market value and it would be the, you know, it could be income approach, it could be cost approach, it could be whatever, you know, gets to a market value. It would not be the cost less depreciation that the statewide property tax is based on. Wouldn't you agree with that?

CJ: Not necessarily, because that might be the fair market value.

DS: 6 dollars, well it's possible....

CJ: That's the amount of the tax, not the fair market value. The value might be the fair market value.

DS: Right, that's what I'm saying...right...

CJ: The value might be the fair market value.

DS: Yeah,

CJ: No one is going to pay more than it cost to build the plant, so if cost new less depreciation...it's probably a pretty good (unintelligible).

DS: Well, I think the point I was making was that's not how when you are talking about the comparison with how this started, that's not how the utility companies were assessed. They were assessed on stock and debt and income and all of those things. It's not an apples-to-apples, to this how the utilities were done when this was first established.

MS: Is it public information how the bypass customers were evaluated? Not the value or tax paid, the method by which they're valued? Would that be public information?

DS: Well I think the, you know, that's something that the local assessors would know. That's not something that we would get. It's the local assessors.

MS: I didn't know of that.

DS: That would have been...property tax is the most transparent of all the taxes. I mean, they put the value of your house right up on the internet. They don't put your...unless you are like us, state

employees, they don't usually put your salary in the Des Moines Register. We get to enjoy that, but most people don't, but your home value is up online.

STEVE EVANS (SE): Could I ask a question that maybe Roland or others would know this. I think it's my understanding from my work here in Iowa and other states that assessors of all kinds are to essentially look to some standards that are out there. Called uniform standards of professional appraisal practices; at least I have and as I read those I see that they are reiterated right in the Iowa Real Property Appraisal Manual, which I think the local folks use and maybe Roland, I mean if you are doing that...

RS: We do.

SE: In Iowa you use that manual and it cites the three methods so who knows what the Local Assessor or the State Assessor might do. They are supposed to consider all three indicators of value and then weigh them as these guys have been doing it a lot longer could tell you. So who knows what they would do, but those are the sorts of things they are supposed to consider all three indicators of value, income, market or stock and debt, then there's cost and then there's various kinds of each one of those three. But those are mapped out at the front end of the Appraisal Manual. I would hope the Local Assessors are using and I think that's what they're supposed to look to; that's its purpose.

CJ: I think the point is that in the report we provided or did provide (unintelligible) basis for a comparison of market value over local value....(unintelligible) so we think the relevant number to look at is what would be assessed at the local level.

SE: Right, and the local and the state are supposed to use the same standards. That's the only point I wanted to make.

CJ: Well it's different than centrally assessed.

SE: They are the same standards.

RS: One of the issues that I think...on the report, and Donn kind of hit on it, was we were talking about the lateral pipeline itself and from what I have determined the lateral pipeline was actually owned by the natural gas company, which then would be centrally assessed by us. So it would have the three approaches to value: income, cost, and stock and debt.

MS: So both of our bypass customers own that; in fact I just had one that made the mistake of buying that from them.

DS: No, he's talking about the grandfathered companies. In Roland's look at that, those pipelines went virtually to the ....

RS: Right up to the point.

DS: Right up to the point of the plant, so there isn't a part that's valued at the local level because the interstate pipeline owned the pipeline up to the plant and that's assessed as a part of a central assessment of interstate pipelines which the...again, is centrally done and then we do that and then there's apportionment among the states and there's a whole formula for how that's done. But again, it's part of the three-pronged approach that Steve was talking about.

MR: I have a quick question here. Are any of these bypass customers, have any of them negotiated lower rates other than the standard rate?

DS: I think by definition it's the ones that are hooked up to the local distribution company that can negotiate a lower rate from that company. The tax...like for instance would fall on MidAmerican, but MidAmerican has the ability to pass that on, not in a one to one basis based on therms. They can negotiate a rate with some customers to get, you know, where a lower part of the taxes is passed on. The bypass customer, they get the rate right onto them, there is...they're the buyer and the seller really, because they are the purchaser and the user. What they can decide is how much of that they're going to pass on to the people who buy their product, you know, they don't have to prorate that out for every bushel of...

MR: Can they negotiate with the recipients of those taxes? The local government to receive some of that as a refund or an abatement or some type of incentive?

DS: There are other incentives like in this Akron example; where they can get some other relief or some services, but the replacement tax just is paid out through a formula that goes through the Department of Management and that's just paid out to the local governments for, you know, where that plant is located.

MR: So do the local governments know how much of the taxes that they are receiving relates to this property tax replacement?

DS: Yes.

MR: So you do know how much that is?

DS: Yes.

MR: You have a separate check?

DS: Yes.

MR: So a person could negotiate with the recipient of that and could ask for some of that back...

DS: Well money is fungible, it's not that you could get a different thing that....

MR: My point is...

DS: ...would neutralize it...

MR: ...the local government is going to be receiving some additional funds that they didn't have before.

DS: Right.

MR: Right? A company could negotiate with that local government and say hey you're going to get $100,000. We would like $75,000 of that if we build our plant near your jurisdiction. They could.

DS: It would be through a different avenue, but it could balance out. But it wouldn't be quite as simple. I know government's unusual that way. It wouldn't be quite as simple as you're saying, but they could get some other incentives.

MR: The government gets--the local government gets a check from the State.

SE: Mike, you said that wouldn't be through the tax laws it's just....

MR: ...development incentive...

DS: Right, exactly and that example I read to you, you know, that's part of it. They, you know, they were asking for property tax relief and they were asking for, you know, some services, some construction, and those kinds of things and they were saying, you know, you're going to get this extra money through the replacement tax. So that kind of negotiation, you know, takes place.

MR: So there's agreements in Iowa regarding specifically the replacement taxes coming back to the local jurisdiction.

DS: We're not privy to, you know, this was in the paper. We're not privy to what kind of agreements all the plants had with where they locate. I mean, I think all of those probably would be public...

MR: They would be public information.

DS: They'd be public information, but they're not something that's reported to the State. I mean people could get that information from the counties or cities and those kinds of things. That's not something...that's not the State's business...

MR: ...agreements that have been reached with the counties or plants?

MS: To the relief of the utility replacement tax? I'm not aware of that.

CARRIE JOHNSON (CJ): I would definitely claim there's some examples of urban renewal and tax increment financing that gets to the tax relief thing that you are talking about, but I don't think there's a TIF mechanism for utility replacement tax.

SE: But we don't know of anything in Iowa law that would preclude the ethanols from going and getting their savings if they could work it out with local governments outside the tax law. See, you still come out economically better than you are. There is no prohibition; it's the wrong forum because it's not a tax issue, but you guys need some help economically is what I am hearing. Is there a way you could do it outside of the tax laws?

MS: We are asking for fair taxation. Regardless of...

SE: I mean you need....

MS: ...economic situation.

SE: Under the assumption that perhaps you could benefit from something, it sounds like that might be an avenue you could do outside the tax law.

MS: I got two ethanol plants of the same size paying vastly different tax rates to the State of Iowa. It (unintelligible) locations. And I don't think the solution to that is to ignore the inequities of the Iowa tax law and to ask the disadvantaged client to go to their local government and ask that local government to give them a tax break or tax incentive. But that's my opinion...

MR: Well I think I understand; but you said they were paying it to the State. Are they really paying it to the State?

MS: Paying (inaudible), no.

MR: The tax, the replacement tax, they're not paying it to the State, I get it, but they re-funnel it back to the local government.

DS: It's a pass-through. The local governments, and really in that way it's similar to the fact that you may have a different tax rate in West Des Moines than you do in Lucas county or something like that. It's the same thing: you have a different tax rate, but if you're going to locate, like some of the major plants have, you know, out in Dallas County or Polk County, they negotiate, you know, the best deal they can for those kinds of places. Even though they're actually locating in a higher tax rate place. I mean they could go, you know, from...

MS: I'm not aware, but I'll use a lawyer word. I'll stipulate that there are different local tax rates. I'll stipulate that plants have the ability and any business has the ability to go to a local tax system/tax entity and try and work out a deal within the rules of the State and whatever that tax is in my opinion. But I would also just note that what we're talking about is a tax enforced by the State of Iowa through Iowa Code that treats in our view, and people disagree, in our view, similarly situated taxpayers

radically different and that's the inequity that we are talking about. We are not saying that you can't do all these other things. We are saying that it's not good public policy to have the problem in the first place. That's our view.

VLD: Isn't that the issue that's before the Supreme Court?

MS: Actually the issue before the Supreme Court, I can look into this, but it's on refund. But that's on a...does a bad public policy....let me... Can I give a non-lawyer answer because I love it please? The issue before the Supreme Court is actually not that at all. It's does the bad public policy raised to the egregious level of being so bad that it's unconstitutional. It may be ruled ultimately unconstitutional or may be ultimately be ruled constitutional. I mean constitutional does not, I would submit, always indicate good public policy.

CKD: Good lawyering.

MS: Was that pretty good?

DS: I think if you don't mind I will use that as part of my closing statement.

CKD: I think...Mr. Douglas, do you have a comment?

MARK DOUGLAS (MD): Yeah, my comment (unintelligible) but just to clarify since we have the state budget director in the room (unintelligible)...the notion of a similar property taxes, so I guess I'm reading into the assumption that if the bypass customers that are paying the replacement tax moved to some kind of local assessment that they would be paying significantly less taxes; therefore, less revenue to the governments? (unintelligible)

TS: Well I think although Donn disputes the evaluation, I think our report pretty clearly shows that if that lateral pipeline is valued upon a local assessment basis, using the cost approach, you can see the disparity between (unintelligible)...natural gas therms. So there's a gap. The gap is made up over time, but there is certainly a gap and again people don't know the total. (Inaudible) I think that our intent in the beginning is not to (unintelligible), that's not the intent with this. (inaudible) There has to be some mechanism to bridge that gap... (unintelligible)...trying to extrapolate based on the tax rate in the CSAs...(inaudible).

CKD: More questions for Donn while he's here? We can summon Tom back up here too, if you would like?

JS: Can I just have a quick clarification? I just got confused by Monte's non-lawyer/lawyer answer in regard to what actually is the issue before...what are we asking the Supreme Court to decide?

DS: It's whether the replacement tax, especially the bypass provision in the replacement tax, violates the constitution, mostly in terms of equal protection, but also dormant commerce clause, and yeah, I think it's just those two at this point, but...

CJ: There's a statute of limitations issue...

DS: But that is one of the equal protections.

CJ: True.

DS: So we have a number of equal protections and a dormant commerce clause, whether, you know, that the replacement tax is unconstitutional really is the issue.

JS: Because of the fact that similarly situated, which means the pre-replacement tax and post-replacement tax, entities are treated different.

DS: I don't think the grandfathered thing is still in there. It's mainly the difference between the municipal utilities and between the different CSAs. Whether that violates the constitution and I think as Monte said you can have a disagreement as, you know, what's the best public policy without it being a constitutional violation. That's why we feel comfortable that we can argue this and, you know, depending on what the state would do. Believe me if they did something that we didn't think we could defend we would let someone know, but, you know, there's a range of things that you can defend as constitutional because the Legislature and the Governor get to make those type of decisions. The Court really isn't in a position to second guess anything unless it goes so far as to violate the constitution; otherwise, it's a decision for the Legislature and the Governor to make.

CKD: Any other questions and comments for Donn?

JS: Well I have one question, when will we know whether the Supreme Court will decide if they're going to hear this?

DS: Well all the briefing is done and I think both sides...we think the Supreme Court will probably keep it as opposed to give it to the Court of Appeals. Because it's a constitutional issue; an issue of first impression on this thing.

They're in a term. They changed the kind of terms setup, and so if it doesn't get announced soon, then it's going to be heard by April or so; that wouldn't be heard until next fall and then I think after that we're probably looking at six months to a year before we got a decision based on some of our other cases. The criminal cases always have precedence because you know, we're talking, you know, at most about money. Whereas someone's liberty is a little more important than that, so they do those cases and try and get those cases decided first.

DAVID ROEDERER (DR): Monte's making it sound like it's kind of a fine line....

DS: So we're talking it could...I think the soonest it could get argued is late spring. More likely, probably in the fall and then six months to a year after that to get a decision probably. Chris you're on the other side, do you think that's reasonable.

CJ: Two months, would be my answer, but I would say, I think it will get in this year, possibly. The argument.

JS: So for sure either the Appellate Court or the Supreme Court will hear it? Or?

DS: Yes.

JS: Okay.

DS: They'll hear it. Whether they make a decision on is whether is to grant... The Supreme Court decides whether they keep it or give it the Court of Appeals and then whichever Court has it, they decide whether they want to hear oral arguments or just decide it on the papers. But they still set a date where it's submitted.

CJ: The soonest possible date is probably a year from now...is the soonest we could have a decision, possibly. Most likely '16; fall of '16.

JS: I just didn't want it dated if (unintelligible)

DS: I just know whatever way it will be, it will be some time before my rule of 88. It's getting closer.

CKD: All right. Julie, any other questions?

JS: No.

CKD: Anybody else? All right, Donn, thank you.

DS: Thank you.

CKD: Go back to your spot. And so now we are onto item 4, which is Comments from the Task Force. Is there anyone from the Task Force would like to provide any comments? Christina, are they close enough for you or do you need them to move up here?

CHRISTINA DOWNING (CD): That's fine as long as they speak loud.

CKD: So speak loudly, but stay in your seat. Do we just want to go around the table and if you have comments, Steve do you want to go first, you can go last and I'll make Mike go first.

MR: I guess I have a couple comments. First of all, I guess a couple of comments and maybe questions so I can get some clarity for it. When the Replacement Tax was first put into place, it was my understanding that one of the objectives was to create a reliable, fairly consistent, growing revenue and that the prior method with valuation based on the fair market and the cost and the debt and income levels there was changes in it...unpredictable and it was causing concerns about the revenue

going up and down. So this new law was to create a more stable, growing type of revenue. Is that a true statement? I recall that from one of the original meetings. Is that one of the intents?

CKD: So...

MR: Okay, was that one of the intents?

DR: Yep.

SE: It was near the top of the talking points when the legislation was being explained.

MR: Okay, and....

SE: ...and the department would...cause...we used to watch that roller coaster of value every year...we had differing opinions about what the roller coaster would look like for all that time. So this would lead us to a more predictive, stable, growing tax.

JS: Didn't you have a lot of appeals of the tax? (unintelligible) so local governments were always uncertain...

SE: MidAmerican Energy Company, we protested every year.

MR: Okay.

SE: But we haven't protested since 1998 now, so it's just a matter of filling out a form and validating numbers and we write checks. And our checks are bigger now than--as they should be--than they ever were in those days.

MR: And it has somewhat accomplished that, your comment there. It has created a kind of a steady, consistent growth in the revenue from the tax...

SE: I'll speak again. It's true on MidAmerican side, the investor-owned side. We were paying like $73 million across 80 counties in Iowa in property taxes, now its $96 million. And we certainly invested a lot more in the State of course as well.

MR: Sure.

SE: It was never advertised as a skyrocketing boom for counties and schools and cities, but that it would probably grow in a nice predictable pattern and at least from the MidAmerican side it's probably overachieved that, so...

MR: Okay, and what was the allocation that was first put into place. It was based on the tax that was being remitted based on the property here originally when the tax went into force. From what I recall though it wasn't the intent that the tax would always be based on the value. In fact there were some

comments ten years from now you really couldn't even do that anymore, because you didn't know the value of the property. Is that, I mean my point, I don't think the intent was that 20 years after the tax was put in place that necessarily had to be reflective of the of the property. That was just a starting point.

SE: I'll tell you what the property is used for today and you are correct.

MR: That was just a starting point.

SE: What the property is used for today is the Department of Management, the Department of Revenue's system has to have some numbers to allocate this big pile of money to the various taxing districts. So the property information that is submitted is used, you know, there is a baseline and if we have net additions and if there are major additions; they get special treatment by Roland and his crew, but the property story is still there. It is a property tax in that sense, right as Donn explained it. It's an excise tax as far as how much the tax is. Okay that's easy to figure how much the tax is. It takes a system based on property to allocate those tax dollars all over 99 counties.

MR: But the intent was the tax...the property tax would be an allocation tool rather than a dollar generation of tax tool.

SE: Yeah, the tax itself is based, in this case, on the delivery of therms to consumers in the State of Iowa times, you know, whether that competitive service area rate is. That's the big pot. And then the property reporting that we do, which has baseline in '98, but has certainly changed a lot since. It's for Management and Revenue's magic system to figure out where those dollars go. So the property isn't absent. And then just to keep the bond attorneys happy, there is a statewide property tax; a smaller tax that assures that it truly is bondable property so the municipal law people could tell you that story better than I could. Property is a role, but it's based on the throughput of therms. Allocated based on property.

MR: So I guess (unintelligible) Is if I had a local distribution company and a bypass customer in the same customer service area they would pay the exact same tax rate. Is that true?

DR: Yes. That's true.

MR: I just wanted to make sure I understood that.

CKD: Thank you Mike. Julie did you have something that you're....

JS: Well I just was, I guess maybe speaking what our direction is going to be here. Because I didn't think our charge was to, was to talk about potential legislation and what we might all think about that. It was to answer the leadership letter and provide information.

CKD: That's item 5.

JS: Oh am I skipping?

CKD: But we're done with commentary.

JS: You know if you don't want to cut it off, but....

CKD: Nothing wrong with getting done with the meeting early. Nothing wrong with that.

JS: There is a lot of hypothetical of what could possibly be and we are starting a new Legislative session and until we have something in front of us again...

CKD: Well and item 5 is report assignments and next steps and I think Donn so nicely walked through what the letter requests and Donn could you come back up here and maybe you could help us remember all the things that we need to do.

SE: Just as an observation as I look at who is here. We are missing the folks that get all of the money. Yeah we, the cities, counties, and schools are usually at this table, but they are not here today. We do have comments from a couple of cities here, but the counties and schools, that's over half of the tax dollars that we're spending, are not here at the table. I just wanted to note that.

JS: Yeah, for the schools we need to add Shawn Snyder.

CKD: To the school boards?

VLD: I thought he was with the Superintendents, is that the same thing?

DR: No, it'd be different; it'd be the school boards or the administrators.

DS: I think that's....

VLD: I think Shawn is representing the Superintendents, not the boards per se...no?

DR: I don't think so guys.

DS: But I think Steve's point is an important one that I have on my list and I didn't mention this. At some of the comments talked about this being created by the utility stakeholders and you know, the Department of Revenue, Department of Management, but there were the stakeholders of the counties, cities and school levels too and so I think it's good to remember that the original legislation was based on meetings of the group that included both the people who were paying the tax and the people who were receiving the tax.

MS: I know that they didn't include a single non-grandfathered bypass customer.

JS: There weren't any.

DS: I think, in your new legal words we would all stipulate to that.

CKD: All right, so there are some things that are data driven and then other are recommendation driven. So do we want to just walk through what's been requested and kind of assign who's responsible for it? Shall we do it that way?

DS: I have the questions, do you want that?

VLD: Donn has the questions.

CKD: Okay.

DS: Question number 1 was the number and types of taxpayers who currently pay the replacement tax. Oh, you have that now.

CKD: So number of type of taxpayers who pay the tax and Donn said that is something that the Department of Revenue has? If the Task Force would like us to gather that information we are happy to do that.

DR: Yes. Great.

CKD: As well as the amount of tax being paid.

DS: You should ask Roland these questions

CKD: To the extent not confidential.

VLD: Was that number 2?

CKD: And then the natural gas consumed, that's not available, right?

VLD: Unknown.

CKD: So we will have to put unknown and then report the amount of property tax that would be paid by each taxpayer identified in 1 if the taxpayer paid locally assessed property taxes at the current rates in respective counties. I don't think we can answer that one. The number and types of taxpayers who currently pay the tax. I don't think that's information that we have at our fingertips that we could calculate correctly. And then allocation in the amount of revenue generated by tax revenue in the local governments, other taxing districts. Do we have that?

DR: Yeah we have that.

CKD: Okay, so that's the data. And the analysis...I'm going back to the beginning. It says that the Task Force is to analyze the information and submit recommendations to the General Assembly. We can certainly get the data as quickly as we can, but it's going to be such piecemeal data that there's not much more analysis I think that...it's not going to lead you to any more conclusions than the data that's already been presented. We'll certainly do that though, so I guess the next question is, is there analysis or recommendation based on the comments that have been provided today that the Task Force would like us to undertake to start drafting for them. Since we are your staff? Yes Dave, what can I do for you sir?

DR: Well it sounds like, I mean the analysis is probably in the briefs that have been filed. You got different ways of looking at something and you have the Attorney General's office and also have the other folks. I don't know what more analysis...unless I am missing something, but...

CKD: So an approach we could take then is to provide the data and then provide basically the packet of information that we received and then that's the analysis. And then the next question is does the Task Force have a recommendation that it would like to make for the Legislature?

TC: I guess I would say, we wouldn't be here if someone didn't have an issue with the way it's being applied and clearly there's an issue being brought, so I guess I would say we would have to wait for a recommendation for legislation from someone who's got a problem with the way it's administered right now before we can do anything. A few years ago there was a company in an eastern county that had an issue with that and we sat down with a specific legislative proposal and I think spent some time working on that and the ins and outs and it was off to the Legislature. There were a couple of sessions, but I don't know if, since we on the Task Force, at least from what I can tell, we the Task Force folks right now see an issue or at least see a way to solve the issue that has been brought to us. It's hard to have a recommendation. That's where I think where we come from. There was a legislative initiative last year. I would just say that if there is another one coming up this year, that'd I'd ask that it would be detailed and brought to us as soon as possible, so we can get it through our own policy development processing back in our own shops. We would come with the educated discussion about it when the Session starts and that's the...I don't think we generate anything, but I think we are in receipt of information mode and I think we would go forward. That's my opinion on this.

CKD: Julie?

JS: I just think we can't make recommendations based on that. And maybe our recommendation is that it's inconclusive, because we don't have the information. So we haven't really analyzed the information. Our assumption is with the information like it says, so maybe we just say we're not; I don't know just something and then, you know, I wouldn't be opposed to saying, you know, these issues are potentially before the Supreme Court within the next few months and we don't want to make a recommendation about something that's in litigation by official tax lawyers.

CKD: Steve?

SE: Yeah, I've seen this Task Force work over the years and it's usually somebody brings something to us to understand it and then make a recommendation based on when we eventually get some understanding and usually have to have, whether it's Revenue or Management in the earlier years, if its technical, Alan over here would find some odd thing going on and we need to do a little technical fix here, so it would take us a long time to try to understand that. And we would recommend to the Legislature let's try this technical fix that the Department of Revenue or Management recommended. And then every other time anything's come up we've met and try and get educated and just the facts of those proposals against the three principles and see how they go. So it's a long way of saying we would see something before we could recommend anything. I think general comments were already submitted.

CKD: Mike, do you have anything you would like to add?

MR: I think I agree with Steve. We have to see something.

CKD: Anyone else have any comments? Does that give us sufficient marching orders to put together a draft, scrivener? I'm looking at the scrivener. And then we can share that with the Task Force. Share a draft with you. We hopefully (inaudible) to meet the December 5th deadline.

VLD: 15th.

CKD: 15th? Okay, sorry everyone. Any other discussion the good of the cause before we adjourn? Twenty-five minutes....Oh, Monte.

MS: I would like to ask as a favor some of the folks who have been around awhile on this issue and maybe have some of that background. I have a question I would like answered. I would like to sift through the proposal and I'd like to get some thoughts from some of you that have been around. At the time the bill was passed, they would have had some current bypass customers we got now that would have owned their own pipes and that were on loan a couple of miles whatever, not like right up to the door of the thing where the interstate pipeline has it. Would those plants that the current bypass customers have been viewed differently back then than the current grandfathered customers. And if so, how would that differentiation have been made, because if I understand that, I think that goes a long way of helping me maybe try to figure out something to bring to you next.

CKD: Based on what Donn said before I don't think it would. This is like the sales/use tax dilemma, so either you pay the sales tax when you buy it, which is, you know, what you pay to MidAmerican based on whatever you negotiate or if you don't pay the sales tax, you pay the use tax. Now let's not talk to me about use tax enforcement, but they're reciprocal, so you have to have them both.

MS: I am not arguing with you; if you don't pay here, you have to pay there, but in terms of the public policy that we are working against, not working against, but working as it's different background, the current policy/current law we have different categories. We have, you know, the municipalities, we have investor-owned utilities...essentially there little competitive service areas. We have grandfathered bypass plants and we have non-grandfathered bypass plants and I'm just trying to figure

out for the bypass plants that exist today, if they had been in operation and existed back when this law was passed, would they have been viewed differently by the people who, and this is an opinion question, it's not necessarily a factual question. But in your opinion, would it have been viewed, would they have been viewed differently than the ones that were grandfathered, and if so, what would have been that dividing line, so that would help me wrap around why there are two different treatments of these facilities.

DS: Monte, I think to try and answer your question, the District Court, and if you...I think that opinion is up online, too, where you can read that. But when you get to the grandfather issue, if the length of the pipe wasn't a factor because neither side even put in the information about these pipes are this long, the other ones are that long...this is information that we have just recently found out. It was primarily based on this reliance interest that the existing taxpayers had a reliance interest on the existing scheme of how they were assessed and that companies who were...went into business after the statute didn't have that reliance interest because the law had already been changed. That was, you know, a primary point of the District Court, so it didn't have anything to do with the length of the pipe.

MS: I am not arguing is it legal to grandfather, so...

DS: No, Yeah...

MS: From a public policy standpoint. Public policy makes a differentiation.

DS: Well in terms of that, you know, the grandfather, all I am saying is that that didn't seem to be a legal issue. I don't know from a policy issue, it wasn't a legal issue.

CKD: Go ahead Dick.

DICK STRADLEY: I will be brief because I no longer believe in free speech now that I am on my own. I did talk to...I was there in the beginning and I did talk to a gentleman by the name of Gene Eich. I think there was only 8 of us in the room. To answer your question, I believe it would be grandfathered because we looked at those and we grandfathered them. But to quote Gene Eich, when I asked him...he somewhat works for me...I don't pay him, okay other than lunches. He said...I asked him what he remembered we did, he said if we didn't do it, we would have blown them out of the water. So that was the reason for grandfathering back when we did that. So I'm done for the day. Thank you.

JIM MILLER: I think it's also kind of difficult to tell, because one of the reasons they allowed grandfathering in, the grandfathered companies in is because there was a relatively small number that wasn't going to affect overall. All of a sudden we have 25 appearing companies that are going to be a factor and I think it's crapshoot at this point. Because we knew there was going to be bypass customers in the State of Iowa.

MS: (unintelligible)...talking about the business case, you could have decided this, you could have done this, I think I would ask the Task Force if they promised something else. Um, put yourself in that time

machine and go back to 2001-2005 timeframe when these were being built. They would do this highly risky venture and if they needed a pipeline, multi-million dollar pipeline, built to them there were some companies that not very eager to build those pipelines and I don't regret that...that was their fiduciary responsibility to their company and their shareholders and their owners. Um, and so it wasn't always a choice of, "Gee, we would rather be a bypass customer." It was kind of like here's the right place, because of rail, water, corn...other things. And but the natural gas pipeline's two miles away, ten miles away, twenty miles away, who's going to build that pipe? I suspect that as most of them were trying to raise capital at that time and I helped a lot of them, if someone else would have taken ten million dollars of pipe off their hands, they probably would have been more than happy to do that; in most cases. I remember with the RECs and we talked about this, where you guys have to deliver power to these plants and we had discussions on, "Hey we are going to have to build a substation in this ethanol plant and have (unintelligible) all this money to this REC and if that plant only operates for 6 months and then goes away think of that strained asset that's going to be a real huge problem for the RECs and we really worked through those more or less, one by the fact that the plant didn't go away. But, um...

TC: You just can't fulfill an entire (inaudible), you just have to...

MS: You just stepped up! You guys stepped up! But um, I think it's important to remember, too, that you know, when we hear this thing, "Well they knew the tax was out there;" Um, yeah but sometimes they didn't have a choice and just because someone knows something's out there...we change laws every year, because we currently don't think that the current law is good enough, so...

DR: Monte, going back to your question, I'm trying to...when you are looking at the history of tax law and you use the words "clear and logical path" and "taxation" all in the same sentence, it's not always real clear nor is it always real pretty.

MS: I'm just curious because I know we tried to figure out kind of what some of the goals were and how we could maybe try to operate within those goals.

CKD: All right, anything further for the group? Thank you all for coming. We appreciate it and I would say we are adjourned.

The meeting adjourned at 2:40 p.m.

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IN THE IOWA DISTRICT COURT FOR POLK COUNTY

LSCP, LLP, Petitioner, v. COURTNEY M. KAY-DECKER, DIRECTOR, IOWA DEPARTMENT OF REVENUE, Respondent.	Case No. CVCV009671 ORDER ON PETITION FOR JUDICIAL REVIEW

Now before the Court is a petition for judicial review in which Petitioner LSCP, LLLP ("Little Sioux") argues the statute imposing an excise tax on consumers of natural gas who directly connect to interstate natural gas pipelines violates the Equal Protection Clause of the Iowa Constitution, the Due Process Clauses of the Iowa and United States Constitutions, and the dormant Commerce Clause. Attorneys Christopher E. James, Stanley J. Thompson, and William E. Hanigan represent Little Sioux, and attorneys James D. Miller and Donald D. Stanley, Jr. represent Respondent Courtney M. Kay-Decker, Director, Iowa Department of Revenue ("the Department"). Having considered the arguments of counsel, the parties' filings, the voluminous record, and the applicable law, the Court concludes the challenged tax comports with the Iowa and United States Constitutions and enters the following Order.

I. BACKGROUND FACTS

The facts in this care are largely undisputed. The Court will provide some general background about the natural gas industry before delving into the implementation of the challenged tax, applicable provisions of the challenged tax, and pertinent facts about Little Sioux. Additional facts will be included in the Discussion section, as needed.

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A. Natural Gas in Iowa

No natural gas is produced in the State of Iowa. Natural gas is moved to Iowa by interstate pipelines, which are regulated by the Federal Energy Regulatory Commission. The Natural Gas Act, codified at 15 U.S.C. § 717, governs the interstate transportation of natural gas. Northern Natural Gas Company is one of the major interstate pipelines serving Iowa.

Investor-owned utilities or municipal utilities distribute the majority of natural gas consumed in Iowa. These local distributors receive the natural gas from the interstate pipelines and then deliver it to consumers through intrastate pipelines. The Iowa Utility Board regulates investor-owned utilities. Municipal utilities are self-regulated.

A small number of consumers of natural gas obtain the gas by directly connecting to interstate pipelines through pipelines owned, operated, and maintained by the consumer. The economic and legal hurdles to directly connecting to an interstate pipeline serve to limit the number of consumers choosing to obtain natural gas in this manner. Most direct-connect consumers are large, industrial consumers of natural gas. These consumers may have special needs for high pressure and volume and may realize cost savings through directly connecting to the interstate pipeline.

B. Enactment of the Replacement Tax

Prior to 1998, natural gas utility companies were taxed on the property they owned in the area the utility serviced—an ad valorem tax. The legislature changed this tax structure when it passed Iowa Code chapter 437A. *See* 1998 Iowa Acts, chapter 1194. Chapter 437A became effective January 1, 1999. As relevant to this case, chapter 437A replaced the ad valorem property tax system with an excise tax on the delivery, consumption, or use of natural gas—the "Replacement Tax." Iowa Code § 437A.3(26). Concerns about the potential impact of possible

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deregulation and restructuring in the utility industry, among other factors, motivated the change. In a detailed section of legislative findings, the Iowa legislature identified a number of factors as motivating the decision to enact Chapter 437A. *See* 1998 Iowa Acts chapter 1194, section 1. The goals of the legislative enactment included: (1) preventing competitive disadvantages that may arise if the existing tax structure was maintained; (2) continuing to allow city-operated municipalities to transfer surplus funds to the city, in lieu of property taxes; (3) maintaining revenue neutrality for local governments, utilities, and consumers; and (4) reducing administrative burdens by eliminating the complex and time-consuming property tax valuation process. *Id.* The legislature reiterated its purposes in Iowa Code section 437A.2.

C. The Replacement Tax

Because the "imposition of a single statewide delivery tax rate would unfairly increase tax costs for some taxpayers while reducing such costs for others," the legislature established geographically based natural gas competitive service areas, with each service area having a unique Replacement Tax rate. 1998 Iowa Acts chapter 1194, section 1. The legislature designed and structured the competitive service areas to accomplish its goals of maintaining revenue neutrality. These legislatively created areas mirrored the geographic areas existing utilities served. There is nothing in the statute, however, that limits the ability of other utilities to provide service in any given service area. There are fifty-two natural gas competitive service areas. Iowa Code § 437A.3(22)(a); Ex. 65. Of those fifty-two areas, forty-six are municipal natural gas competitive service areas. Iowa Code § 437A.3(22)(a)(1)(a)-(at).

Initially, section 437A.5 instructed the Director of Revenue to determine the Replacement Tax rates for the non-municipal competitive service areas based upon average property tax payments made by the utility primarily serving the area during assessment years

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1993 through 1997, divided by the amount of therms delivered to users in that area by that utility during 1998. Iowa Code § 437A.5(3)(a-c). The legislature designed the rate to roughly equal the property tax that the utility would have paid to the local government, if the old property tax system had remained in place.

The tax rate for a given competitive service area is not static. The statute allows for adjustment of the tax rate based upon the number of therms delivered to an area each year. *See* Iowa Code § 437A.5(8) (setting the formula for adjusting the tax rate). If the number of therms delivered increases above a threshold level, the rate is adjusted down. If it decreases below a threshold level, the rate is adjusted up.

The legislature continued to treat municipal utilities distinctly from investor-owned utilities under the Replacement Tax. *See* Iowa Code § 437A.5. Prior to the passage of the Replacement Tax, municipal utilities generally were not subject to central assessment. The legislature recognized that transfers from utilities to municipalities "take the place of a property tax," and considered the risk of the loss of these in-lieu-of-transfers in crafting the Replacement Tax. 1998 Iowa Acts chapter 1194, sec. 1. Thus, municipal utilities are subject to a municipal natural gas transfer Replacement Tax rate, in addition to any delivery Replacement Tax. *See* Iowa Code §§ 437A.5(4) and 437A.5(1). However, because they were not subject to central assessment property tax liability, the delivery rate would be zero.

Producers of natural gas and interstate pipelines are not subject to the Replacement Tax. Iowa Code § 437A.5(7). The Department continues to centrally assess interstate pipelines for property tax purposes based upon the fair market value of all their operating property. When natural gas passes directly from an interstate pipeline to a consumer, the Replacement Tax is generally passed on to direct-connect consumers. Iowa Code § 437A.5(2). In essence, the

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statute treats a direct-connect consumer as delivering the natural gas to itself. Direct-connect consumers pay the same rate as any local distributor in its competitive service area.

The statute created an exception, or grandfather provision, for direct-connect consumers who were connected to an interstate pipeline prior to January 1, 1999. Iowa Code § 437A.5(7). Unlike utility companies, these entities had not been centrally assessed prior to the implementation of the Replacement Tax. They had been locally assessed like all property holders. They were exempted from the Replacement Tax because there was no central property tax assessment to replace. These entities remain subject to property tax by local government in the same manner they were prior to 1999. The record reflects five consumers who qualify under this exception.

D. Little Sioux

Little Sioux is an ethanol manufacturing company located in Cherokee County near Marcus, Iowa. Little Sioux's plant began operations in April 2003, more than three years after the Replacement Tax went into effect. In deciding to locate the plant in Cherokee County, the owners considered the site's access to locally grown corn, transportation infrastructure, sufficient electricity and natural gas, and an ample water supply. The owners sought property tax relief and road construction from Cherokee County as part of building the ethanol plant near Marcus.

Little Sioux uses a large amount of natural gas during the manufacture of ethanol, its primary product, and two derivative products: distillers' grains and corn oil. Little Sioux does not buy natural gas from a utility; it purchases natural gas directly from the producer. It then receives the natural gas directly from the Northern Natural Gas pipeline through its own directly connected pipeline. The Iowa Utility Board approved of the construction, operation, and

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maintenance of the Little Sioux pipeline in 2002, noting the pipeline would provide "a safe, low-cost energy source to the Little Sioux ethanol plant." Resp't Ex. B, Attach. 2, p. 4.

As a direct-connect consumer not in existence on January 1, 1999, Little Sioux is subject to the Replacement Tax. Little Sioux pays the Replacement Tax at the rate for the competitive service area in which it is located.[1] The rate in Little Sioux's competitive service area has stayed relatively stable. For example, the rate in 1999 was .01103529 and the rate in 2011 was .01057313.[2] Little Sioux delivered, consumed, and was subject to taxation on 13,870,630 therms of natural gas in 2007; 25,914,580 therms in 2008; 28,836,670 therms in 2009; and 29,798,970 in 2010.

II. PROCEDURAL HISTORY

In October 2010, Little Sioux filed a claim for refund for the Replacement Tax it paid in 2007, 2008, 2009, and 2010. Little Sioux claimed the Replacement Tax violated the Equal Protection Clauses of the Iowa and United States Constitutions. The Department denied Little Sioux's refund claims. Little Sioux appealed the denial. On appeal, Little Sioux added claims that the Replacement Tax violates the Due Process Clauses of the Iowa and United States Constitutions, as well as the dormant Commerce Clause of the United States Constitution. The case came before an administrative law judge[3] for an evidentiary hearing and argument. The ALJ issued a proposed decision on the case, in which it denied Little Sioux's claims for refund. Little Sioux did not appeal the decision to the Director of the Department of Revenue, making

[1] The parties refer to this service area as the "MidAmerican Service Area." Nothing in the statute designates this name. *See* Iowa Code § 437A.3(22)(a)(2) (designating the geographic area including Cherokee County as a distinct natural gas competitive service area, without giving any name or priority utility company for the area). While MidAmerican does provide natural gas distribution service to this area, nothing in the statute prohibits any other investor owned utility or other entity from providing distribution service in the area, as well.

[2] Other service areas have experienced significant decreases in the rate, which makes Little Sioux's rate higher in relative terms.

[3] The Honorable Jeffrey D. Farrell. Judge Farrell has since been appointed to serve as an Iowa District Judge in Judicial District 5-C.

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the ALJ's decision the final agency action pursuant to Iowa Administrative Code rule 701-7.17(8)(d).

Little Sioux thereafter timely filed a petition for judicial review with this Court. Little Sioux raises a number of distinct constitutional challenges to the Replacement Tax. Little Sioux alleges the Replacement Tax violates the equal protection principles articulated in the Iowa Constitution[4] by treating Little Sioux disparately than three other classes of taxpayers it claims to be similarly situated to: (1) natural gas consumers who are located in other natural gas competitive service areas; (2) natural gas consumers who are located in its same natural gas competitive service area; and (3) natural gas consumers who directly connected to the interstate pipeline prior to the enactment of the Replacement Tax and who were exempted from the new tax. Little Sioux argues there is no rational basis for the disparate treatment. The Department contends Little Sioux is not similarly situated to the classes of taxpayers it seeks to contrast itself with and, even if the classes were comparable, there is a rational basis for the disparate treatment.

Little Sioux also alleges the statute of limitations applicable to claims for Replacement Tax refunds violates equal protection because it sets a shorter time limit (ninety days) for constitutional challenges than for all other claims for refunds (three years). The Department contends the imposition of different time periods for different types of claims passes constitutional muster.

Little Sioux also alleges the Replacement Tax violates the Due Process Clauses of the Iowa and United States Constitutions. Little Sioux contends the Replacement Tax violates

[4] Although Little Sioux says it is also relying upon the Equal Protection Clause of the United States Constitution, all of the arguments in support of its equal protection claim are based solely upon the Iowa Constitution. *See* Pet'r's Br. 11–14. The Court therefore examines the equal protection claims under Iowa law only. The Court notes, however, that federal equal protection analysis would not require a contrary conclusion.

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substantive due process because it results in an unjust deprivation of property. The Department contends no deprivation of property occurs because the Replacement Tax serves a legitimate government purpose through means reasonably related to advancing that purpose.

Finally, Little Sioux contends the Replacement Tax violates the dormant Commerce Clause of the United States Constitution. Little Sioux argues the Replacement Tax hinders interstate commerce by discouraging consumers to directly connect to interstate pipelines. The Department challenges Little Sioux's standing to assert the dormant Commerce Clause claim and argues the Replacement Tax does not improperly burden or discriminate against interstate commerce.

III. STANDARD OF REVIEW

Little Sioux raises only constitutional challenges in this judicial review proceeding. No deference is due to the agency decision "because it is entirely within the province of the judiciary to determine the constitutionality of legislation enacted by other branches of government." *NextEra Energy Res. LLC v. Iowa Utils. Bd.*, 815 N.W.2d 30, 44 (Iowa 2012) (citing *ABC Disposal Sys. Inc. v. Dep't of Natural Res.*, 681 N.W.2d 596, 605 (Iowa 2004) and Iowa Code § 17A.19(11)(b)). The Court therefore reviews the issues presented de novo. *Qwest Corp. v. Iowa State Bd. of Tax Review*, 829 N.W.2d 550, 557 (Iowa 2013).

IV. DISCUSSION

The Court will address each of Little Sioux's constitutional challenges, in turn. The Court "begins with the presumption that Iowa's tax statutes are constitutional." *Camacho v. Iowa Dep't of Revenue and Fin.*, 666 N.W.2d 537, 543 (Iowa 2003). As the party challenging the validity of the Replacement Tax, Little Sioux "'has the burden to demonstrate that the statute is unconstitutional by negating every reasonable basis for supporting the validity of the statute.'"

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State v. Groves, 742 N.W.2d 90, 92 (Iowa 2007) (quoting *State v. Milner*, 571 N.W.2d 7, 12 (Iowa 1997)). And Little Sioux must prove the unconstitutionality beyond a reasonable doubt. *Id.* The Court will not find the Replacement Tax unconstitutional "'unless it clearly, palpably, and without doubt infringes the constitution.'" *Hearst Corp. v. Iowa Dep't of Revenue and Fin.*, 461 N.W.2d 295, 301 (Iowa 1990) (quoting *Zilm v. Zoning Bd. of Adjustment*, 260 Iowa 787, 150 N.W.2d 606, 609 (Iowa 1967)).

A. Equal Protection under the Iowa Constitution

The Court first considers Little Sioux's claims based upon the Equal Protection Clause of the Iowa Constitution. The Court will outline the legal principles governing all of the equal protection claims raised, and then apply the principles to the separate alleged violations.

1. Applicable Law

Article 1, section 6, of the Iowa Constitution states: "All laws of a general nature shall have a uniform operation; the General Assembly shall not grant to any citizen, or class of citizens, privileges or immunities, which, upon the same terms shall not equally belong to all citizens." In essence, this provision directs that "all persons similarly situated should be treated alike." *Varnum v. Brien*, 763 N.W.2d 862, 878 (Iowa 2009) (citations and internal quotation marks omitted).

When considering whether tax legislation comports with Iowa's equal protection principles, courts apply the rational basis test. *Qwest Corp. v. Iowa State Bd. of Tax Review*, 829 N.W.2d 550, 558 (Iowa 2013). In *Qwest*, the supreme court explained the rational basis test in the tax context:

> [The rational basis test] is a very deferential standard. Under rational-basis review, the statute need only be rationally related to a legitimate state interest. The state does not have to produce evidence, and only a plausible justification is required. The challenging party has the heavy burden of showing the statute

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> unconstitutional and must negate every reasonable basis upon which the classification may be sustained. The fit between the means and the end can be far from perfect so long as the relationship is not so attenuated as to render the distinction arbitrary or irrational.
>
> When we have applied the rational basis test to tax laws, they have generally been upheld without much difficulty. The rational basis standard is easily met in challenges to tax statutes.

Id. (Internal citations, quotation marks, and alterations omitted)). The *Qwest* Court reviewed the application of this standard in cases upholding legislation that exempted newspapers, but not magazines, from Iowa's sales and use tax (*Hearst Corp. v. Iowa Dep't of Revenue & Fin.*, 461 N.W.2d 295, 306 (Iowa 1990)); that provided for differential property tax treatment of buildings with one or two units, as compared with buildings with three or more units, even when both types of buildings are used for the same purpose (*Sperfslage v. Ames City Bd. of Review*, 480 N.W.2d 47, 49 (Iowa 1992)); and that imposed a parks fee on residential but not commercial developers (*Home Builders Ass'n of Greater Des Moines v. City of West Des Moines*, 644 N.W.2d 339, 352–53 (Iowa 2002)). *Qwest*, 829 N.W.2d at 558–59. The court also discussed the application of the rational basis test in *Racing Association of Central Iowa v. Fitzgerald (RACI II)*, 675 N.W.2d 1, 15–16 (Iowa 2004). Following remand from the United States Supreme Court, the *RACI II* Court held "the legislature's decision to tax racetrack gross gambling receipts at a rate of thirty-six percent and riverboat gross gambling receipts at a rate of twenty percent violated article I, section 6 of the Iowa Constitution." *Qwest*, 829 N.W.2d at 559 (discussing *RACI II*, 675 N.W.2d at 15–16).

After this exhaustive review, the *Qwest* Court applied the established principles to an equal protection challenge to a statute that imposed a tax on the Iowa-based personal property of incumbent local telephone exchange carriers, but not on that of long distance and wireless telephone service providers. *Id.* at 561–65. First, the court rejected the State's contention that it

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need not reach the question of whether there was a rational basis for the differential tax treatment, because the party challenging the tax statute (Qwest) was not similarly situated to the telephone service providers receiving more favorable tax treatment. *Id.* at 561. The court chose to assume the groups were similarly situated, noting the risk of "succumbing to a tautology" if it decided the case on those grounds. *Id.* (citing *Varnum*, 763 N.W.2d at 882–83).

The court then concluded that a rational basis exists for not taxing post-1995 investments in personal property in Iowa by long distance telephone carriers. *Id.* at 561–62. The court found that the tax structure was "a reasonable way for the legislature to encourage the deployment of new infrastructure that would foster competitive wireline networks and result in lower prices for consumers" and that the legislature "could have rationally believed that the [existing local telephone exchange carriers] had a powerful built-in competitive advantage based on their existing facilities, whose development had been underwritten by Iowa ratepayers over the past century." *Id.* The court concluded this is a "'realistically conceivable' justification, which does not involve 'extreme degrees of overinclusion and underinclusion,'" and therefore withstands rational basis scrutiny. *Id.* at 563 (quoting *RACI II*, 675 N.W.2d at 10).

The court also concluded the disparate treatment of the personal property of wireless providers passed the rational basis test. *Id.* at 563–64. The court noted "the legislature could reasonably conclude that the wireless market is competitive, with four companies of national scope doing business in Iowa (AT&T, Verizon, Sprint and T–Mobile), and that the wireline market is not." *Id.* at 563. Because pricing approaches marginal cost in a competitive industry, "the legislature might logically conclude that the burdens of a tax on the wireless providers' personal property in Iowa would simply be passed along to consumers in higher prices, while, a tax on a monopolist would not." *Id.* at 563–64. The court concluded this "justification for

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differential treatment is not 'specious'; it is 'credible.'" *Id.* at 564 (quoting *RACI II*, 675 N.W.2d at 8 n. 3.)

Guided by the principles outlined and applied in *Qwest*, the Court considers the equal protection claims raised by Little Sioux.

2. Consumers in other Natural Gas Service Areas

Little Sioux contends the Replacement Tax violates the Iowa Constitution's Equal Protection Clause because it does not apply the same rates to all large general service consumers of natural gas across the state. Of particular concern to Little Sioux is the rate paid by large general service consumers of natural gas located in municipal natural gas competitive service areas. Little Sioux argues that these direct-connect consumers receive more favorable tax rates based solely on geography, in contravention of the Equal Protection Clause.

The Department urges the Court to hold that Little Sioux is not similarly situated to the consumers located in other competitive service areas. The supreme court's opinion in *City of Coralville v. Iowa Utilities Board*, 750 N.W.2d 523, 530–31 (Iowa 2008), provides strong support for this proposition. In *City of Coralville* the court rejected the contention that "the Iowa Constitution require[s] that all Iowa laws be *geographically* uniform." 750 N.W.2d at 530 n.3. The *Coralville* Court concluded that Iowans served by different public utilities are not similarly situated and therefore a constitutional challenge based upon different rates paid could not be sustained. *Id.* at 531. Here, the various competitive service areas are geographically based. Iowa Code § 437A.3(22)(a). And the consumers located within the various competitive service areas are largely served by different utilities. For purposes of this analysis, however, the Court will assume that Little Sioux is similarly situated to other large natural gas consumers located in

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other natural gas service areas. *See Qwest*, 829 N.W.2d at 561 (assuming that taxpayers are similarly situated).

The Court then turns to the justification for the different rates in different competitive service areas. The Court concludes a rational basis exists for allowing for different tax rates among different geographic competitive service areas. The legislature created the competitive service areas consistent with the geographic zones in which utilities were providing natural gas service. The original rate was designed to closely approximate the property tax that the utility would have paid, so as to maintain revenue neutrality. As the legislature stated, "imposition of a statewide delivery tax rate would unfairly increase the costs for some taxpayers while reducing costs for others." 1998 Iowa Acts, Chapter 1194, Section 1. This justification is "credible." *RACI II*, 675 N.W.2d at 8 n.3.

This reasoning holds true even as one considers deliveries made by municipal utilities. Prior to the Replacement Tax regime, cities received surplus funds from municipal utilities through in-lieu-of-tax transfers. The legislature acknowledged that these transfers take the place of property taxes and designed the Replacement Tax to continue to allow municipalities to transfer surplus funds from a city operated utility. 1998 Iowa Acts, Chapter 1194, Section 1. Those large consumers of natural gas who chose to locate within and be serviced by municipal utilities therefore continue to receive a lower tax rate under the Replacement Tax regime.[5] That does not render the Replacement Tax unconstitutional. The legislature could reasonably favor municipal utilities as a means to support local government. The legislature gave a substantial role to city governments in setting rates for municipal utilities. Iowa Code § 437A.5(3)–(4).

[5] The record does not provide sufficient information to conclude that the overall cost of the natural gas purchased by large general service providers serviced by municipal utilities is lower. A reasonable legislature could also conclude that a municipal utility may build in additional costs to the gas provided to its customers for public purposes. Directly connected customers would not have such expenses.

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And in the legislative findings, the legislature acknowledged the unique relationship between municipal utilities and the communities they serve. Little Sioux cannot meet the high burden of establishing an equal protection violation on these grounds.

3. Consumers in the Same Natural Gas Service Area

Little Sioux alleges it is denied equal protection because other large natural gas consumers within its competitive service area do not directly pay the Replacement Tax. It argues that the tax structure discriminates against Little Sioux, vis-à-vis other large natural gas consumers, because the natural gas consumers who do not directly connect to an interstate pipeline pay the rate set by the local distributor, which has been less than the full Replacement Tax rate.

Little Sioux points to Valero Renewable Fuels-Fort Dodge, as an example. Valero is not directly connected to an interstate pipeline. It receives the natural gas it consumes from MidAmerican, the primary local distributor of natural gas in the service area in question. As the deliverer of the natural gas, MidAmerican pays the per-therm Replacement Tax and then passes on some of the costs of the Replacement Tax to Valero; the overall rate Valero pays includes an allocation of expenses to recover costs such as the Replacement Tax. *See, e.g.*, *City of Coralville v. Iowa Utils. Bd.*, 750 N.W.2d 523, 528–30 (Iowa 2008) (discussing utilities using tariffs to recoup expenses with the authority of the Iowa Utilities Board). Little Sioux contends the disparate result—its input costs for natural gas are significantly higher than Valero's—constitutes discrimination.

Little Sioux's argument fails. First, the two groups are not similarly situated. Little Sioux claims they are similarly situated for tax purposes because they are both ethanol plants that use large volumes of natural gas. This is a similarity without significance, however. Valero is

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not and has not ever been treated by the State of Iowa as a pipeline company. In contrast, although Little Sioux is not actually a pipeline company, it functions as one because it owns, operates, and maintains a pipeline and the State has treated it as a pipeline company within the meaning of Iowa Code Chapter 479. Resp't Ex. B., Attach. 2. The Court acknowledges the reluctance expressed in deciding equal protection challenges on this ground. *See Qwest*, 829 N.W.2d at 561. However, when the asserted similarities—similar businesses using large quantities of natural gas—are unrelated to the classifications created by the statute, such concerns are minimized, if not eliminated. In *Qwest*, the challenged tax statute differentiated tax treatment based upon the classifications at issue: wireline versus wireless; long distance versus local exchange. *Id.* at 551–54. Here, the classifications in the tax statute primarily address the delivery of natural gas, whether by a consumer who chooses to directly connect to an interstate pipeline (Iowa Code § 437A.5(2)) or by a local distribution company (Iowa Code § 437A.3(30)), not the volume of natural gas a customer uses or the use to which the gas is put. Because Little Sioux delivers its own gas and Valero does not, they are not similarly situated.

Second, this argument is not a challenge to the Replacement Tax as much as it is a challenge to the ability of utilities to flex their rates when dealing with large general services consumers. The Replacement Tax is the same for all therms of natural gas delivered in Little Sioux's service area. The result Little Sioux claims is discriminatory is not caused by the Replacement Tax, but by the action of a private entity, MidAmerican, acting under the regulation of the Iowa Utilities Board. "[E]qual protection claims require state action." *King v. State*, 818 N.W.2d 1, 25 (Iowa 2012) (citation and internal quotation marks omitted). "The mere fact that a private entity is subject to state regulation, even if the regulation is extensive and detailed, as in the case of a public utility, does not cause it to become a state actor" for purposes of equal

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protection analysis. *Principal Cas. Ins. Co. v. Blair*, 500 N.W.2d 67, 69–70 (Iowa 1993). To be considered a state action, "there must be a sufficiently close nexus between the state and the challenged action of the regulated entity." *Id.* Here, MidAmerican has contracted with its customers for a certain rate for natural gas. Little Sioux contends that MidAmerican has strategically chosen to allocate a far smaller amount of the Replacement Tax to its large general consumer class. That is an independent action by MidAmerican. There is not a sufficient nexus between the State and MidAmerican's contracting decisions with its large general services consumers to make the term of the contract into a state action.

Third, even if the Court considers the groups similarly situated and assumes sufficient state action to support an equal protection claim, there is a realistically conceivable justification for the disparate treatment that is not specious. Interstate pipelines are exempt from the Replacement Tax. If the Replacement Tax did not apply to direct-connect customers, the gas used by direct-connect consumers would not be subject to tax. This could create an economic incentive to bypass local distributors, making tax costs a major factor in the competitive environment. It also could negatively impact the tax base, reducing revenue for local governments.

For all of these reasons, Little Sioux cannot meet the high burden of establishing it an equal protection violation on these grounds.

4. Consumers Who Directly Connected to the Interstate Pipeline Prior to January 1, 1999

Little Sioux challenges the exemption granted to those entities directly connected to the interstate pipeline at the time the Replacement Tax took effect. These five grandfathered consumers continue to pay a traditional property tax to the local jurisdiction based upon the

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assessment of their bypass facilities. The Court finds Little Sioux cannot establish an equal protection violation on these grounds.

The supreme court has acknowledged that property taxes are "an area where reliance interests have been viewed as significant." *Qwest*, 829 N.W.2d at 555. Here, the five entities that were directly connected to an interstate pipeline before the Replacement Tax took effect had an expectation that the structure of the tax system applicable to them would remain constant. They had chosen their operation location and invested in the infrastructure required to directly connect to the pipeline. This reliance interest provides credible justification for the legislature's exemption of these entities from a change from a property tax to an excise tax. *See id.* ("It is reasonable for the State to preserve those reliance interests by continuing to tax property as it had been taxed from the date of purchase by its owner."). Moreover, the exemption serves the stated purpose of maintaining revenue neutrality for all existing stakeholders, a legitimate state interest. These justifications are credible.

The legislature also had a rational basis for including future direct-connect consumers in the Replacement Tax. First, these consumers would be embarking on a business venture knowing the tax structure applicable to their business. The record indicates that Little Sioux was well aware of the Replacement Tax at the time it decided to locate its plant in Cherokee County. It was reasonable for the legislature to assume that businesses sophisticated enough to negotiate the legal and procedural hurdles required to establish a pipeline connection would also consider the tax consequences of their decision to direct connect, along with the many other factors weighed in establishing a new venture.

Second, the legislature could reasonably conclude that exempting directly connected consumers established after 1999 would undermine the tax base and could negatively affect local

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governments. Interstate pipelines are exempt from the Replacement Tax. Iowa Code § 437A.5(7) (excluding interstate pipelines because they are not permitted pursuant to chapter 479 of the Iowa Code). But for the inclusion of the end-consumer backstop in section 437A.5(2), the natural gas that passed directly from an interstate pipeline to a consumer would not have been subject to *any* delivery tax. The legislature could reasonably conclude that allowing for this disparate treatment of the distribution of gas would result in a decrease in the available tax base for the excise tax and reduced revenue for local governments.

Little Sioux therefore cannot meet the high burden of establishing an equal protection violation on these grounds.

5. Statute of Limitations

Iowa Code section 437A.14(1)(b) sets forth a statute of limitations on claims for Replacement Tax funds. Generally, a claim for refund or credit must be filed within three years after the Replacement Tax payment was due, or one year after the Replacement Tax payment was made, whichever is later. A claim that a tax is unconstitutional, however, must be filed within ninety days after the tax became due. Little Sioux claims the differential treatment of the types of claims violates equal protection.

As an initial matter, because the Court finds that Little Sioux cannot meet the high burden of establishing a constitutional violation on any substantive ground, the Court need not address whether the differential treatment of constitutional claims by the statute of limitations offends equal protection. The statute of limitations has no impact on the outcome of this case.

The Court notes, however, that there is sufficient justification for the differential treatment of constitutional challenges. The legislature could reasonably have concluded that constitutional challenges create a greater threat to government coffers than other types of

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challenges. Contrast a challenge based upon a calculation error in one return with a constitutional claim undermining the validity of the tax structure itself, and the different interests of the Department become clear.

Miller v. Boone County Hospital, 394 N.W.2d 776, 779–80 (Iowa 1986), is therefore distinguishable. In *Miller*, the supreme court overturned prior precedent that held the notice and statute of limitations provisions applicable to tort claims against local governments comported with the Equal Protection Clauses of the Iowa and Federal Constitutions. *Id.* at 780–81. The *Miller* Court concluded that there was not a rational basis for requiring plaintiffs suing governmental entities to provide notice of their claim within sixty days, or else face a six month (as opposed to a two year) statute of limitations, when all other tort plaintiffs had a uniform two year statute of limitations. *Id.* The court found that one proffered justification—prevention of stale claims—applied equally to private defendants. *Id.* at 779. It found that budgetary planning was an insufficient rationale because of the prevalence of liability insurance to cover tort claims and concluded that settlement of valid claims is not enhanced by the shortened timeline. *Id.* at 779–80. Finally, the court stated "experience teaches" that it is unreasonable to conclude that a notice requirement enhances the government's ability to repair defective conditions. *Id.* at 780. In short, it found all proffered justifications to be specious.

The justifications asserted here are not specious; they are credible. Unlike a tort claim, which is likely covered by liability insurance, or a run-of-the-mill claim for a tax refund or credit, a claim challenging the constitutionality of a tax statute places substantial funds in the State treasury at risk. Requiring timely notification of such claims serves the legitimate purpose of reducing the State's financial exposure and promoting fiscal planning. *Cf. McKesson Corp. v. Div. of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 44 (1990) (suggesting that shorter statutes

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of limitations for constitutional claims could be utilized "to secure the State's interest in stable fiscal planning when weighed against its constitutional obligation to provide relief for an unlawful tax."). As such, Little Sioux cannot meet the high burden of establishing an equal protection violation on these grounds.

B. Substantive Due Process under the Iowa and United States Constitutions

Little Sioux alleges that subjecting directly connected consumers of natural gas to the Replacement Tax results in an unlawful taking of property without due process. The applicable law and the Court's analysis follow.

1. Applicable Law

The Iowa and Federal Constitutions guarantee that property shall not be deprived without due process of law. U.S. Const. amend V, XIV; Iowa Const. art. I, § 9. Little Sioux claims that the Replacement Tax violates its substantive due process rights, under both the federal and state constitutional provisions. Little Sioux does not advocate for a different due process analysis under the Iowa Constitution, recognizing that the two provisions "'are nearly identical in scope, import, and purpose.'" Pet'r's Br. 31 (quoting *State v. Seering*, 701 N.W.2d 655, 662 (Iowa 2005) (internal quotation marks omitted). Without cause to interpret the Iowa Constitution distinctly from its federal counterpart, the Court's analysis applies equally to both Little Sioux's state and federal due process claims. *See In re Detention of Garren*, 620 N.W.2d 275, 280 n.1 (Iowa 2000).

"Generally speaking, substantive due process principles preclude the government from engaging in conduct that shocks the conscience, or interferes with rights implicit in the concept of ordered liberty." *Zaber v. City of Dubuque*, 789 N.W.2d 634, 640 (Iowa 2012) (internal quotation marks omitted). The analysis of a due process claim follows a familiar process:

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> With a substantive due process claim, we follow a two-stage analysis. First, we determine the nature of the individual right involved, then the appropriate level of scrutiny. If the right at issue is fundamental, strict scrutiny applies; otherwise, the state only has to satisfy the rational basis test. When the rational basis test applies, there need only be a reasonable fit between the legislature's purpose and the means chosen to advance that purpose. We have said that the doctrine of judicial self-restraint requires us to exercise the utmost care whenever we are asked to break new ground in the field of substantive due process.

King v. State, 818 N.W.2d 1, 31 (Iowa 2012) (citation and internal quotation marks omitted).

2. Analysis

Substantive due process analysis must begin with a careful description of the asserted right. *Reno v. Flores*, 507 U.S. 292, 302 (1993). In the case at hand, Petitioner does not identify a fundamental right at issue. Nor can the Court identify any infringed upon fundamental right. *See Home Builders Ass'n of Greater Des Moines v. City of West Des Moines*, 644 N.W.2d 339, 353 (Iowa 2002) (finding no fundamental right at issue when park fee is assessed differently on commercial and residential builders). As such, the rational basis test applies: is there "a reasonable fit" between the legislature's purpose and the means chosen to advance that purpose. *Zaber*, 789 N.W.2d at 640. To survive rational basis review, the legislature need not employ the best means of achieving its interest. *Hensler v. City of Davenport*, 790 N.W.2d 569, 584 (Iowa 2010). And, like in the equal protection context, the party alleging a due process violation must negate every reasonable basis upon which the government's act may be sustained. *Zaber*, 789 N.W.2d at 640.

The Court's equal protection analysis largely foretells the substantive due process evaluation, as well. This is not uncommon. *See, e.g.*, *Sanchez v. State*, 692 N.W.2d 812, 820 (Iowa 2005) (deciding a due process claim fails "[f]or the reasons discussed in the equal protection analysis"). For the reasons already expressed in the equal protection analysis, the

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Court finds that there is "a reasonable fit" between the purposes for enacting the Replacement Tax and the provisions of the tax. *Zaber*, 789 N.W.2d at 640.

Additionally, the Court finds unpersuasive Little Sioux's argument that the tax is really a property tax and is an unlawful taking because it fails to take into account the value of Little Sioux's property. Pet'r's Br. 33. As Petitioner acknowledged at oral argument, the Replacement Tax is an excise tax. It is clearly defined as such in the statute. Iowa Code § 437A.3(26). As an excise tax, the relative value of the tax as compared to the value of Little Sioux's property is irrelevant. *Cf. Plank v. Grimes*, 28 N.W. 34, 35 (Iowa 1947) (holding that a motor fuel tax is an excise tax and not a tax on property).

Little Sioux cannot meet the high burden of establishing a due process violation.

C. Dormant Commerce Clause

Little Sioux alleges hinders interstate commerce in contravention of the dormant Commerce Clause of the United States Constitution.[6] The applicable law and the Court's analysis follow.

1. Applicable Law

The United States Constitution reserves to the United States Congress the ability to "regulate Commerce . . . among the several States." U.S. Const. art. I, § 8, cl. 3. The Commerce Clause has consistently been interpreted as including "a limitation on state regulatory powers, as well as an affirmative grant of congressional authority." *See, e.g., Fulton Corp. v. Faulkner*, 516 U.S. 325, 330 (1996). This implicit restriction on state action, known as the dormant Commerce

[6] In a footnote, Little Sioux asserts in the alternative that the Replacement Tax violates the Commerce Clause itself, "because Congress has intentionally deregulated the natural gas industry to promote interstate competition, and the replacement tax discourages Iowa consumers' direct purchases from interstate pipelines." Pet'r's Br. 37 n.4. This claim was not raised in the Petition for Judicial Review or briefed beyond a single footnote in Little Sioux's opening brief. It is not properly before the Court and the Court will not address it.

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Clause, "prohibits economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *Id.* (internal quotation marks omitted).

When considering a challenge under the dormant Commerce Clause of the United States Constitution, this Court is to decide the case in the manner in which "the United States Supreme Court would decide this case under its case law and established dormant Commerce Clause doctrine." *KFC Corp. v. Iowa Dep't of Revenue*, 792 N.W.2d 308, 322 (Iowa 2010). The Supreme Court has explained that a state's "power to lay and collect taxes, comprehensive and necessary as that power is, cannot be exerted in a way which involves a discrimination against [interstate] commerce." *Pennsylvania v. West Virginia*, 262 U.S. 553, 596 (1923). Under modern commerce clause jurisprudence, a dormant Commerce Clause claim against a state tax is examined under the four-part test articulated in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).[7] Under the four-part test of *Complete Auto*, a state tax does not violate the Commerce Clause if it: (1) is applied to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to services provided by the state. *Id.* at 279.

The first requirement, that of a "substantial nexus" is "informed . . . by structural concerns about the effects of state regulation on the national economy. . . . Thus, the 'substantial

[7] The Court notes the Supreme Court's more recent opinions addressing dormant Commerce Cause challenges to state taxes have not consistently utilized the four-part test. *Compare Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179–200 (1995) (citing and applying the *Complete Auto* four-part test in finding Oklahoma's tax on the sale of transportation services does not contravene the Commerce Clause) *with Dep't of Revenue of Kentucky v. Davis*, 553 U.S. 328 (2007) (deciding a dormant Commerce Clause challenge to the structure of Kentucky tax without reference to the four-part test); *see also Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine*, 520 U.S. 564 (1997) (finding Maine's property tax that exempted property owned by charitable institutions, except that operated principally for the benefit of nonresidents, violated the dormant Commerce Clause without reference to *Complete Auto*); *General Motors Corp. v. Tracy*, 519 U.S. 278, 287–311 (1997) (deciding that exemption of local distribution companies from sales and use tax did not violate the dormant Commerce Clause without reference to *Complete Auto*).

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nexus' requirement is not like the due process' 'minimum contacts' requirement . . . but rather a means for limiting state burdens on interstate commerce." *Quill Corp. v. North Dakota*, 504 U.S. 298, 312–13 (1992) (finding invalid a tax on an out-of-state office products vendor with no physical presence in the state). The second requirement addresses the concern that each state only tax its fair share of an interstate transaction. *See Jefferson Lines*, 514 U.S. at 184–85. A reviewing court must consider both internal consistency, whether each state could impose the same tax without overburdening interstate commerce, and external consistency, "whether a state's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing state." *Id.* at 185.

The third prong of the test requires determining that a state has not "impose[d] a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959). Finally, *Complete Auto*'s final test is whether the amount of tax can be justified as compared with the burdens posed by the taxpayer's activities in the state. The tax will be upheld "[w]hen a tax is assessed in proportion to a taxpayer's activities or presence in a State," because "the taxpayer is shouldering its fair share of supporting the State's provision of police and fire protection, the benefit of a trained work force, and the advantages of civilized society." *Edison Co. v. Montana*, 453 U.S. 609, 627 (1981) (internal quotation marks omitted). Each prong of the *Complete Auto* test must be satisfied.

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2. Analysis

The Replacement Tax survives analysis under the *Complete Auto* test.[8] First, the tax applies to an activity—delivery and use of natural gas in Iowa—that has a substantial nexus to the State. *Cf. D.H. Holmes Co., LTD v. McNamara*, 486 U.S. 24, 32–33 (1988) (finding a substantial nexus with state when catalogs are delivered to the customers within the state). Little Sioux essentially conceded this point. *See* Pet'r's Br. 38 ("Although the tax has a nexus to Iowa because it is applied to natural gas delivered within Iowa . . . .").

Second, the Replacement Tax is fairly apportioned. It taxes each therm of gas distributed to an end user in Iowa at the same rate, whether delivered by a utility or via a direct connection to an interstate pipeline. Little Sioux's argument as to apportionment misunderstands this aspect of the *Compete Auto* test. It essentially recharacterizes its equal protection arguments under the fair apportionment prong, claiming the tax is disproportionate as to directly connected consumers. However, in considering fair apportionment, the Court must determine fair apportionment as to the tax's impact on interstate commerce by making certain the state is only taxing its fair share of an interstate transaction. *See Jefferson Lines*, 514 U.S. at 184–85. Here, the tax is internally consistent; every other state could impose the same gas delivery tax without overburdening interstate commerce. The tax is also externally consistent—it does not "reach[] beyond that portion of value that is fairly attributable to economic activity within" Iowa. *Id.* at 185.

The third prong is satisfied, as well, as the Replacement Tax does not discriminate against interstate commerce. It provides no "direct commercial advantage to local business."

[8] The Court notes the Department initially challenges Little Sioux's standing to bring a Commerce Clause challenge. Resp't Br. 50. However, the Department does not separately brief or provide any legal authority in support of its challenge to Little Sioux's standing. The Court will assume, without deciding, that Little Sioux has standing to pursue this claim.

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Northwestern States Portland Cement Co., 358 U.S. at 458. The Replacement Tax is not charged to interstate pipelines delivering natural gas to Iowa. Out-of-state suppliers are not subject to the Replacement Tax. Again, each therm of natural gas distributed to an end user, either via a directly connected pipeline or from a utility, is taxed at the same rate. *Cf. Commonwealth Edison Co.*, 453 U.S. at 617–19 (finding no discrimination against interstate commerce when state coal severance tax rate was the same, computed based upon the amount of coal consumed, regardless of final destination). Nothing in the record supports a finding of discrimination against interstate commerce.

Finally, the Replacement Tax is fairly related to the presence and activities of Little Sioux within the state. The fourth prong of the *Complete Auto* test "focuses on the wide range of benefits provided to the taxpayer, not just the precise activity connected to the interstate activity at issue." *Goldberg v. Sweet*, 488 U.S. 252, 267 (1989). Here, Little Sioux, like all of the taxpayers subject to the Replacement Tax, benefits from "police and fire protection, the use of public roads and mass transit, and the other advantages of civilized society." *Id.* These benefits are fairly related to the Replacement Tax. *Id.*

V. CONCLUSION

For the foregoing reasons, the Court finds Petitioner LSCP, LLP, "Little Sioux" has not established the Replacement Tax is unconstitutional. No provision of Iowa Code chapter 437A has been shown to be in violation of the Equal Protection Clause of the Iowa Constitution, the Due Process Clause of the Iowa or United States Constitutions, or the Commerce Clause of the United States Constitution.

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IT IS THEREFORE THE ORDER OF THE COURT that the Agency decision is hereby AFFIRMED. The denial of tax refunds for tax years 2007, 2008, 2009, and 2010 is AFFIRMED.

IT IS FURTHER ORDERED that court costs are taxed to the Petitioner.

IT IS SO ORDERED this 28th day of February, 2014.

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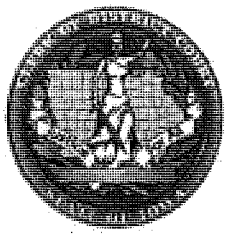

State of Iowa Courts

Type: OTHER ORDER

Case Number	**Case Title**
CVCV009671	LSCP, LLLP, ET AL VS COURTNEY M KAY DECKER ET AL

So Ordered

Rebecca Goodgame Ebinger

Rebecca Goodgame Ebinger, District Court Judge,
Fifth Judicial District of Iowa

Electronically signed on 2014-02-28 14:27:03 page 28 of 28

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IN THE SUPREME COURT OF IOWA

No. 14-0494

LSCP, LLLP,

Petitioner-Appellant,

v.

COURTNEY M. KAY-DECKER, DIRECTOR,
IOWA DEPARTMENT OF REVENUE,

Respondents-Appellees.

APPEAL FROM THE DISTRICT COURT OF POLK COUNTY
THE HONORABLE REBECCA GOODGAME EBINGER, JUDGE

PETITIONER-APPELLANT'S REPLY BRIEF

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STATEMENT OF ISSUES PRESENTED FOR REVIEW

I. Little Sioux Is Similarly Situated to Other Directly Connected Ethanol Plants.

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City of Coralville v. Iowa Utilities Board, 750 N.W.2d 523 (Iowa 2008)
Levy v. Parker, 346 F. Supp. 897, 902-03 (E.D. La. 1972) *aff'd*, 411 U.S. 978, 93 S. Ct. 2266, 36 L. Ed. 2d 955 (1973)
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II. The Replacement Tax Lacks A Rational Basis To Discriminate Between Little Sioux And Similarly Situated Natural Gas Consumers.

Cases

C.I.R. v. National Alfalfa Dehydrating and Milling Co., 417 U.S. 134, 149 (1934)
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Maine v. Taylor, 477 U.S. 131, 144 (1986)
Rasmussen v. Yentes, 522 N.W.2d 844, 846 (Iowa Ct. App. 1994)

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ARGUMENT

I. Little Sioux Is Similarly Situated To Other Directly Connected Ethanol Plants.

The Department repeatedly claims that Little Sioux is not similarly situated to other Directly Connected Ethanol Plants[1] on the basis that ethanol plants in question are located in varying taxing districts and subject to different levy rates. (Dep. Br. Pgs. 35-37). The only legal or factual support for this claim is the erroneous interpretation of the *City of Coralville* case. *City of Coralville v. Iowa Utilities Bd.*, 759 N.W.2d 523 (Iowa 2008). For that reason, there are serious factual and legal flaws with the Department's claims.

The Department equates Little Sioux's challenge of the tax-rate differential between competitive service areas to a taxpayer challenging differing tax rates among taxing districts. (Dep. Br. Pgs. 35-37). Little Sioux certainly agrees that there are variances in tax rates among local tax districts, from property tax levy rates to local option sales taxes. However, there are significant and important differences between those examples and the varying rates among Competitive Service Areas ("CSAs"). Notably, the

[1] Little Sioux defined the term Directly Connected Ethanol Plants in its brief at page 10 as "producers of ethanol which receive their natural gas from the interstate pipeline".

Replacement Tax is a *state-level tax* and is not a tax levied by, or in, a local taxing district.

Under Iowa Code § 444.1, "taxing districts in the state, including townships, school districts, cities, and counties" have the power to set property tax rates. These "taxing districts" meet the requirement set forth in *State ex. rel. Howe v. City of Des Moines*, 72 N.W. 639, 644 (Iowa 1897), where the court states that a tax "ought not to be conferred on a body of persons who are not the direct representatives of the people, who are not elected by them, and who, therefore, are not directly responsible to them unless the people assent thereto." The taxing districts contemplated by Iowa Code § 444.1, including townships, school districts, cities, and counties, are bodies that are direct representatives of the people to be taxed.

As applied to this case, a competitive service area is not the equivalent of a taxing district. A competitive service area has no persons serving it who are direct representatives of those on whom it imposes tax. The individuals and entities within a competitive service area do not, by vote, elect those responsible for the tax rate in their area. Because this is a state level tax and not a tax imposed by a local taxing district, Little Sioux has no influence over the Replacement Tax rate because it has no ability to participate in the local political process.

In addition, CSAs are not taxing districts. They are creations of statute for ease of administering a statewide excise tax focused on local distribution companies ("LDCs"). CSAs were certainly not created with Directly Connected Ethanol Plants in mind. (Replacement Tax Task Force Meeting Minutes, App. 325). The Department ignores this fundamental difference.

In fact, the Replacement Tax is wholly unique in applying differing state level tax rates based solely on geographic location -- a critical distinction in this case. The example the Department gave of varying property tax levy rates were tax rates independently levied by *each* taxing district. (Dep. Brief Pgs. 35-37). The Department provides no example where the *State* of Iowa has imposed *different* tax rates simply based on *geographic* location.

An illustrative example is the Hotel and Motel tax. In Iowa Code § 423A.3 a "state-imposed hotel and motel tax" is levied in the amount of five percent. The following section, § 423A.4 authorizes a "locally imposed hotel and motel tax" subject to local taxing district procedures. Thus, the dichotomy can be seen - the state level imposed tax is equal among all geographic locations while the local tax is completely a function of local

governments (within the bounds of the statute) and thus, subject to the decision making power of the local electorate.

In this case, it is the state level excise tax rate (not a property tax levy rate) that applies the tax across CSAs. Mr. Simmons, the sole witness for the Department at the Evidentiary Hearing agreed that Little Sioux cannot work with local government officials to affect the rate and the Replacement Tax rates are not affected by any local government action. (Simmons, Transcript Vol. II, Pgs. 95-96, App. 399). In essence, the Replacement Tax is not a tax that varies across taxing districts, rather the Replacement Tax rates vary across the *same* taxing district - the State of Iowa. Simply because the State of Iowa has drawn up arbitrary CSAs does not make a CSA a taxing district. The end result is a state imposed tax that varies across the State with no rational basis and a taxpayer with no ability to influence the local tax rate.

The Department categorically states that the *City of Coralville* decision is "indistinguishable" from the case at hand. (Dept. Br. at 35). Such an assertion fails completely when the facts of the present case are compared to the facts of *City of Coralville*.

It is important to bear in mind, as was pointed out in Little Sioux's Brief, that the *City of Coralville* does not discuss taxation—it is solely a

regulatory case which only involved *local* tariff rates. *Id.*; (Little Sioux Br. Pg. 24). The Department highlights the following quote in *City of Coralville,* "[c]itizens serviced by different public utilities are not similarly situated". *Id.;* (Dep. Br. Pg. 36). Little Sioux does not challenge this determination. However, it is wholly irrelevant to the case at hand.

Little Sioux and other directly connected ethanol plants are not serviced by *any* public utility and are not subject *to any* tariff rates. This raises the question as to how much relevance a case dedicated to tariff rates can have to a case involving excise tax rates levied by the State of Iowa. As illustrated above, there are no local jurisdictions involved or any consideration of the needs of a small, local area. CSAs for LDCs encompass broad swaths of the State of Iowa based solely on historic service territories of LDCs. The needs of local jurisdictions had no bearing on the implementation of the CSAs.

The Department goes to great lengths to emphasize that the Replacement Tax is an excise tax which replaced a property tax. (Dep. Br. Pgs. 11-12). This is precisely the point—an excise tax does not operate like property tax or a tariff. Rather, the Replacement Tax is a statewide tax, similar to a sales tax. For example, in Iowa the state level sales tax rate applied to retail purchases is six percent, regardless of the taxpayer's

location in the state. Iowa Code §432.2. Little Sioux readily concedes that local governments may impose varying rates of tax. But the Iowa Constitution requires a rational basis for the different treatment of similarly situated taxpayers when a state law imposes varying rates of tax based solely on geographic location. *See Levy v. Parker*, 346 F. Supp. 897, 902-03 (E.D. La. 1972) *aff'd*, 411 U.S. 978, 93 S. Ct. 2266, 36 L. Ed. 2d 955 (1973) ("While distinctions based on geographical areas are not, in and of themselves, violative of the Fourteenth Amendment, ..., a state must demonstrate, if it wishes to establish different classes of property [for tax purposes] based upon different geographical localities. . . that the classification is neither capricious nor arbitrary but rests upon some reasonable consideration of difference or policy."); *See also, Racing Association of Central Iowa v. Fitzgerald*, 675 N.W.2d 1 (Iowa 2004).

Little Sioux is clearly similarly situated to other Directly Connected Ethanol Producers and the Department has failed to demonstrate a lack of similarity.

II. The Replacement Tax Lacks A Rational Basis To Discriminate Between Little Sioux And Similarly Situated Natural Gas Consumers.

The Department fails to present a rational basis that would justify the drastic differences in tax rates imposed on similarly situated taxpayers.

A. Department Fails to Demonstrate any Rational Basis Applicable to Taxpayers Under 437A.5(2).

The Department throughout its brief, starting in its fact section and continuing into its argument section, continue to raise red herrings as it applies to the rational basis to support the Replacement Tax. (Dep. Br. Pgs 10-12, 38-46). The Department ignores that the Replacement Tax is more than just one code section levying a tax on one group of taxpayers. The Department defends the imposition of tax under Iowa Code § 437A.5(1) by pointing out the numerous benefits of the Replacement Tax as implemented under that code section. To a certain extent is it true that an LDC experiences the benefits spelled out by the legislature. For an LDC, the Replacement Tax mirrored almost exactly the property tax levied on the value of their assets, the amount paid by the LDCs was similar in amounts to historic property taxes, and any LDC delivering gas into Iowa would pay a rate of tax that corresponded to their asset value. However, for those subjected to the tax imposed under Iowa Code § 437A.5(2), none of those benefits apply.

First, directly connected ethanol plants pay a rate of tax that does not correspond to the value of any of their assets.

Second, the revenue to be paid to counties from the Replacement Tax was not based on receiving any income from Directly Connected Ethanol

Plants. The CSA is set to only allow moderate increases each year, despite the presence of additional taxpayers and despite overall consumption. Therefore, the Replacement Tax, as implemented under Iowa Code § 437A.5(2), will never be revenue neutral as applied to Directly Connected Ethanol Plants because there were no tax revenues to replace for consumers.

Third, because the tax under Iowa Code § 437A.5(2) is based upon the value of the assets of taxpayers under Iowa Code § 437A.5(1), the Replacement Tax could never accurately replicate the property tax of Directly Connected Ethanol Plants resulting in an application of the tax that is anything but uniform. Directly Connected Ethanol Plants are subject to a tax that bears no connection to any of their assets, historic property taxes or any activity on their part. In fact, the Department admits that Little Sioux has no control or input into the rate of tax that is applied to it. (Dep. Br. Pg. 45). Rather, the rate of tax is driven by the activity and assets of the taxpayer taxed under Iowa Code § 437A.5(1). Meanwhile, the taxpayers under Iowa Code § 437A.5(2) are held captive by historic property tax and asset values of taxpayers under Iowa Code § 437A.5(1). The Department does not even address the distinction between Iowa Code § 437A.5(1) and (2). As such, the Department has not raised any conceivable rational basis for the disparate treatment among taxpayers under Iowa Code § 437A.5(2).

The Department makes a bold claim by stating that "allowing bypass customers like Little Sioux the right to receive their natural gas free from delivery tax ... is exactly the scenario the Legislature intended to prevent." (Dep. Br. Pg. 42). Notably, there is no citation to any part of the record or legal support of any kind. This is because the Department is merely engaging in unsupported speculation. The Department indicates that directly connected consumers who do not pay the Replacement tax are a threat to the Replacement Tax regime, with no citation to the record to support this assertion. (Dep. Br. Pg. 43). In fact, the statute itself contradicts the Department's position in this matter. Iowa Code § 473A.5(7) exempted all directly connected consumers in place at the time the Replacement Tax was passed. If the inclusion of Directly Connected Ethanol Plants was such a vital part of the Replacement Tax regime, it begs the question why the entire class of taxpayers would be exempted.

The real danger feared was the expansion of competitors of LDCs located on the borders and operating in Iowa without paying property tax. (Whelan Transcript Vol. I, Pgs. 204-206, App. 380-381). This fear was largely driven by the electric utility side and not natural gas. *Id.* Early on, the proliferation of Directly Connected Ethanol Plants was clearly seen as an unintended result of the legislation. (Replacement Tax Task Force Minutes,

App. 325, 332) (Minutes include statement that "these bypasses that have come to pass in those years since ...have created...[an] unintentional result of the legislation"). Once again, the Department has no basis for its claims of a rational basis for the discriminatory tax imposed under Iowa Code § 473A.5(2) and is engaging in mere speculation.

B. Tax-Free Status of Little Sioux.

The Department alleges that allowing Little Sioux to take its natural gas free from delivery tax would make tax cost a factor in a competitive environment. (Dep. Br. Pg. 42). The Department does not elaborate as to exactly how tax costs would be a factor nor does the Department explain how the Replacement Tax is not already a factor in a competitive environment. Little Sioux is not escaping taxation if it did not pay the replacement tax. (Little Sioux Br. Pg. 11). Rather, Little Sioux would pay a property tax that would be based on the value of its assets. *Id.* A property tax based upon value would result in a more accurate tax on the delivery of natural gas. *Id.* In fact, Little Sioux would pay over $300,000.00 less under a property tax system than under the delivery tax regime. *Id.* (Exhibit 20, App. 191; Grotjohn, Transcript Vol. I at 131-133, App. 375).

The Department makes another unsupported claim as it relates to the Replacement Tax as implemented under Iowa Code § 437A.5(2) when it

claims that the Legislature may have foreseen that "bypassing the LDC could significantly weaken the tax base of local government." (Dep. Br. Pg. 43). This is a frivolous argument. The Replacement Tax was designed to be revenue neutral at its inception and remain so over its implementation by allowing for increases or decreases in therms used. (Little Sioux Br. Pgs. 7-9). Thus, whether or not any consumers were introduced into a CSA, the tax was designed to replicate the original tax dollars in the area. Thus, if all bypass customers left the Replacement Tax system tomorrow, the system is designed to ensure that the same amount of tax revenues flow into the CSA to local governments. *Id.*

Moreover, all bypass companies were exempted at the inception of the Replacement Tax under Iowa Code §437A.5(7). If bypass consumers were such a critical part of the Replacement Tax system, then it necessarily generates the question as to why every single one of the pre-existing bypass consumers would be exempted. The Department's claim that somehow the tax neutrality of the Replacement Tax system depends on bypass consumers is pure speculation.

C. Little Sioux Did Not Waive Their Constitutional Rights.

The Department appears to assert that Little Sioux cannot assert its constitutional rights because it chose to locate in the Mid America CSA.

(Dep. Br. Pgs. 40-41). The Department is fond of quoting the maxim that a taxpayer must accept the tax consequences of his or her actions. *C.I.R. v. National Alfalfa Dehydrating and Milling Co.*,417 U.S. 134, 149 (1934). While this maxim is certainly true, it has no bearing on this case. Little Sioux is not arguing against this maxim at all and readily agrees with the proposition. However, the Department's suggestion is that a taxpayer is forever barred from making a constitutional claim simply because it chose to form a company at the time a tax was enacted. Such a proposition is an affront to very principals of the equal protection clause of the Iowa and United States constitutions. Little Sioux did not, and could not, waive its constitutional rights by choosing to build its facilities in the MidAmercan service area.

The Department goes on to argue that this tax treatment was among considerations that also included the government incentives that Little Sioux received. (Dep. Br. Pgs. 40-41). Essentially, the Department is arguing that by entering a jurisdiction with knowledge of its current laws, a person waives his or her constitutional right to challenge those laws. *Id.* Under this legal theory, knowledge of the law when moving to a jurisdiction would constitute assent to such law no matter how egregiously unconstitutional. Under the Department's assertion, a same-sex couple moving to Iowa,

before the ruling in *Varnum v. Brien*, 763 N.W. 2d 862 (Iowa 2009), would have waived their constitutional right to challenge the ban on same-sex marriage, simply because the couple knew same-sex marriage was not legal in Iowa at the time the couple moved to the state. Although a fundamental right was at issue in *Varnum*, the level of scrutiny has no bearing on whether a party has standing to challenge a law. *Id.* An implied waiver of the right to challenge a law is clearly against the intent of equal protection under the Constitution. The fact that Little Sioux knew of the taxing regime on bypass customers does not mean Little Sioux waived its constitutional rights.

The Department also implies that receipt of government benefits limits and precludes the assertion of constitutional rights of Little Sioux. Despite receiving government benefits for locating in this service area, the "doctrine of unconstitutional conditions" prevents a waiver by Little Sioux. That doctrine provides that the government may not condition benefits on the recipients' agreement to surrender their constitutional rights in exchange." Jason Mazzone, *The Waiver Paradox*, *97* NW. U. L. REV. 801, 807 (2003); *see e.g., Racing Ass'n of Central Iowa v. Fitzgerald*, 675 N.W. 2d 1 (Iowa 2004) (receipt of a government benefit does not require the recipient to waive equal protection rights.). The fact Little Sioux received government benefits for constructing a plant in the MidAmerican service

area does not affect the constitutional analysis, because the State cannot condition a benefit in exchange for Little Sioux's waiver of constitutional rights. *See Id.*

This argument also breaks down upon further analysis because Little Sioux cannot control its tax rate or predict how wildly it might shift year to year. (Little Sioux Br. Pg. 37; Exhibit 36, App 257). It is important to note that the tax rate has varied significantly. *Id.* Had Little Sioux chosen the lowest rate in 2003, the United Cities Gas CSA (.00647), Little Sioux would be subject to the highest CSA tax rate in 2011 (.01542). *Id.* The disparity between the highest replacement tax rate and the lowest tax rate is staggering. When placed into more recognizable tax rates (as would be appear per thousand therms) the difference becomes more evident. In 2011, the highest tax rate was 26.35 per thousand therms while the lowest was 2.58. *Id.* This difference is exaggerated more when it is considered that in the case of the Directly Connected Ethanol Plant in the Emmetsburg CSA which pays a zero rate[2] of tax. (Little Sioux Br. Pg. 31). One can only imagine the outcry if property taxes or sales taxes varied by *twelve fold*

[2] Most municipal CSAs have tax rates of zero or close to zero and those bypass customers located within a 2 mile radius of the municipality receive their natural gas at a zero rate of replacement tax. (Little Sioux Br. Pg. 31).

among taxing jurisdictions. No other tax levied in Iowa has imposed so varied a tax rate upon similarly situated taxpayers.

The Department's attempts to demonstrate a rational basis fails when viewed in light of the facts. Mere conjecture unsupported by the record is not enough to overcome the tax inequality imposed by the Replacement Tax. *See Racing Association of Central Iowa v. Fitzgerald,* 675 N.W. 2d at 1.

III. Iowa Code § 437A.14(1)(b) Impermissibly Discriminates Between Similarly Situated Taxpayers.

Iowa Code § 437A.14(1)(b) impermissibly discriminates between two classes of taxpayers solely on the basis of whether one class seeks to exercise their constitutional rights. The Department concedes that Iowa Code § 437A.14(1)(b) creates two classes of taxpayers—those with constitutional claims and those without. (Dep. Br. Pg. 47). The Department also identifies the "end to be achieved" by creating two classes. *Id.* The end is "stable financial planning" and "protecti[on of] the state's treasury from potentially enormous claims." *Id.* at 48. The Department speculates that an erroneous calculation is "less devastating." *Id.* Thus, the main issues under dispute are limited to the constitutional standard of review and whether the statute survives either based on the proffered justifications.

As a threshold matter, the Department oversimplifies and misstates Little Sioux's case. Little Sioux is not challenging statutes of limitations, in

general. The constitutional violation creating the disparate treatment at issue is the *differential length* of the statute of limitation between the two classes of taxpayers, and the "*precondition*" of a "written protest which specifies the particulars of the alleged unconstitutionality" at the time of payment. *See* Iowa Code § 437A.14(1)(b).

The Court should apply strict scrutiny because a fundamental right is implicated, namely one's ability to have a meaningful access to the "only forum effectively empowered to settle [this] dispute." *Boddie v. Connecticut*, 401 U.S. 371, 376 (1971). A statute "which effectively bars persons on relief from commencing actions" implicates the fundamental right to access the court system, thus demanding the most exacting standard of review. *Id.* at 373.

In *Boddie*, the United States Supreme Court examined filing fees for indigent married people seeking a dissolution through the court system. *Id.* at 375. The Supreme Court acknowledged, unlike common law marriage, there is no other forum, other than the judiciary, empowered to grant divorces. *Id.* Given the court system is the only forum available, the Court examined the $60 filing fee and the $15 to $50 service fees. *Id.* at 372. The Supreme Court did not strike down filing or services fees in toto. Rather, it rejected the state's refusal to waive the fee when the only forum to accord

relief was the court system and the fees operated impermissibly to effectively close the courthouse doors. *Id.* at 383.

Similar to the indigent married in *Boddie*, Little Sioux's relief is with the Court. Constitutional review of statutes uniquely belongs to the judiciary. Nothing is more fundamental to the American justice system than the concept of checks and balances and the Court's ability to review statutes for constitutionality. *Hensler v. City of Davenport*, 790 N.W.2d 569, 581 (Iowa 2010) ("only rights and liberties that are objectively deeply rooted in this Nation's history and tradition and implicit in the concept of ordered liberty qualify as fundamental.") (internal quotations omitted). An instantaneous statute of limitations requiring "specifi[cations of] the particulars" on the date of payment *only* for taxpayers with constitutional claims plainly creates two classes of people and implicates a fundamental right and must survive strict scrutiny. *See also Hightower v. Peterson*, 235 N.W.2d 313, 319 (Iowa 1975) (recognizing the holding in *Boddie* that a filing fee may unreasonably deny access to the courts).

Here, generalized concerns about fiscal stability do not pass strict scrutiny. *In re S.A.J.B.*, 679 N.W.2d 645, 649 (Iowa 2004) (applying strict scrutiny to the fundamental right of parental rights, noting the state's concern for public expense in a parental termination lawsuit in not

compelling). Strict scrutiny analysis does not allow the Department to speculate about unrealized financial harm or eviscerate one's fundamental right to access the courts, merely because, if successful, it might cost money to rectify the impact of an unconstitutional law. The implication of the Department's arguments is that the state may insulate itself from enacting and enforcing unconstitutional laws solely on the basis that constitutional harms may be expensive to the state to rectify.

The Department argues that statutes of limitation cannot involve a fundamental right. The Department relies upon *Koppes v. Pearson*, 384 N.W.2d 381, 384 (Iowa 1986) (overruled); *Conner v. Fettkether*, 294 N.W.2d 61, 62 (Iowa 1980) (constitutional challenge to the minor tolling provisions); *Krupke v. Witkowski*, 256 N.W.2d 216, 224 (Iowa 1977) (discussing statutes of limitations in general and their application/usefulness); and *Argenta v. City of Newton*, 382 N.W.2d 457 (Iowa 1986) (overruled as to the precise reasoning cited). These cases are largely inapplicable because they speak to statute of limitations in general, and not instantaneous limitations periods such as the one involved in this case. The closest analogous case still falls grossly short. The Department cites *Kentucky, Revenue Cabinet v. Gossum*, 887 N.W.2d 329, 335 (Ky. 1994) in that a temporal differential between taxpayers with and without

constitutional challenges is constitutional. However, in *Gossum*, the inquiry was about a two-year statute, as compared to a four-year limitation. *Id.* This case does not illuminate reasoning or constitutional soundness of an instantaneous limitations period, i.e. an effective bar for constitutional challenges.

Lastly, the Department cites *American States Ins. v. State of Michigan*, 560 N.W.2d 644 (Mich. Ct. App. 1996) to support a 90 day limitation for tax refunds. This case does not involve an instantaneous limitation or a precondition. The case is further distinguishable because the 90 day limitation did not bar the constitutional claim itself, rather, only the payment of refunds on the basis thereof. Importantly, the Michigan Court of Appeals found the statute did not escape judicial review by the short statute, as the statute only prevented the payment of refunds, but not the underlying constitutional challenge. The Michigan statute states a refund "shall not be paid" if not filed within 90 days, unlike the much stronger language in the Iowa Code stating the claim "shall not be allowed." *See id.* at 649; Iowa Code § 437A.14(1)(b)(1). The Department has not cited any authority to support the Iowa statute's cumulative effect of shortening a statute of limitations, and requiring instantaneous articulation of the specific grounds of constitutional infirmity.

Moreover, the statute fails to survive a rational basis review. The Department goes to great lengths to justify and legitimize its goal to reduce state exposure and promote fiscal planning. *See* (Dep. Br. Pgs. 47-50) (citing *McKesson Corp. v. Div. of Alcoholic Bevs. & Tob. of Florida*, 496 U.S. 18, 45 (1990); *American States Ins. v. State of Michigan*, 560 N.W.2d 644, 650 (Mich. Ct. App. 1996); *Dickinson v. Porter*, 35 N.W.2d 66, 75 (Iowa 1949)). However, even if this were a legitimate justification, the Department ignores the second step of the analysis. *See Fed. Land. Bank of Omaha v. Arnold*, 426 N.W.2d 153, 156.

Espousing a legitimate goal is not *ipso facto* proof of constitutionality under any standard. *Id.* (striking down a statute as violative of equal protection under the Iowa Constitution, though there was a legitimate goal intended). "The question is whether these [alleged] legitimate goals are *rationally served* by a legislative scheme." *Id.* at 156-57. In examining the rationale advanced by the Department, the Court is "obliged to 'consider matters of common knowledge and common report and the history of the times.'" *Id.* (citing *Miller v. Boone Co. Hosp.*, 394 N.W.2d 776, 779 (Iowa 1986) (quoting *State v. Bartels*, 181 N.W.2d 508, 515 (Iowa 1921))).

Economic statutes are not immune from review. *See e.g., RACI, II*, 675 N.W.2d 1, 16 (Iowa 2004); *Fed. Home Loan*, 426 N.W.2d at 156;

Miller, 394 N.W.2d at 779). In both *Federal Home Loan* and *Miller* this Court examined the espoused goal to determine truly whether that goal was rationally advanced. For example, in *Miller*, there were four proffered legitimate goals: stale claims, planning of budgets, settling of valid claims and repairs. The Court easily disregarded these seemingly legitimate goals because the challenged 60 day notice prior to commencement of a lawsuit did not in any way bear on these identified goals. Most notable and applicable to this case was the planning of fiscal budgets. The disparate treatment of tort plaintiffs seeking redress from the municipality was not justified by generalized reference to public budgets.

A similar analysis occurred in *Federal Home Loan*. The court found that the disparate treatment of member and non-member financial institutions was not rationally related to the stated goals. Two goals were proffered: non-members lack a community stake, and were not legally bound to sell the farmland at issue within a designated time. The Court critically examined these goals in light of the statute at issue which was nobly created to ease the impact of the 1980's farm recession. 426 N.W.2d at 156. Notwithstanding the nobility, the court found non-member banks could not, constitutionally, be treated differently. The court reasoned non-members had Iowa connections and cannot be reasonably said to lack a stake in the

community. Further, not all member institutions were bound by a time limit to dispose of the farm real estate. The legitimate goals were not served; the disparate treatment is arbitrary and could not stand.

Similarly, here, there are many common sense reasons why the Department's proffered goal is not met by this statute of limitations. There is considerable delay in prosecuting a constitutional challenge and the state or local government may adjust its budget if exposure is expected. Further, there are financing vehicles available to lessen any alleged burden on public coffers. (*See* Little Sioux Br. Pgs.45-48).

Here, the Department refuses to answer the question, regardless of the constitutional standard: how does the "precondition" requirement to specify the particulars of unconstitutionality advance the goal of fiscal planning? Presumably, the Department will answer that it is an early indicia of monetary exposure. However, monetary exposure is not impacted by whether a tax protestor has met with an attorney and articulated, with specificity (more than a notice pleading standard), the legal grounds for the challenge. The Department does not answer why the limitation of filing a claim within 90 days, after satisfying the precondition, advances the Department's goal. The Department does not reconcile the reasons for the precondition and 90 day limitation for a tax that is operational *annually*.

The disparate treatment between the two classes of taxpayers cannot be justified. The alleged legitimate state interest is not advanced. The disparate treatment cannot stand and must be struck as unconstitutional under both the state and federal constitutions.

IV. The Replacement Tax Applied To Participants In Interstate Commerce By Iowa Code § 437A.5(2) Violates The Dormant Commerce Clause.

Iowa Code § 437A.5(2) applies greater replacement tax rates to consumers directly participating in interstate commerce. Little Sioux has standing to object to this application of the tax as an interstate commerce participant. The Department may not allege facts not in the record to support its claim to the contrary. Strict scrutiny requires a finding that the dormant Commerce Clause invalidates Iowa Code § 437A.5(2).[3]

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[3] There is no merit to the Department's perfunctory comments regarding defects in error preservation. (Dep. Br. Pg. 56). The Department concedes the argument was raised and ruled upon. Summy v. City of Des Moines, 708 N.W.2d 333, 338 (Iowa 2006) (rejecting a claim error was not properly preserved noting that error preservation requires the nature of the argument o be advanced); see also, Lee v. State, 815 N.W.2d 731, 739-40 (Iowa 2012) (internal quotations omitted) ("We will not exalt form over substance when the objectives of our error preservation rules have been met."); Griffin Pipe Prods. Co. v. Bd. of Review, 789 N.W.2d 769, 772 (Iowa 2010) (rejecting a "hyptertechnical error preservation" challenge, emphasizing the record revealed sufficient notice to the appellee); In re Estate of Potter, 798 N.W.2d 737, 011 WL 768787, at *3 (Iowa Ct. App. 2011) (unpublished) (dismissing a hypertechnical argument noting additional legal authorities, regarding the legal issues argued below, may be advanced at the appellate level).

A. *Little Sioux has Standing under the Dormant Commerce Clause because it pays more for its Natural Gas than do similar Large General Service Customers of Iowa LDCs because it directly participates in Interstate Commerce.*

The Department asserts on page 57 of its brief that Little Sioux has no standing under the dormant Commerce Clause because its out-of-state suppliers do not pay the Replacement Tax. The U.S. Supreme Court found in *General Motors Corp. v. Tracy*, that dormant Commerce Clause violations do not require a direct burden upon nonresidents. 519 U.S. 278 at 282–283 (1997) The Court found that the dormant Commerce Clause is invoked even if a bypass consumer such as Little Sioux, "presumably pays more for the gas it gets from out-of-state producers and marketers" as a result of the tax. *Id.* at 286.

Alternatively, the Department claims at page 59 of its brief that "all therms of gas delivered into the same service area are subject to the same tax." This is untrue. Little Sioux's expert witness proved at trial, without contradiction, that Little Sioux's replacement tax rate is 295% greater than is

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Additionally, despite the vague assertion by the Department, the IUB is not an "indispensible party" under Iowa Rule Civ. Pro. §1.234(2) which must be joined under Iowa Rule Civ. Pro. §1.234(3). Little Sioux seeks no remedy from the IUB. The IUB has no authority over and is unaffected by Little Sioux's tax refund claim. Invalidating Iowa Code § 437A.5(2) has no effect over IUB's tariff rates or its jurisdiction.

the replacement tax rate paid by competing ethanol plant customers of the LDC in the same competitive service area. (*See* Exhibit 32 - Supplemental Expert Report of Casey D. Whelan, App Pg. 239). This results from the authority exercised by the Iowa Utilities Board ("IUB") under Iowa Code § 476.6(19).

The Department further objects to Little Sioux's dormant Commerce Clause standing by claiming that there is no state action in utility ratemaking which provides discounted replacement tax rates to LDC customers as compared to the customers of out-of-state suppliers. The Department cites *King v. State*, an equal protection case and not a dormant Commerce Clause case. 185 NW 2d 1, 25 (Iowa 2012). The test is different for dormant Commerce Clause violations. Strict scrutiny applies. *See Maine v. Taylor*, 477 U.S. 131, 144 (1986).

The state, and not just the LDC, is the actor in this case. Utility tariff rates are derived from formal hearings, also known as tariff rate cases. *See* Iowa Code § 476.6(4). The IUB is not merely a regulating entity; it must docket each case as "a formal proceeding," and therefore is a party to an administrative proceeding pursuant to Iowa Code Chapter 17A. *See* Iowa Code § 476.6(4). Either the utility or the IUB may appeal the results of these proceedings to the District Court and ultimately this Court. *See* Iowa

Code §§ 17A.19; 476.13. The IUB is a state actor when it sets tariff rates, whether or not appealed, as "agency action" consists of any agency decision, proceeding, or exercise of discretion. Iowa Code 17A.2(2). Clearly there is no factual basis for the argument that no state action is involved in determining the LDC's tariff rate, which provides a 295% replacement tax rate discount for large general service customers competitive with Little Sioux. *See* Iowa Code § 476.6(19) (providing for the allocation of replacement taxes to utility customers). Furthermore, the Department is a state actor when it assesses the tax under Iowa Code § 437A.5(2).

Little Sioux has standing to claim that the Replacement Tax violates the dormant Commerce Clause. This is because the IUB provides the tariff which allows the LDC to discount the Replacement Tax rates of its large general service customers by approximately two-thirds. This results in Little Sioux paying substantially more for its natural gas than do its competitors as a result of bypassing the LDC in interstate commerce which triggers the negative effects of Iowa Code § 437A.5(2).

B. ***The Department improperly alleges facts not in the record to claim that Little Sioux's Out-of-State Natural Gas Suppliers are dissimilar to Iowa LDC's in the marketplace for Large General Service Customers such as Little Sioux.***

In page 62 of its brief, the Department makes the following unsupported statement,

> The legislature recognized the potential loss of large customers to bypass the LDC in order to purchase their gas free of any tax costs attributable to the LDC's centrally assessed tax liability. Any significant loss of high volume customers would not only weaken the LDC's ability to service its residential customers but would weaken the tax base of local government. To avoid this from occurring, the Legislature implemented the replacement tax system whereby tax costs were removed as a factor in a competitive environment.

This alleged legislative history and purpose is absolutely nowhere in the record of this case or the record of the General Assembly. *Rasmussen v. Yentes*, 522 N.W.2d 844, 846 (Iowa Ct. App. 1994) ("We do not address issues not properly raised or based on information not contained in the record"). In fact, just the opposite is the case. The record contradicts this assertion. (*See,* Replacement Tax Task Force Minutes, App. 325, 332) (Minutes include statement that "these bypasses that have come to pass in those years since ...have created...[an] unintentional result of the legislation"). The Department chose to present only one witness at the evidentiary hearing and did not offer any rebuttal expert witness. Thus, this unsupported statement is simplly false and made up out of whole-cloth.

This false factual claim is at best an ineffective attempt to liken this case to the majority opinion in *General Motors Corp.* However, in page 58 of its brief, Little Sioux has already demonstrated that the rationale of the majority opinion which upheld differential sales tax rates for bypass natural

gas customers in Ohio does not apply in Iowa. The Supreme Court, in *General Motors*, found Ohio LDC's to be unlike General Motors Corporation's nonresident suppliers because large general service customers in Ohio subsidize the rates of residential customers. The opposite is true in Iowa. Here, residential ratepayers subsidize the replacement tax rates of large general service customers. (Little Sioux Br. Pg. 58).

Little Sioux's appeal is better analogized to Justice Stevens' dissent in *General Motors Corp. v. Tracy*. 519 U.S. at 313-315. Although public policy may require that the state provide competitive advantages to its LDCs in captive residential markets, the dormant Commerce Clause prohibits states from providing competitive advantages to their LDCs in the competitive large general service markets.

C. *The Replacement Tax violates the Extraterritoriality Doctrine.*

At page 64 of its brief, the Department asserts that the extraterritoriality doctrine is not violated because each therm of natural gas entering the state "would only be taxed once". Little Sioux's complaint is not that its therms are taxed more than once. Its complaint is that its therms are taxed more. If every state would adopt the Iowa Replacement Tax regime, and allow its LDC's to discount rates for large general service customers, while requiring their taxing authorities to demand the full rates from residents bypassing their LDCs, then all residents of all states would be rewarded for buying locally by saving taxes, thereby impeding interstate commerce.

CONCLUSION

For all of these reasons, the Court should declare that Iowa Code §§ 437A.5(2) and 437A.14(1)(b) violate the United States and Iowa Constitutions and hold that Little Sioux is entitled to the refunds and its attorneys fees claimed in its refund requests.

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CERTIFICATE OF FILING AND SERVICE

I hereby certify that on the 16th day of October, 2014, I will file this document by delivering eighteen (18) copies of Petitioner-Appellant's Reply Brief to the Clerk of the Iowa Supreme Court, 1111 East Court Avenue, Des Moines, Iowa.

I further certify that on the 16th day of October, 2014, one (1) copy of Petitioner-Appellant's Reply Brief was served on:

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by enclosing the same in an envelope bearing the appropriate address, with prepaid postage affixed thereto, and by depositing the same in a United States Post Office depository in Des Moines, Iowa.

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I hereby certify that the actual cost of printing the foregoing Reply Brief of Appellant was the sum of 106.66.

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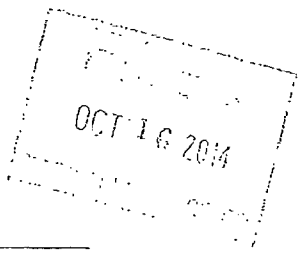

IN THE SUPREME COURT OF IOWA

No. 14-0494

LSCP, LLLP,

Petitioner-Appellant,

v.

COURTNEY M. KAY-DECKER, DIRECTOR,
IOWA DEPARTMENT OF REVENUE,

Respondents-Appellees.

APPEAL FROM THE DISTRICT COURT OF POLK COUNTY
THE HONORABLE REBECCA GOODGAME EBINGER, JUDGE

PETITIONER-APPELLANT'S FINAL BRIEF AND REQUEST FOR ORAL ARGUMENT

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ROUTING STATEMENT

Because this case raises constitutional issues of first impression under Iowa Code Chapter 437A, this appeal should be considered by the Iowa Supreme Court. See I.R.A.P. 6.1101(2)(c).

STATEMENT OF THE CASE

This case is an appeal of the Iowa Department of Revenue's ("Department") denial of four years of refund claims of Little Sioux Corn Processors or LSCP, LLLP ("Little Sioux") for the tax imposed by Iowa Code Chapter 437A (the "Replacement Tax"). (*See* App. 2-12 specifying that the years under protest are 2007-2010). The case was presented in an evidentiary hearing before the Administrative Law Judge, Jeffrey Farrell, on August 23-24, 2012. Little Sioux presented evidence through a fact witness, Gary Grotjohn, and an expert witness, Casey Whelan. The Department presented evidence through one fact witness, Roland Simmons. The Parties fully briefed the case following the evidentiary hearing.

The ALJ ruled in favor of the Department on January 29, 2013 in a proposed order. Little Sioux determined not to appeal the decision to the Director of the Department of Revenue. As such, the ALJ's decision become the final agency action pursuant to Iowa Administrative Code § 701-7.17(8)(d) on February 28, 2013. Little Sioux timely appealed the final

agency action to the Iowa District Court for Polk County on March 27, 2013. (App. 38-68).

Briefs were submitted to the District Court and a hearing was held on September 20, 2013. The District Court entered its ruling on February 28, 2014 (hereinafter "Order"). (App. 141-168). Notice of appeal was filed on March 21, 2014. (App. 169-170).

FACTUAL BACKGROUND

Little Sioux is a dry mill fuel ethanol manufacturing company located near Marcus, Iowa. (App. 365 at 64:16-18). It is owned by approximately seven hundred fifty mostly local investors. (App. 366 at 66:4-14). Its founders set out to process locally grown corn in order to capture the processing profits within the local community. (App. 367 at 69:8-23). Little Sioux purchases approximately forty million bushels of locally grown corn per year. (App. 368 at 77:8-12). Little Sioux, like all ethanol manufacturing plants at issue in this appeal, produces fuel ethanol and its byproducts in the same manner with the use of substantial amounts of natural gas received from out-of-state suppliers. (App. 365 at 62:23-25, 63:1-8).

In 2007-2010, Little Sioux consumed 13,870,630; 25,914,580; 28,836,670; and 29,798,970 therms of natural gas, respectively. (App. 315, 323). The boilers create steam to heat its ethanol manufacturing process, dry

its distiller's grain products, and provide ambient heat to its manufacturing facilities. (App. 369 at 84:22-25; App. 370 at 85:1-12).

In 1998, the State of Iowa restructured the application of property taxes as applied to natural gas and electric services within the state. Iowa Code 437A.2. The tax was designed to replace the traditional property taxes paid by natural gas and electric utilities. *Id.*

Little Sioux's expert witness testified that there are three main components to the natural gas industry: Commodity Supply Service, Interstate Pipeline Service, and Distribution Service. (App. 379 at 193:24-194:17). Commodity Supply Service is comprised of natural gas that is produced from wells and processed to meet interstate pipeline quality standards. *Id.* Generally, there is significant price transparency and liquidity in the commodity supply market. *Id.* In the State of Iowa, commodity supply comes from many regions within North America, but not Iowa. (App. 379 at 194:24-25).

Interstate Pipeline Service involves interstate pipelines that are large diameter, high pressure pipeline facilities that move gas from production areas to market areas. (App. 379 at 195:9-196:8). Interstate pipelines are regulated by the Federal Energy Regulatory Commission ("FERC") with respect to prices, service terms, and conditions. *Id.* The major interstate

pipelines serving Iowa include Northern Natural Gas Company (NNG), Natural Gas Pipeline Company of America (NGPL) and Northern Border Pipeline Company (Northern Border). *Id.*

Distribution Service, the final service component, includes receipt of gas from interstate pipelines, pressure reduction and delivery to consumers. (App. 379 at 196:9-21). Generally, distribution service pricing is regulated by state or municipal authorities. *Id.* In Iowa, Investor Owned Utilities (IOU), such as MidAmerican Energy ("MidAmerican"), are regulated by the Iowa Utilities Board (IUB) and municipal utilities are self-regulated. (App. 246). Distribution companies are assigned service territories within which they have the right to provide distribution services. *Id.* Those companies are commonly referred to as a local distribution company, or "LDC".

Prior to the Replacement Tax, a LDC would be centrally assessed for property taxes based on its natural gas operating property by the Department every year. (App. 392 at 62-64). The assessment procedure was similar to the method of assessment for other centrally assessed taxpayers, such as telephone companies. *Id.; see e.g.* Iowa Code Chapters 433 & 438. Interstate pipeline companies were, and still are, centrally assessed. *See* Iowa Code § 438.3.

The initial Iowa Replacement Tax rate for each IOU, such as MidAmerican, was computed by dividing each utility's average property tax liability from the years 1993-1997 by natural gas deliveries in 1998. (App. 381 at 206-207) (mathematically expressed as $\left(\frac{\text{Average Property Tax Liability Per Taxpayer (1993–1997)}}{\text{1998 Deliveries by Taxpayer}} = \text{1999 } IRT\right)$; *see* Iowa Code § 437.5(3). There is a unique and different Iowa Replacement Tax rate for each IOU operating within the state. Iowa Code § 437A.3. The Replacement Tax is reviewed each year and can be changed based on changes in deliveries within each IOU. Iowa Code § 437A.5(8).

The process for determining the Replacement Tax rate for municipal utilities is different and essentially examines payments made from the municipal competitive service area to the Department. Iowa Code 437A.5(4). If there were no payments from the municipal utility to the Department, then the rate was zero. *Id.* Most municipal Replacement Tax rates are low, if not zero. (App. 274-290).

The statute divided the State of Iowa into different geographic areas, called competitive service areas (CSA). Iowa Code §437A.3. Each CSA was set out according to a LDC's distribution area and each CSA is assigned a Replacement Tax rate based on the historic property taxes paid by the LDC. *Id.* Thus, there is a different Replacement Tax rate for each CSA.

There are provisions for small increases or decreases in the rate based on the volume of deliveries into the CSA. Iowa Code § 437A.5(8).

Iowa Code § 437A.5(2) placed a tax on any consumer which directly connected to an interstate pipeline and bypassed the LDC. Such a bypass consumer is subject to the same Replacement Tax rate as the LDC in that CSA. *Id.* Iowa Code §437A.5(7) granted a permanent exemption to all such directly connected consumers of natural gas existing prior to January 1, 1999.

Most directly connected consumers fall into the category of large general service consumers. (App. 379 at 196:9-21). These are consumers of natural gas who use a large volume of natural gas in an industrial setting as an input to manufacture an end product. *Id.* This is a wholly separate and distinct class from the residential consumer which is much more highly regulated by the IUB. (App. 383 at 213:24-214:25). The market for large general service consumers is essentially deregulated and has been since the early part of the 1990s. (App. 381 at 206-207). While natural gas utilities no longer pay a property tax, large general service consumers are still subject to local property tax assessment on all non-natural gas delivery property. *See* Iowa Code § 437A.18. There is a small property tax on all natural gas delivery equipment called the "statewide property tax" that is

part of the Replacement Tax. *Id.* It is 3 cents of every $1,000.00 of value. *Id.* This causes a pipeline used to connect to the interstate pipeline to not be subject to local assessment. *See* Iowa Code §437A.19. However, the remainder of an ethanol plant, such as Little Sioux, is still subject to local property tax assessment.

Little Sioux challenges the constitutionality of the Replacement Tax regime based on the severe discrepancies that occur in the rates of tax paid by similarly situated producers of ethanol which are directly connected to the interstate pipeline, the statue of limitations as it applies to those bringing a constitutional claim, and the discriminatory effect that the tax has on interstate commerce.

SUMMARY OF THE ARGUMENT

Little Sioux is similarly situated, and identical to other producers of ethanol which receive their natural gas from the interstate pipeline ("Directly Connected Ethanol Plants"). (App. 371-374 at 96-107). Directly Connected Ethanol Plants are consumers of natural gas in the large general service customer market for natural gas. (App. 382 at 210:13-25; App. 241-255). These large commercial users of natural gas utilize natural gas as an input to produce an end product. The government cannot, constitutionally, select who pays more for their direct inputs based solely on where they are located.

See Racing Association of Central Iowa v. Fitzgerald, 675 N.W.2d 1, 4 (Iowa 2004) (hereinafter "*RACI II*"). Yet, the Replacement Tax does just this - it allows the State the ability to alter the tax cost of natural gas among identical Directly Connected Ethanol Plants in drastic ways. (App. 241-255).

The Replacement Tax takes assets utilized in the production or delivery of natural gas and removes them from local property taxes and subjects the therms delivered or consumed via those assets to an excise tax on a per therm basis. *See* Iowa Code §§ 437A.5 & 437A.18. The difference is substantial between paying the Replacement Tax and paying a local rate of property tax on the pipeline for a Directly Connected Ethanol Plant. The property tax value of the pipeline for Little Sioux in 2010 was $157,308.00. (App. 191; App. 375-376 at 131-133). The total Replacement Tax paid for that tax year was $304,894.00. (App. 171-190). The local property tax rate for Marcus, in Cherokee County, was 2.151282%; thus, the local property taxes that would be paid on the lateral pipeline would have been $3,384.14 - *a difference of $301,509.86. See* (*Id*). The total property taxes paid on the remainder of the property of Little Sioux, including its ethanol plant, was $255,776.00. (App. 335). Obviously, the consequence of being subjected to the Replacement Tax is significant. For a LDC there is no such difference as

virtually all of their assets are exempt from property tax and the Replacement Tax was designed to replicate their property tax. *See* Iowa Code §§ 437A.5 & 437A.18.

Moreover, Little Sioux pays as much as four times the tax rate of other Directly Connected Ethanol Plants located in other CSAs. (App. 386 at 235; App. 274-290). Further, if a Directly Connected Ethanol Plant is located near a municipal natural gas service provider, then that ethanol plant will not pay any tax at all for their natural gas. (App. 398-399 at 92-93).

The Replacement Tax rate differential, as it applies to Little Sioux, is an unintended consequence of the Replacement Tax statute. (App. 325-334). Failure by the Iowa legislature to foresee the emergence of directly connected large general service natural gas consumers has led to a tax rate that treats similarly situated consumers extremely different. (App. 239-240; App. 386 at 236). The taxation of directly connected large general service natural gas consumers does not fulfill any part of the intended purposes of the Replacement Tax. *See* Iowa Code § 437A.2.

Instead of creating a level playing field, which is one of the statutorily proposed justifications for the statute, the tax rate differential tilts the playing field against direct-connect natural gas consumers. A consumer like Little Sioux, who chooses to directly connect to a pipeline, is economically

disadvantaged by the Replacement Tax as compared to similar ethanol plants. Because the stated purposes for the legislation have failed, there is no rational basis for the disparate treatment of similarly situated taxpayers. Accordingly, the purposes of the Replacement Tax statute as they are applied to Iowa Code § 437A.5(2) are not plausible, not realistically conceivable, and do not have a basis in fact.

Iowa Code § 437A.14(1)(b) provides the mechanics for applying for a refund of Replacement Taxes paid. The statute provides a general and broad three year statute of limitations for bringing a refund claim. However, Iowa Code § 437A.14(1)(b) draws a sharp distinction for constitutionally based refund claims. Instead of a broad three year statute of limitations, Iowa Code § 437A.14(1)(b) provides that:

> [a] claim for refund or credit of tax alleged to be unconstitutional not filed with the director *within ninety days* after the Replacement Tax payment upon which a refund or credit is claimed became due shall not be allowed. *As a precondition* for claiming a refund or credit of alleged unconstitutional taxes, *such taxes must be paid under written protest which specifies the particulars* of the alleged unconstitutionality.

Id. (emphasis added).

Although, the statute at first blush offers 90 days as a statute of limitations, the "precondition" requirement makes this an *instantaneous* statute of limitations for constitutional claimants. The taxpayer must fully

identify the particulars of a challenge at the exact same time that payment is made. The statute creates two classes of taxpayers with refund claims: those who make challenges based upon an error, such as a mathematical error, and those who have constitutional concerns. One group is allowed a broad, unqualified three year window to present claims. The other group, those who wish to exert their constitutional rights, must immediately protest at the time of payment. This requires every taxpayer to be immediately aware that their constitutional rights have been violated at the time of payment and sets a higher bar against the protection of constitutional rights.

There is no constitutional basis to treat constitutional claimants so adversely as compared to similarly situated taxpayers. At hearing, the Department presented *no evidence* which supported a distinction based upon protection of government treasuries. Suggestions that such disparate treatment of taxpayers is warranted, based on upon the impact of constitutional claims, is baseless speculation. As a result, the State may not discriminate against constitutional claimants by applying Iowa Code § 437A.14(1)(b) to deny any portion of its refund claim.

Iowa Code § 437A.5(2) further discriminates against interstate commerce, non-resident participants, and their Iowa customers. The Replacement Tax makes an express distinction between intrastate purchases

and interstate purchases, and assesses a penalty on consumers purchasing from non-resident suppliers and interstate transporters. As a result, the Court must strictly scrutinize Iowa Code § 437A.5(2). Consumers, such as Little Sioux, pay an after-tax effective natural gas price that is approximately triple the rate paid by consumers of in-state suppliers and transporters. (App. 239-240). The result of the tax is that Iowans such as Little Sioux pay more for natural gas because the tax penalizes Iowa commercial consumers for bypassing instate distribution companies.

ARGUMENT

STANDARD OF REVIEW

Generally, the Iowa Supreme Court reviews "a district court's decision on a petition for judicial review of agency action for correction of errors at law."[1] *Qwest Corp. v. Iowa State Bd. of Tax Review*, 829 N.W.2d 550, 557 (Iowa 2013) (citing *Timberland Partners XXI, LLP v. Iowa Dep't of Revenue*, 757 N.W.2d 172, 174 (Iowa 2008)). However, in cases such as this, where constitutional issues are raised, the standard of review is de novo. *Qwest Corp.* at 557 (citing *Timberland Partners* at 174) ("We typically review a district court's decision on a petition for judicial review of agency

[1] In a suit for judicial review of agency action, the Court may either affirm the agency's decision or remand the case to the agency for further proceedings. Iowa Code § 17A.19(10).

action for correction of errors at law ... However, in cases such as this one, where 'constitutional issues are raised, ... we must make an independent evaluation of the totality of the evidence and our review ... is de novo.'"); *Brummer v. Iowa Dep't of Corr.*, 661 N.W.2d 167, 171 (Iowa 2003); *Simonson v. Iowa State Univ.*, 603 N.W.2d 557, 561 (Iowa 1999); *Office of Consumer Advocate v. Iowa State Commerce Comm'n*, 465 N.W.2d 280, 281 (Iowa 1991) (clarifying that when constitutional issues are raised, "we are obliged to make an independent evaluation of the totality of the evidence; our review becomes de novo."); *Latiker v. City of Council Bluffs*, 720 N.W.2d 191 at 2 (Iowa Ct. App. 2006) (explaining that although the plaintiff-appellant makes constitutional claims and does not indicate whether he bases his claims on the United States or Iowa Constitution, the Court's de novo standard of review is the same); *Butt v. Iowa Bd. of Med*, 12-1118, 2013 WL 2637283 at *8 (Iowa Ct. App. 2013).

The Iowa Supreme Court has explained:

> We do not give any deference to the agency with respect to the constitutionality of a statute or administrative rule because it is entirely within the province of the judiciary to determine the constitutionality of legislation enacted by other branches of government. *ABC Disposal Sys.*, 681 N.W.2d at 605; *see also* Iowa Code § 17A.19(11)(b).

NextEra Energy Res. LLC v. Iowa Utils. Bd., 815 N.W.2d 30, 44 (Iowa 2012). Consequently, this court must make an independent evaluation based

on the totality of the circumstances because such analysis is the equivalent of de novo review. *See Silva v. Emp't Appeal Bd.*, 547 N.W.2d 232, 234 (Iowa Ct. App. 1996).

I. The Framework For An Equal Protection Analysis Under Iowa Law.

The Equal Protection Clause of the United States Constitution provides that no state shall "deny to any person within its jurisdiction the equal protection of laws." U.S. Const. Amend. 14. Likewise, the Iowa Constitution provides that "[a]ll laws of a general nature shall have a uniform operation; the general assembly shall not grant to any citizen, or class of citizens, privileges or immunities, which, upon the same terms shall not equally belong to all citizens." Iowa Const. Art. 1, § 6. This provision is sometimes referred to as the "equality provision." *Racing Association of Central Iowa v. Fitzgerald,* 675 N.W.2d 1, 4 (Iowa 2004) ("*RACI II*").

The Iowa Constitution is more specific than the federal provision in its requirement of uniformity. But both the state and federal equal protection clauses are essentially "a direction that all persons similarly situated must be treated alike." *Timberland Partners XXI, LLP v. Iowa Dept. of Revenue,* 757 N.W.2d 172, 175 (Iowa 2008) (quoting *RACI II,* 675 N.W.2d at 7 (Iowa 2004)).

A. *Similarly Situated.*

The first step in an equal protection analysis begins with a determination of whether one or more classes of similarly situated taxpayers are singled out for differential treatment. *Timberland Partners XXI, LLP*, 757 N.W.2d at 175. Next, the Court must then determine whether the differential tax treatment is rationally related to a legitimate government interest. *See, Racing Association of Central Iowa v. Fitzgerald, 648* N.W. 2d 555, 559 (Iowa 2002) ("*RACI I*").

This analysis was applied by the Iowa Supreme Court in two important decisions as it relates to the equal protection clause of Iowa and how it relates to taxation of Iowans. See *RACI I,* 648 N.W.2d at 555; *RACI II,* 675 N.W.2d at 1. The *RACI* line of cases involved a challenge of legislation that significantly increased wagering taxes on racetracks, but not on riverboats (a difference in taxing rates of 36% and 20%, respectively). *Id.*

In *RACI I,* the Court reversed the District Court's grant of summary judgment in favor of the state. 648 N.W.2d at 555. The Court held racetracks and riverboats were similarly situated taxpayers for purposes of Iowa's equal protection analysis. The Court held that taxing similar property at disparate tax rates was unconstitutional. The case was appealed

to the United States Supreme Court, which reversed, holding that the statute was valid under the federal constitution, after applying that Court's rational basis analysis. *Fitzgerald v. Racing Association of Iowa*, 539 U.S. 103 (2003).

On remand, the Iowa Supreme Court, in *RACI II,* applied the Iowa equality provision standards and again held the disparate statutory tax rates were unconstitutional. Although the Court still characterized its analysis as the application of a rational basis test, it applied a different test than the U.S. Supreme Court, using a more probing analysis to test the justifications advanced to support the legislative classifications. *See RACI II,* 675 N.W.2d at 7-8 & n.3.

The state argued in the *RACI I* case that racetracks were not similarly situated to riverboats, but the Iowa Supreme Court stated:

> At first blush, this is an appealing argument. However, in reality the essence of the differential treatment is not rooted in the dissimilar scenery surrounding the main activity at both facilities. Rather, the heart of the tax statute is in its disparate treatment of the *main activity* taking place at both riverboats and racetracks. That is, the essence of the tax is that it treats racetrack slot machines differently than riverboat slot machines. Where the same activity is being taxed at significantly different rates, a mere difference in location is not sufficient to uphold the discriminatory tax.

648 N.W.2d at 559 (emphasis added). Thus, it is not enough that certain taxpayers or competitors are not exactly the same in terms of location, type

of industry, or products. *Id.* Rather, in order to be similarly situated, there only needs to be a common characteristic or main activity that connects Little Sioux to others affected. In this case, a significant main activity among all taxpayers is consumption of natural gas in order to produce ethanol and related by-products.

B. ***Rational Basis.***

The court must then determine whether a rational basis exists for the different classifications. *Qwest Corp. v. Iowa State Bd. of Tax Review,* 829 N.W.2d 550 (Iowa 2013). To satisfy the rational basis standard, the classification must be reasonable and operate equally upon all within the class. *See RACI II,* 675 N.W.2d at 7-8. The *RACI II* court stated that "although the rational basis standard of review is admittedly deferential to legislative judgment, 'it is not a toothless one in Iowa.'" *See Id.* at 9 (collecting cases where Iowa Supreme Court has found statutes in violation of the equal protection provision). The state's proffered rational basis will not be accepted at face value, but will be examined to determine whether the stated classification is "realistically conceivable", "plausible", and has a "basis in fact". *Qwest,* 829 N.W.2d at 559; *see RACI II,* 675 N.W.2d at 7. While Little Sioux bears the burden of proof, any proffered rational basis must pass muster as realistic and plausible.

In *Qwest,* the court affirmed the application of the rational basis standard in *RACI II* by reiterating that the state must demonstrate a "plausible policy reason for the classification". *Id.* Further, the stated policy reason must be "realistically conceivable" and have a "basis in fact". *Id.* The court went on to affirm the *RACI II* definitions of "plausible reason", "realistically conceivable", and "basis in fact":

> The requirement of "'a *plausible* policy reason for the classification'" may be the aspect of equal protection analysis most susceptible to differing conclusions in application. ... [A] classification must be "*realistically* conceivable" [that] reflects the latter understanding of a "plausible" reason.

Id.

The court in *Qwest* went on to further affirm *RACI II* by reiterating the principle set forth in *RACI II*, that "although this element of equal protection analysis does not require 'proof' in the traditional sense, it does indicate that the court will undertake some examination of the credibility of the asserted factual basis for the challenged classification rather than simply accepting it at face value." *Id.*

It is not sufficient that a rational basis exists at the inception of a law because Iowa law requires the rational basis must be viewed in light of the current environment and changes that have incurred since the inception of the law. *Bierkamp v. Rogers,* 293 N.W.2d 577 (Iowa 1980). The Court in *Bierkamp* stated, "changes in underlying circumstances may vitiate any

rational basis. Additionally, the passage of time may call for a less deferential standard of review as the experimental or trial nature of legislation is less evident." *Id.* at 581.

II. The Replacement Tax Is Unconstitutional Because It Applies Drastically Different Rates Of Tax To Similarly Situated Taxpayers Located In Other Natural Gas Competitive Service Areas Without A Rational Basis.

Preservation of Error

Little Sioux preserved error on all matters raised in Issue II. All matters raised in Issue II were raised on petition for judicial review and were ruled on by the District Court. (App. 91, 125, 152-154).

A. Little Sioux is Similarly Situated Vis-à-vis Other Directly Connected Ethanol Plants.

The only distinction made between Directly Connected Ethanol Plants within different competitive service areas is their geographical locations. The court in *RACI I* disagreed with the proffered argument that the difference in the location of the gambling sites, one being on water the other on land, was a sufficient basis to find them to be dissimilar. *RACI I*, 648 N.W.2d at 559. With regard to Directly Connected Ethanol Plants, the use to which the gas is put is identical to that of Little Sioux. (App. 382 at 210:13-25). Thus, there cannot be any legitimate argument that the main activity at other Directly Connected Ethanol Plants is not similar.

The District Court erroneously perceived one of Little Sioux's arguments to be that it was claiming to be similarly situated to an ethanol plant that received its natural gas from municipal providers of natural gas. (App. 160-161). However, this is not the case; Little Sioux is claiming that it is similarly situated to a Directly Connected Ethanol Plant *located in a municipal natural gas competitive service area.* There is no plausible argument that Directly Connected Ethanol Plants located in other CSAs are not similar. An equal protection argument cannot be denied on a "similarly situated" analysis based solely on the very characteristic that creates the discrimination in the first place. *See, Varnum v. Brien*, 763 N.W.2d 862, 883 (Iowa 2009).

The District Court's analysis of the *City of Coralville* decision in relation to the similarly situated nature of Directly Connection Ethanol Plants located in different CSAs is flawed. 750 N.W.2d 523 (Iowa 2008). (App. 152). *City of Coralville* has no precedential value to this case as it does not even discuss taxation—it is a regulatory case involving local tariffs. *Id.* Indeed, the case turns on the fact that "public utilities are required to file tariffs with the IUB reflecting the *costs unique to their service area.*" *Id.* at 531 (emphasis added). A Directly Connected Ethanol Plant has no connection to tariffs of the LDC because the LDC and Directly Connected

Ethanol Plants are wholly unrelated. A tariff case has very limited application in a taxation case as the two subjects involve different sets of facts and law. Compare *City of Coralville*, 750 N.W.2d at 531 (stating that tariffs reflect the costs of a utility attributable to a defined area of service); with *Home Builders Ass'n of Greater Des Moines v. City of W. Des Moines*, 644 N.W.2d 339, 346 (Iowa 2002) (stating that excise taxes are charges to pay the cost of government without consideration to benefits received and are charges against a transaction).

The Order paraphrases and discusses a quote in *City of Coralville* where the court stated "[c]itizens serviced by different public utilities are not similarly situated". *Id.;* (App. 152). However, Little Sioux and other Directly Connected Ethanol Plants are not serviced by different public utilities because they are not served by ***any public utility***. Quite the contrary, Directly Connected Ethanol Plants are virtually all serviced by the *same* interstate deliverer of natural gas - Northern Natural Gas. (See App. 203-205, 256). Neither Little Sioux, nor the other comparable Directly Connected Ethanol Plants, are subject to the tariff rates of a local public utility.

Little Sioux is not seeking geographic uniformity as a *per se* rule. The claimed discrimination in this case happens to be geographic, but in other

types of cases, such as those involving tariff rates, geographic differences may not rise to unconstitutional discrimination. Rather, Little Sioux challenges the Replacement Tax's arbitrary classification based *solely* on location. *See, Levy v. Parker*, 346 F. Supp. 897, 902-03 (E.D. La. 1972) aff'd, 411 U.S. 978, 93 S. Ct. 2266, 36 L. Ed. 2d 955 (1973) ("While distinctions based on geographical areas are not, in and of themselves, violative of the Fourteenth Amendment, ... a state must demonstrate, if it wishes to establish different classes of property [for tax purposes] based upon different geographical localities ... that the classification is neither capricious nor arbitrary but rests upon some reasonable consideration of difference or policy").

At most, the *City of Coralville* decision is one of the many cases discussing equal protection principles. 750 N.W.2d at 523. In *City of Coralville,* the court did not provide extensive analysis that provides precedential application to broader constitutional cases. *Id.* In a concise opinion limited to the unique facts of the case, the Court in *City of Coralville* found that the City failed to prove its claim that one group of residential utility customers were substantially similar to another group of residential utility customers. *Id.*

The analysis by the *RACI II* court is more sound and applicable to this case:

> In the end, we return to the fact that the item taxed--gambling revenue--is identical. The higher tax rate is triggered by the location where such revenues are earned. Yet there is no legitimate purpose supported by fact that justifies treating one gambling enterprise differently than another based on where the gambling takes place, other than an arbitrary decision to favor excursion boats. *See Ill. Sporting Goods Ass'n,* 845 F. Supp. at 591.

675 N.W.2d at 9 (Iowa 2004).

B. ***The Replacement Tax Lacks a Rational Basis to Discriminate Between Little Sioux and Similarly Situated Natural Gas Consumers Located in Other Natural Gas Competitive Service Areas.***

The District Court further erred by failing to properly analyze the fact that directly connected consumers have no relationship whatsoever to a local provider of natural gas (the LDC). Directly connected consumers are wholly disconnected from the LDC and have nothing to do with the rate of natural gas paid by consumers of natural gas which take their natural gas from an LDC. In fact, directly connected consumers of natural gas are taxed under a different part of the Replacement Tax statute than are LDCs.[2] Directly connected consumers (which are not grandfathered) are taxed under Iowa Code § 437A.5(2) while LDCs are taxed under Iowa Code § 437A.5(1).

[2] Consumers of LDCs are not taxed at all under the Replacement Tax.

This difference is critical because, even though Iowa Code § 437A.5(1) may be justified as set forth in Iowa Code § 437A.2, the rationale completely breaks down when it is applied to Iowa Code § 437A.5(2).

The District Court also erred when analyzing the Replacement Tax. When the District Court addresses the issue of the zero Replacement Tax rate applicable to municipal utility CSAs, the District Court stated that a rational basis could exist for those companies taking their gas *from* a municipal utility. (App. 153). The District Court held that the Legislature could have chosen to favor local governments. (*Id).* However, this scenario does not implicate the code section being challenged-- Iowa Code § 437A.5(2). The District Court erred by concluding that if a directly connected consumer does not take its natural gas from the local municipal provider of natural gas, the Replacement Tax rate is still zero. An identical Directly Connect Ethanol Plant, as explained in more detail below, receives its gas directly from the interstate pipeline, but because it happens to be located within a municipal CSA, is taxed at a zero rate - an effective exemption from the Replacement Tax. There is no benefit to local government or any connection to local government which could conceivably support the proposed rational basis for this, in effect, exemption from the Replacement Tax. Again, those that receive their natural gas from the

interstate pipeline are wholly unrelated and disconnected from the LDC, whether a private or public provider. Thus, the proposed rational basis for essentially exempting a direct connected consumer in a zero rate CSA cannot be justified on the basis that it takes gas from the municipal provider - because that is not that case. This error undermines the entirety of the District Court's basis for its conclusion.

The sole proposed rational basis for the variance of the Replacement Tax rates among CSAs (excluding municipal CSAs) found in the Order is actually a rational basis of Iowa Code § 437A.5(1). However, the same rational basis cannot be applied to taxpayers under Iowa Code § 437A.5(2) as taxpayers under this code section have no connection to the LDC. The only proposed rational basis for the variance in Replacement Tax rates across CSAs in the District Court's decision was that because revenue neutrality was a goal, aligning CSAs with the LDC, upon which the revenue neutrality was based, was a "credible" justification for the Replacement Tax. (App. 153). The District Court's analysis may support a rational basis for Iowa Code § 437A.5(1), but cannot support a rational basis for Iowa Code § 437A.5(2) because directly connected consumers, taxed under Iowa Code § 437A.5(2), have nothing to do with revenue neutrality. The law was designed to be revenue neutral before any taxpayers were in existence under

Iowa Code § 437A.5(2). Thus, it was not necessary to bring directly connected consumers into the Replacement Tax regime in order to preserve neutrality. It makes no sense to tie historic property tax bills of a LDC to a consumer that has nothing to do at all with any LDC by irrationally confining them to a CSA and forcing them into a Replacement Tax rate. In the following analysis Little Sioux will demonstrate the confused and irrational nature of the Replacement Tax as applied through Iowa Code § 437A.5(2).

1. The Stated Purposes of the Replacement Tax are not Realistically Conceivable and do not have a Basis in Fact.

Due to where a consumer of natural gas is located within the State of Iowa, the tax rate may be zero or it may be only a fraction of the tax that Little Sioux pays. One must go to the background of the Replacement Tax in order to understand why there are different rates of tax. Iowa Code § 437A.2 provides a purposes clause for both the natural gas Replacement Tax and the electricity Replacement Tax. Its stated goals were to "remove tax costs as a factor in a competitive environment, preserve revenue neutrality, and provide a system of taxation which reduces existing administrative burden on state government". Iowa Code § 437A.2. As discussed above, when these purposes are applied to directly connected consumers, they fail

in having any basis in fact and have no realistically conceivable justification. The reason is that Directly Connected Ethanol Plants taking gas from the interstate pipeline was not foreseen and the application of the Replacement Tax to those taxpayers is an unintended consequence. (App. 332).

The basis of the differences in the rate of tax was based on the differences in the value of the property held in each CSA by the LDC or the total amount of proceeds remitted from the LDC. *See* Iowa Code §437A.5. In the case of the Interstate Power and Light ("IPL") CSA, for example, the Replacement Tax rate was based on the average of the amount of property tax that it paid over the preceding five years before the Replacement Tax went into effect. *Id.* Because the total average tax was less than the MidAmerican CSA, the Replacement Tax rate for the IPL CSA was also less than the rate applied to MidAmerican. (App. 274-290). For the Emmetsburg CSA, the calculation was based on payments made from that CSA and like several municipal utilities there was no prior tax proceeds to replace. *See* Iowa Code § 437A.5; (App. 274-290). As such, the Replacement Tax rate for that CSA is zero.

This way of calculating the tax rates was designed to make the bill revenue neutral by closely approximating what the property tax would have been. Iowa Code 437A.2. (App. 397-398 at 85-90). To a certain extent,

this made some sense if the goal was to replace property taxes paid only by the LDCs and could be a rational basis for the Replacement Tax as implemented under Iowa Code § 437A.5(1). What was not factored in was the problem of directly connected consumers located in the varying districts and the fact that they would be forced into the tax rate of the CSA and thus, drastically varying tax rates would apply throughout Iowa to the exact same type of consumer. Because of the entrance of the directly connected consumers, the Replacement Tax fails to provide an equal rate of tax across similarly situated consumers and thus, revenue neutrality fails as a rational basis for the Replacement Tax as implemented under Iowa Code § 437A.5(2). (App. 381 at 205-206). Revenue neutrality was not achieved by the inclusion of directly connected consumers, such as Little Sioux, and had nothing to do with Iowa Code § 437A.5(2).

Little Sioux has no relationship with MidAmerican in terms of natural gas procurement. Yet, Little Sioux is forced into a tax rate based almost exclusively upon the value of MidAmerican's assets. The stated goal of revenue neutrality did not consider the collateral effect upon Directly Connected Ethanol Plants. Iowa Code § 437A.5(2) has no purpose clause and is silent as to why the statute fails to take into account the property of consumers when constructing its tax rate, just like it did for MidAmerican

and IPL. Rather, Little Sioux, even now in 2014, is forced into a tax rate based upon the tax liability, during the years 1993-1998, of a multi-billion dollar utility. *See* Iowa Code 437A.5. There is no rational basis that is plausible or realistically conceivable to justify this absurd result.

One striking example of how this disparity works is seen with the Directly Connected Ethanol Plant, POET Biorefining-Emmetsburg (POET). The Emmetsburg city limits and the surrounding two miles are part of the Emmetsburg Municipal CSA. Iowa Code §437A.3(22)(a)(1)(j). Because the Replacement Tax is, at its core, a replacement property tax, and there were no property taxes to replace for the Municipal Emmetsburg CSA, the Replacement Tax rate is zero for the Municipal Emmetsburg CSA (which includes the city of Emmetsburg and *any directly connected consumers located within two miles of its city limits)*. (App. 398 at 92-93). Due to the operation of Iowa Code Chapter 437A, the POET Biorefining-Emmetsburg plant pays zero in Replacement Taxes and yet is also exempt from local assessment on the value of its pipeline. (App. 387 at 240). POET enjoys an exemption *without even receiving its gas as a customer of the local municipal utility*. *Id.* The result is one ethanol plant paying over $300,000.00 in Replacement Taxes and another completely exempt from taxation - based solely on where the ethanol plant is located. *Id.*

Another stated purpose contained in Iowa Code §437A.2 is management of the competitive environment. Leading up to the passing of the Replacement Tax in 1998, there was concern among utilities and regulators regarding a potential restructuring of the market for electricity transfer and consumers. (App. 239-240). Whelan, an expert in the natural gas industry, explains this restructuring in detail in his expert report and testified regarding the same at hearing. (App. 380-381 at 204-205). Due to fears of interstate competition, the in-state electricity providers and generators received a property tax system that would not create a competitive disadvantage with regard to interstate competition. *Id.* For the electricity market, there could be some merit to this purpose if electric deregulation ever occurred as there could be a means to compete in Iowa from out of state without paying any property taxes. (App. 381 at 205:6-8). Conversely, competition for natural gas was a non-factor and has no basis in fact. *Id.* First, there is no in-state production of natural gas to protect from out of state competitors. *Id.* Second, there was already a level playing field prior to the passage of the Replacement Tax because all direct-connect consumers were paying tax on their assets at the local level. *Id.* Last, there has never been an instance of an LDC located outside the state providing natural gas to an in-state customer. *Id.* If there were, the out of state LDC

would have paid property taxes on the assets in the ground to the same extent as an in-state provider would have prior to the implementation of the Replacement Tax. *Id.* Whelan, the only expert who testified at the hearing, stated "With the implementation of the Replacement Tax, then it's my view that it actually became an unlevel playing field tilted very much in favor of the distribution companies." (App. 381 at 205:9-206:4).

Language from Senate File 2416 (1998) for the Replacement Tax, illustrates the concern and supports the lack of a plausible policy reason for the Replacement Tax as it applies to natural gas:

> 1 16 Section 1. LEGISLATIVE FINDINGS. The general assembly
> 1 17 finds that with the advent of restructuring of the electric
> 1 18 and natural gas utility industry, a competitive environment
> 1 19 will replace the current regulated monopoly environment.
> 1 20 Currently, utility companies are subject to property taxes
> 1 21 which are levied in various amounts with respect to utility
> 1 22 property located in areas serviced by the utility companies.
> 1 23 If the property tax, as currently levied, continues, the
> 1 24 property tax costs in Iowa will become a factor among
> 1 25 competitors in the pricing of electricity and natural gas.
> 1 26 Moreover, non-Iowa located electricity and natural gas
> 1 27 suppliers do not have property in Iowa subject to property tax
> 1 28 and to the extent that they are located in a low property tax
> 1 29 state, such property tax costs would grant to such non-Iowa
> 1 30 suppliers an unfair tax advantage over Iowa-based utility
> 1 31 companies.

(*See* App. 239-240).

The concerns regarding the electric marketplace were unfounded as it was not restructured at all in Iowa. (App. 381 at 206:11-13). Moreover, the natural gas marketplace was already restructured to allow industrial customers access to a variety of supplier options well before the Replacement Tax was implemented. (App. 389 at 20:19-21). Unlike the electricity market, all natural gas is transported from outside Iowa; there is no in-state supply of natural gas to protect from out of state competition. (App. 379 at 194-195). Therefore, a stated goal of removing competitive barriers has no basis in fact and has no relation to Directly Connected Ethanol Plants taxed under Iowa Code § 437A.5(2) and cannot be a plausible rational basis for disparate Replacement Tax rates.

C. *The Volatility of the Replacement Tax Rates Further Illustrates That the Replacement Tax Discriminates between Similarly Situated Taxpayers without a Rational Basis.*

As it relates to the Replacement Tax rates, one can see that Little Sioux has experienced drastic differences in the rate of Replacement Tax that it has paid. In 2003, the MidAmerican CSA had the third lowest tax rate among non-municipal jurisdictions. (App. 257-294). However, by 2011, the MidAmerican CSA had the third *highest* Replacement Tax rate. *Id.* The lowest tax rate in 2011, the IPL CSA (.0026), was the highest tax rate (.0184) in 2003. *Id.* Although, revenue neutrality is a stated goal of the

legislation, it fails to account for the fact that local revenues can change routinely because of volatile rates of tax placed upon directly connected consumers. Iowa Code 437A.2. Moreover, these volatile rates of tax illustrate the inequity of the tax. There is no purpose found within the Replacement Tax which relates to the widely varying rates of tax and their effect on directly connected consumers.

The decrease within the IPL CSA, discussed above, was not an isolated incident. The Replacement Tax rate in Allerton Gas CSA went from .01588 in 2003 to .02635 in 2011 (the highest rate). (App. 257-294). Likewise, United Cities Gas CSA went from .00647 in 2003 (the lowest rate) to .01542 in 2011 (the second highest rate). *Id.* IES Utilities CSA went from .01204 in 2003 (second highest) to .00778 in 2011 (third lowest). *Id.* As can be readily seen from the preceding numbers, it is completely impossible to plan the tax burden or strategically plan business operations to take account of a low tax rate. What is the highest one year may be the lowest the next. Long term predictability is utterly impossible when it comes to the Replacement Tax. Compared to other shifts in tax rates, these increases and decreases vary dramatically. One can only imagine the public outcry if sales tax rates were to double in one year for only part of the state or income tax rates were to increase by one hundred and fifty percent for

those living in a certain county. The purpose clause contained in Iowa Code 437A.2 offers no basis at all for this disparate treatment. Certainly, the stated goals of competitive burdens and revenue neutrality do not justify this unequal treatment and tax simplicity was not achieved through the Replacement Tax.[3]

Moreover, Little Sioux is unable to affect the Replacement Tax rates in one way or another. Little Sioux's experience is illustrative of this point. (App. 384-385 at 227-230). Little Sioux's throughput volume, before Little Sioux's expansion, was three percent of the total volume of the MidAmerican CSA. *Id.* In order to make threshold adjustments in the Replacement Tax rate, total throughput volumes must change by in excess of 10%. *Id.* Mr. Whelan further testified as follows:

> Q Well, in 2008 Little Sioux completed a plant expansion that doubled their production and essentially doubled their natural gas usage...then 2009 was the first year that the volumes associated with doubling of the plant were included in the deliveries...
>
> Q 2010 rates would then reflect the rate after the increase?
>
> A That is correct...
>
> Q And what does that show?

[3] Moreover, bringing directly connected consumers into a centrally assessed tax framework only added complexity as Little Sioux would have remained locally assessed - imposing no administrative burdens on the State of Iowa.

A And what is shown in 2009 MidAmerican's rates is .0101 per therm. And in 2010, which would be the year after the doubling of the plant and the doubling of the volume, MidAmerican Energy's rate increased to .0105. So kind of contrary to what one would think. With -- with Little Sioux's volumes doubling, their unit rate went up as well. So there was kind of a...double whammy.

Q Now, what does that tell you about Little Sioux's ability to influence its rates at all?

A Based on this one data point, it appears that even extreme behavior on the part of Little Sioux, which is doubling their plant size, had --well, I hesitate to even say de minimis impact because the rate actually went up...But clearly it seems that it was something on the MidAmerican side that was driving this rate and not something that was happening by Little Sioux.

Id.

Little Sioux could not simply choose a low tax rate - it is impossible - and Little Sioux has no control over the tax rate that it pays as Little Sioux will never consume enough gas to rise to a level that would have any impact on the MidAmerican CSA. *Id.* Without any rational basis, a *state-wide tax* is levied on Little Sioux drastically different than it is for other taxpayers based on solely on where those taxpayers are located.

Notably, the Replacement Tax is a *state-level tax* and is not a tax levied by local jurisdictions. In fact, the Replacement Tax is wholly unique in applying differing *state level* tax rates based solely on geographical

location. There are, of course, variances in tax rates among local jurisdictions, from property tax levy rates to local option sales taxes. However, there is a significant and important difference between those examples and the varying rates among CSAs.

In this case, it is the state level tax that imposes the tax across CSAs. The Replacement Tax does not vary across jurisdictions, rather the Replacement Tax rates vary across the *same* jurisdiction - the state of Iowa. Simply because the State has drawn up arbitrary CSAs, without any relation to the Directly Connected Ethanol Plants, does not make a CSA a jurisdiction for a statewide tax. The end result is a state imposed tax that varies drastically across the state with no rational basis and a taxpayer with no ability to influence a local tax rate.

III. The Statute Of Limitations Contained In Iowa Code § 437A.14(1)(b) Unconstitutionally Discriminates Between Classes Of Similarly Situated Taxpayers.

Error Preservation

Little Sioux preserved error on all matters raised in Issue III. All matters raised in Issue III were raised on petition for judicial review and were ruled on by the District Court. (App. 132, 158).

A. The Shortened Statute of Limitations and Protest Requirement of Iowa Code § 437A.14(1)(b) Violate the Equal Protection Clause.

The protest requirement and the shortened statute of limitations contained in Iowa Code § 437A.14(1)(b) violate the Equal Protection Clauses of Iowa and the United States by discriminating against taxpayers who bring constitutional claims against the Replacement Tax. The statute creates two classes of people, dividing them by the type of claim they are bringing. *See* Iowa Code § 437A.14(1)(b). Those bringing constitutional claims for a refund receive discriminatory treatment that cannot be justified by any state interest. The alleged fiscal concerns of the State cannot justify taxpayers being denied access to the court when a constitutional violation has occurred.

Iowa Code 437A.14(1)(b) provides that a claim for refund of Replacement Taxes must be filed within three years. *Id.* However, if the claim is alleging that the Replacement Tax is unconstitutional, the claim must be filed "within ninety days after the Replacement Tax payment," and "[a]s a precondition for claiming a refund or credit of alleged unconstitutional taxes, such taxes must be paid under written protest which specifies the particulars of the alleged unconstitutionality." *Id.* Thus, a refund claim must be filed within three years unless the claim is alleging that the Replacement Tax is unconstitutional, in which case a claim must be filed within ninety days and the tax must be paid under written protest. *Id.*

While the shortened statute of limitations and the protest requirement are generally permitted under the due process analysis of *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 44-45 (1990), that analysis is irrelevant to the equal protection violation at issue here.

The facts of the present case are similar to *American States Insurance Company v. State Department of Treasury*, a Michigan case in which the claimants argued that a refund statute violated the Equal Protection Clauses of the United States and Michigan Constitutions because a subsection of the statute had a shorter statute of limitations (ninety days) than the general statute (four years). 560 N.W.2d 644, 647 (Mich. App. 1996). The subsection of the statute treated "'preemption claimants,' those whose claims arose because a Michigan tax statute has been preempted by a constitutional provision or federal law, differently than other refund claimants." *Id.* at 646. In deciding that the refund statute did not impinge upon a fundamental right, the Michigan court emphasized that the statute section "does not impose a limitation exclusively on those with constitutional arguments against a tax statute." *Id.* at 649. That fact is directly contrary to the Replacement Tax which imposes a limitation solely on constitutional claims—"A claim for refund or credit of tax alleged to be unconstitutional." Iowa Code § 437A.14(1)(b).

The Replacement Tax statute severely limits plaintiffs' access to the courts for the purpose of bringing a constitutional claim against the Replacement Tax. *See Bounds v. Smith*, 430 U.S. 817, 828 (1977) (emphasizing the "fundamental constitutional right of access to the courts"). Although other procedural requirements for tax refunds have been found permissible, the Replacement Tax crosses a significant line in creating a class distinction between those bringing constitutional claims as opposed to other claims and thus erecting a considerable barrier for plaintiffs arguing that the tax violates the constitution.

Because the Replacement Tax statute creates a distinction based upon constitutional claims, the level of scrutiny should be heightened as compared to other cases. *See RACI II*, 675 N.W.2d 1, 9 (Iowa 2004). The Iowa Supreme Court has stated that "classifications...affecting fundamental rights are evaluated according to a standard known as 'strict scrutiny.'" *Varnum v. Brien*, 763 N.W.2d 862, 880 (Iowa 2009); *see also Am. States Ins. Co.*, 560 N.W.2d at 648 ("To determine whether the rational basis or the strict scrutiny test applies, we must consider...whether [the statute] impinges on the exercise of a constitutional right"). "Classifications subject to strict scrutiny are presumptively invalid and must be narrowly tailored to serve a compelling governmental interest." *Varnum*, 763 N.W.2d at 880.

The Replacement Tax violates the very principles and purpose of the constitution by mandating that taxpayers who wish to challenge the constitutionality of the tax must do so on the very day the tax is due, while others who argue for a refund because of a simple clerical error, for example, have three years to do so. *See* Iowa Code § 437A.14. The process outlined in § 437A.14(1)(b) is the only available option for taxpayers protesting the constitutionality of the Replacement Tax. *Id.* The U.S. Supreme Court has stated that when "the judicial proceeding becomes the only effective means of resolving the dispute at hand...denial of a defendant's full access to that process raises grave problems for its legitimacy." *Boddie v. Connecticut*, 401 U.S. 371, 376 (1971). As such, the Replacement Tax impinges on the fundamental constitutional right of access to the court for bringing a constitutional claim and should be analyzed using a heightened level of scrutiny.

Under heightened scrutiny, the Replacement Tax fails. There are "no conceivable state of facts [that] could justify the class distinction drawn by the statute" between those bringing constitutional claims and those bringing other claims. *Fed. Land Bank of Omaha v. Arnold*, 426 N.W.2d 153, 156 (Iowa 1988) (citing *In re Bishop*, 346 N.W.2d 500, 505 (Iowa 1984)). While the State argues that its interest is fiscally related, such an interest cannot

overcome the vital importance of giving taxpayers access to the court when a constitutional violation has occurred.

Even if a rational basis test is used, the Replacement Tax still fails. The Iowa Supreme Court has stated, "Our prior cases illustrate that, although the rational basis standard of review is admittedly deferential to legislative judgment, 'it is not a toothless one' in Iowa." *RACI II*, 675 N.W.2d at 9 (quoting *Mathews v. de Castro*, 429 U.S. 181, 185 (1976)). Indeed, although "deferential scrutiny" is accorded the state "in the realm of economic policy and regulation...even in the economic sphere, a citizen's guarantee of equal protection is violated if desirable legislative goals are achieved by the state through wholly arbitrary classifications." *Fed. Land Bank of Omaha*, 426 N.W.2d at 156. When applying the rational basis test, the standard is "whether the classifications drawn in a statute are reasonable in light of its purpose." *RACI II*, 675 N.W.2d at 7 (quoting *McLaughlin v. Florida*, 379 U.S. 184, 191 (1964)). Although protecting government coffers is a legitimate goal, the classifications in Iowa Code § 437A.14(1)(b) are not reasonable in light of that purpose.

There is nothing in the record to indicate that constitutional claims are more expensive for the State than other claims. Alternatively, some claims based upon a rate calculation error regarding the Replacement Tax of a very

large taxpayer could be considerably more expensive than some constitutional claims of small taxpayers. As such, the suggestion that constitutional claims are always broad and expansive is merely speculation. The Iowa legislature did not have a sufficiently valid reason to treat constitutional claims differently from all other claims.

This is especially true considering the various protections the state already has in place to safeguard itself from the possibility of substantial refunds for unconstitutional taxes. Although this case differs from *Miller v. Boone County Hospital*, in that it is a tax refund claim rather than a tort claim, the differences are not significant. 394 N.W.2d 776, 780-81 (Iowa 1986). It is true that a tort claim against a local government is "likely covered by liability insurance," while a tax refund claim is not covered by insurance. (App. 159). However, the State has multiple methods to protect itself from large refund obligations. First, unlike refunds based on clerical errors, refund claims based upon the Constitution typically require much more administrative process and time if not also judicial process and time. For example, LSCP filed its first refund claim on October 21, 2010 and its appeal is ongoing. (App. 146). As such, the State has had more than adequate notice of this pending claim and notice of the possible tax refund that LSCP is owed. Second, states, counties, and municipalities have the

authority to issue bonds. In that way, they are able to raise capital which will enable them to finance a tax refund or supplement their budgeted revenues in order to account for a large tax refund without defaulting on other obligations. For example, counties may issue "general purpose bonds" as well as "essential purpose bonds." Iowa Code § 331.442–443.

Additionally, counties have the authority to enter into loan agreements to borrow money for any public purpose when there is a financial need. Iowa Code § 331.402(3). Counties also have the authority to make additions to their basic levies when there is an unusual circumstance creating the need for additional property taxes. Iowa Code § 331.426.

Therefore, the differential treatment of the Replacement Tax statute violates the Equal Protection Clauses of the United States and Iowa Constitutions. It impinges on a fundamental right by limiting access to the court exclusively for constitutional claims, and it is not narrowly tailored to serve the state's fiscal interests. Although the state has an interest in reducing its financial exposure, that interest cannot justify depriving taxpayers of an equal opportunity to file for a refund of an unconstitutional tax. *See, e.g.*, *Miller*, 394 N.W.2d at 780-81 (finding that a notice requirement for claims against local government violates the equal

protection clause and noting that "rather than furthering a legitimate governmental interest, the statute has proved to be a trap for the unwary").

IV. The Replacement Tax Violates The Dormant Commerce Clause.

Error Preservation

Little Sioux preserved error on all matters raised in Issue IV. All matters raised in Issue IV were raised on petition for judicial review and were ruled on by the District Court. (App. 111, 137-138, 162, 163 fn. 7).

A. *Iowa Code § 437A.5(2) Violates the Dormant Commerce Clause by Applying a Greater Tax Rate to Participants in Interstate Commerce.*

Iowa Code § 437A.5(2) impermissibly discriminates against interstate commerce because it applies a greater replacement "use" tax rate to large general service customers receiving natural gas directly from nonresident suppliers than its counterpart Iowa Code § 437A.5(1) which applies a replacement "sales" tax rate to large general service customers receiving natural gas from resident LDCs.

The United States Constitution reserves to the United States Congress the ability to "regulate Commerce...among the several States." U.S. Const. Art. I, § 8, cl. 3. The Commerce Clause has consistently been interpreted as including "a limitation on state regulatory powers, as well as an affirmative grant of congressional authority." *Fulton Corp. v. Faulkner*, 516 U.S. 325,

330 (1996). This implicit restriction on state action, known as the dormant Commerce Clause, "prohibits...regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *Id.* (quoting *Assoc. Indus. of Mo. v. Lohman*, 511 U.S. 641, 647 (1994)) (internal quotation marks omitted). (App. 162).

Relying upon *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959), the District Court found that Iowa Code § 437A.5(2) did not violate the dormant Commerce Clause because the Replacement Tax was not charged to interstate pipelines or out-of-state suppliers. (App. 166). The District Court concluded that "no direct commercial advantage [was provided] to local business" because "each therm of natural gas distributed to an end user, either via a directly connected pipeline or from a utility, is taxed at the same rate." (App. 165-166).

The District Court erred in that analysis. Dormant Commerce Clause violations include cases where resident customers of out-of-state producers pay more for natural gas than do customers of local state-regulated distribution companies (LDCs) as a result of state excise taxes. *See General Motors Corp. v. Tracy*, 519 U.S. 278, 286 (1997). In *General Motors Corp. v. Tracy*, the taxpayer challenged an Ohio industrial natural gas sales tax

exemption for the customers of LDCs. 519 U.S. 278 at 282–283. The state of Ohio denied the exemption to General Motors Corporation because it "bought virtually all the natural gas for its Ohio plants from out-of-state marketers, not LDC's." *Id.* at 285. The United States Supreme Court found, however:

> [C]ognizable injury from unconstitutional discrimination against interstate commerce does not stop at members of the class against whom a State ultimately discriminates, and customers of that class may also be injured, as in the case where the customer is liable for payment of the tax and as a result presumably pays more for the gas it gets from out-of-state producers and marketers.

Id. at 286.

Accordingly, the Replacement Tax can violate the dormant Commerce Clause even when neither interstate pipelines nor out-of-state suppliers pay the tax. *See id.* The fact that a direct-connect company such as Little Sioux pays substantially more for natural gas as a result of Iowa Code § 437A.5(2)'s Replacement "use" Tax than do Large General Service customers of LDCs benefiting from the Replacement "sales" Tax rates of Iowa Code § 437A.5(1) is enough injury to violate the Dormant Commerce Clause. Direct-connect customers are discriminated against for choosing to get natural gas directly from an out-of-state entity rather than an in-state supplier.

B. ***The District Court Erred by Not Finding that the Little Sioux Pays a Replacement Tax Rate that is Greater than the Replacement Tax Rate Paid by Customers of the LDC in the same CSA.***

The District Court also erred by failing to find that Little Sioux pays a Replacement "use" Tax rate under Iowa Code § 437A.5(2) that is 295% times greater that the Replacement "sales" Tax rate paid by customers of the Local Distribution Company in its same competitive service area under Iowa Code § 437A.5(1). (App. 239-240). Although the LDC in the Little Sioux's same competitive service area pays the same Replacement Tax unit rate per therm of natural gas as does Little Sioux, its large general service customers pay much less. (App. 239-240). Little Sioux's supplemental expert witness report provides the following:

> Q Did MidAm equally apply the $.01012/therm [Replacement Tax] unit rate to all rate classes?
>
> A No. MidAm allocated different unit amounts to each customer class. LGS customers were allocated much less per unit than other classes.

(App. 239). Large general service direct-connect natural gas customers are thereby economically disadvantaged relative to similar customers of LDCs.

Iowa Code § 437A.5(2) is the "use tax" counterweight to the "sales tax" of Iowa Code § 437A.5(1). A sales tax is an excise tax on the value of a product assessed against the purchaser and collected and remitted to the

State by the resident retailer. *See* Iowa Code § 423.2. A use tax is a similar excise tax assessed against and remitted to the State by the purchaser in the absence of a resident retailer. *See* Iowa Code § 423.5. Sales and use taxes complement each other by collectively assessing the same excise tax upon the universe of applicable purchases. *See, e.g., Assoc. Ind. of Mo. v. Lohman*, 511 U.S. 641, 643-44 (1994) (explaining that Missouri's 4% sales tax is paralleled by a 4% use tax). The Replacement Tax is an excise tax. *See* Iowa Code § 437A.5. Iowa Code § 437A.5(1) imposes the Replacement Tax, "on every person who makes a delivery of natural gas to a consumer within this state," i.e. every party selling natural gas delivery services to customers. Iowa Code § 437A.5(1). This group is comprised only of LDCs. Alternatively, Iowa Code § 437A.5(2) imposes the Replacement Tax upon consumers of natural gas in this state if, "such natural gas is not subject to the tax imposed under subsection 1," i.e. it is imposed upon any consumer purchasing neither natural gas nor delivery services from LDCs. Iowa Code §§ 437A.5(1) and (2) are the functional equivalent of a sales tax, and a use tax, respectively assessing separate excise taxes upon transactions involving resident and nonresident suppliers.

The dormant Commerce Clause requires that a State's use tax rate, applying to articles purchased out-of-state, may not exceed the sales tax rate

applying to articles purchased in-state. *Assoc. Ind. of Mo. v. Lohman*, 511 U.S. at 648. In *Associated Industries of Missouri*, the State of Missouri imposed an "additional use tax" of 1.5% upon the storage, use, or consumption of any personal property within Missouri that was purchased outside of Missouri. *Id.* at 643. It imposed no directly counterbalancing sales tax, although local jurisdictions were authorized to enact local sales taxes varying between 0.5% and 3.5%. *Id.* at 644. The petitioners included Missouri manufacturing companies paying the "additional use tax" on goods purchased from outside the state and their trade association. *Id.* In 53.5% of local taxing jurisdictions, the "additional use tax" exceeded the local option sales tax. *Id.* at 645. The United States Supreme Court applied the compensatory tax doctrine and found that Missouri's additional use tax violated the dormant Commerce Clause in each of those jurisdictions. *Id.* at 647-648. The "compensatory tax doctrine" allows that a state may assess an excise tax upon transactions originating from outside the state, so long as the excise tax rate on nonresidents does not exceed the excise tax rate for transactions originating within the state. *Id.* at 647. In other words, "the burdens imposed on interstate commerce and intrastate commerce must be equal." *Id.* at 648. Missouri's tax system failed because Missouri's rate disparity was "incompatible with what we have termed the 'strict rule of

equality.'" *Id.* at 649 (citing *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 73 (1963)).

Here, the State of Iowa discriminates against the resident customers of out-of-state natural gas providers by providing a disguised Replacement Tax rate reduction to the resident customers of in-state natural gas providers. Iowa Code § 476.6(19) authorizes the Iowa Utilities Board to provide a tariff rate to the large general service customers of LDCs that allocates less than the full Replacement Tax rate paid by direct-connect natural gas consumers. For direct-connect consumers such as Little Sioux, Iowa Code § 437A.5(2) provides that, "If natural gas is consumed in this state, whether such natural gas is purchased or transferred, and the delivery, purchase, or transference of such natural gas is not subject to the tax imposed under subsection 1, a tax is imposed on the consumer at the rates prescribed under subsection 1." When considered alone, this seems to apply the same tax rate to direct-connect consumers as to the customers of LDCs. However, the Large General Service customers of the LDC in the same competitive service area of Little Sioux do not pay the full Replacement Tax rate provided under subsection 1. They pay the Iowa Utilities Board tariff rate per therm of natural gas consumed which only allocates 33.90% of the full Replacement Tax rate "provided under subsection 1". (*See* App. 239-240 - Large general service

customers of the LDC pay approximately 33.90% of the Replacement Tax per therm as does a direct-connect customer such as LSCP (100/295)). In Little Sioux's competitive service area, the replacement use tax rate exceeds the replacement "sales" tax rate by 295%. (*See id.* - explaining that direct-connect customers are charged a Replacement Tax rate 295% higher than the rate for a large general service customer of MidAmerican Energy).

The distinction between the sales and use taxes and Replacement Taxes is unimportant under dormant Commerce Clause analysis. The Replacement Tax is a function of the volume delivered, while sales and use taxes are a function of the value of the volume delivered. The legislature might have assessed the Replacement Tax upon value rather than upon volume, and then varied the rate of tax based upon value rather than volume. *See* Iowa Code § 437A.5(1). However, this distinction has no bearing upon whether the excise tax discriminates along state lines. *See Assoc. Ind. of Mo. v. Lohman*, 511 U.S. at 648 (noting that the "basic requirement" for a nondiscriminatory tax is that "the burdens imposed on interstate and intrastate commerce must be equal").

It is similarly insignificant that the State discriminates against interstate commerce through the dual use of Iowa Code §§ 437A.5(2) and 476.6(19), as the Court in *Associated Industries of Missouri* stated:

> What is required is that state action whether through one agency or another, or through one enactment or more than one, shall be consistent with the restrictions of the Federal Constitution. *Assoc. Ind. of Mo.*, 511 U.S. at 655 (quoting *Gregg Dyeing Co. v. Query*, 286 U.S. 472, 480 (1932)). [W]e repeatedly have focused our Commerce Clause analysis on whether the challenged scheme is discriminatory in "effect," and we have emphasized that "equality for the purpose of...the flow of commerce is measured in dollars and cents, not legal abstractions."

Id. at 654 (citations omitted).

The test is whether the collection of state laws applied by one or more state agencies charges a greater excise tax on transactions involving non-resident suppliers.

The legislative intent expressed in Iowa Code § 437A.2 is also unimportant in dormant Commerce Clause analysis. *See City of Phila. v. New Jersey*, 437 U.S. 617, 626 (1978) (noting that the legislative purpose of the statute at issue "would not be relevant to the constitutional issue to be decided in this case"). The U.S. Supreme Court has emphasized that "a court need not inquire into the purpose or motivation behind a law to determine that in actuality it impermissibly discriminates against interstate commerce." *Assoc. Ind. of Mo. v. Lohman*, 511 U.S. at 653.

The law requires that parties claiming discrimination under the dormant Commerce Clause be "substantially similar" to more favorably

treated parties in the same market. Here, Little Sioux's out-of-state suppliers and Iowa LDCs must sell natural gas into the same market.

The U.S. Supreme Court held in *General Motors Corp. v. Tracy*, "any notion of discrimination assumes a comparison of substantially similar entities." 519 U.S. at 298. In assessing the validity of an Ohio state sales tax on natural gas, the majority found that the out-of-state natural gas suppliers serving General Motors Corporation were not substantially similar to LDCs because the LDCs serve both the regulated residential market as well as the deregulated large general service market. *Id.* at 303.

However, the laws governing Iowa LDC's, including the Replacement Tax, are unlike the Ohio laws at issue in *General Motors v. Tracy*. As a result, Little Sioux's out-of-state suppliers and Iowa's LDC's serve the same market for purposes of applying the dormant Commerce Clause in this case.

In *General Motors v. Tracy*, the Court concluded that the LDC was in a market separate from the out-of-state suppliers of natural gas. *Id.* It did so out of concern that absent Ohio's preferential sales tax exemption for LDCs, the residential customers of LDCs could suffer economically from competition from the out-of-state suppliers of Iowa large general service customers. *Id.* at 825. The Court theorized that, because of the Ohio tax, large general service customers such as General Motors Corporation would

be more inclined to purchase natural gas services from Ohio LDCs, and this extra volume from the LDCs would help subsidize the rates of the residential customers. *Id.* at 307. In the present case, however, as demonstrated in Little Sioux's supplemental expert witness report, the "customers were allocated much less [Replacement Taxes] per unit than other classes." (App. 206). Therefore, with respect to the Iowa Replacement Tax, the residential customers subsidize the large general service customers which is opposite of the situation in *General Motors v. Tracy*.

Furthermore, the terms of the large general service tariff allow the LDC in Little Sioux's competitive service area to price under the tariff rate and also flex its natural gas delivery price down to zero. *See* Iowa Code § 476.6(19).

The testimony of Little Sioux's expert witness confirmed the following:

> Q In terms of rate regulation, are there differences in how MidAmerican Energy can price its service among customer classes?
>
> A Yes. Let's just talk specifically about the large general service class. Generally, there are two pricing options for MidAmerican. They can price under their standard tariff a large general service rate, and then they also have a competitive service rate that allows them to price their distribution service down to zero.

(App. 383 at 213-14).

Therefore, not only do the LDC's residential customers shoulder a large portion of its large general service customers' Replacement Tax burden, the rate making authority granted to the Iowa Utilities Board under Iowa Code § 476.6 does not require that natural gas delivery tariffs economically contribute to Iowa LDCs or their residential customers whatsoever. While the Court in *General Motors v. Tracy* relied upon economic contribution from Ohio large general service customers to conclude that Ohio LDCs were not similarly situated to out-of-state natural gas suppliers, Iowa law does not require this contribution. *See* 518 U.S. 278 at 307; *See* Iowa Code § 476.6(19).

Finally, Iowa Code § 437A.2 provides that the purpose of the Replacement Tax is, in part, to "remove tax costs as a factor in a competitive environment by imposing like generation, transmission, and delivery taxes on similarly situated competitors who generate, transmit, or deliver electricity or natural gas in the same competitive service area ..." Accordingly, the Legislature recognized competition in the Iowa marketplace between LDCs and out-of-state natural gas providers whose customers, such as the Little Sioux, pay the tax under Iowa Code § 437A.5(2).

The District Court incorrectly found that Little Sioux and the LDCs were similarly situated for Equal Protection Clause purposes because they were both licensed as pipeline companies. (App. 155). However, that determination does not apply in dormant Commerce Clause analysis. The "substantially similar" market requirement of the dormant Commerce Clause is not the same as the "similarly situated" plaintiff requirement of the Equal Protection Clause. Compare *General Motors Corp. v. Tracy*, 519 U.S. 278, 300 (1997) with *Varnum v. Brien*, 763 N.W.2d 862, 883 (Iowa 2009).

Alternatively, for dormant Commerce Clause purposes, entities are "substantially similar" if they compete in the same market. *See Rocky Mountain Farmers Union v. Corey*, 730 F.3d 1070, 1088 (9th Cir. 2013) (citing *Tracy*, 519 U.S. at 299)) ("Entities are similarly situated for [dormant commerce clause] constitutional purposes if their products compete against each other in a single market"); *Jordan v. Dep't of Motor Vehicles*, 89 Cal. Rptr. 2d 333, 342 (1999) ("For used California-certified vehicles and used federally-certified vehicles to *constitute different products* that are not similarly situated for commerce clause purposes, they must have different markets and not compete with each other"). The "substantially similar" analysis begins with "identify[ing] the interstate market that is being subjected to discriminatory or unduly burdensome taxation." *Tamagni v.*

Tax Appeals Tribunal of State, 695 N.E.2d 1125, 1131 (N.Y. Ct. App. 1998).

When the LDC in Little Sioux's competitive service area competes for the sale and delivery of natural gas to large general service customers such as the Little Sioux, it competes with Little Sioux's out-of-state suppliers for the sale of natural gas. Alternatively, due to the regulatory environment, and practical considerations, out-of-state suppliers are unlikely to ever sell gas to Iowa residential customers. (App. 142). Thus, the LDC is substantially similar to out-of-state natural gas suppliers because it competes in the same market for the sale of natural gas.

Although the majority decision in *General Motors v. Tracy* does not apply to the present case because of the differences in Ohio and Iowa regulation, Justice Stevens' dissent is very much on point. 518 U.S. 278 at 314 (Stevens, J., dissenting). In his dissent, Justice Stevens recognized the direct competition in the marketplace between LDCs and out-of-state suppliers in the unregulated interstate market. *Id.* ("I do not believe that the fact that the LDC is heavily regulated in the 'bundled gas' market would justify granting it a special preference in the [unregulated] market for thermostats or gas furnaces.") Because Iowa LDCs compete with out-of-state natural gas suppliers for sales to Iowa large general service customers,

the dormant Commerce Clause regulates the Replacement Tax paid by Little Sioux pursuant to Iowa Code § 437A.5(2).

Because the Replacement Tax discriminates along state lines, it is subject to strict constitutional scrutiny. *See Oregon Waste Sys, Inc. v. Dep't of Envtl Quality of State of Or.*, 511 U.S. 93, 99 (1994) ("If a restriction on commerce is discriminatory, it is virtually *per se* invalid"); *Maine v. Taylor*, 477 U.S. 131, 144 (1986) ("[T]he proffered justification for any local discrimination against interstate commerce must be subject to 'the strictest scrutiny'"). This is because Iowa Code § 437A.5(1) applies only to customers of LDCs. LDCs are resident Iowa companies selling natural gas to Iowa residents. *See* Iowa Code § 437A.5(1). Alternatively, Iowa Code § 437A.5(2) applies only to resident natural gas consumers purchasing natural gas out-of-state and delivering it to themselves. As stated above, the large general service customers who purchase natural gas out-of-state are subject to higher rates under Iowa Code § 437A.5(2) than are LDC customers who purchase gas from the in-state company under Iowa Code § 437A.5(1).

Large general service customers are essentially being punished for purchasing natural gas from an out-of-state entity instead of an in-state entity. In this way, the Replacement Tax is "a law that overtly blocks the flow of interstate commerce at [Iowa's] borders" by dissuading large general

service customers from purchasing natural gas from out-of-state. *City of Phila. v. New Jersey*, 437 U.S. at 624; *see also Walling v. Michigan*, 116 U.S. 446 (1886) ("A discriminating tax imposed by a State operating to the disadvantage of the products of other States when introduced into the first mentioned State, is, in effect, a regulation in restraint of commerce among the States"). Under strict scrutiny dormant Commerce Clause analysis, if a state law discriminates against interstate commerce "either on its face or in practical effect," the State must show that the law "serves a legitimate local purpose," and that there are no "nondiscriminatory alternatives adequate to preserve the local interests at state." *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979). The requirement that there be no nondiscriminatory alternatives essentially means the law must be necessary to achieve the State's goals. *See, e.g., Maine v. Taylor*, 477 U.S. at 131 (upholding a ban on the importation of baitfish into Maine because there was no other method to ensure the state was protected from parasites and non-native species).

The Replacement Tax was certainly not the only means the State could have chosen in order to achieve its stated goals of preserving revenue neutrality and reducing existing administrative burdens on state government. *See* Iowa Code § 437A.2. Replacement of the local property tax system for natural gas assets with the current competitive service area based

Replacement Tax system might have been preferable, but it was not crucial. Local jurisdictions were not doing without revenue for essential services under the prior property tax system. The legislature might have accomplished the purposes set forth in Iowa Code § 437A.2 by treating the direct-connect consumers such as Little Sioux as it did the grandfathered direct-connect consumers under Iowa Code § 437A.5(7). Those Iowa natural gas consumers pay locally assessed property taxes based upon the value of their own natural gas pipelines. (App. 145) ("These [grandfathered] entities remain subject to property tax by local government in the same manner they were prior to 1999"). Alternatively, the legislature might have based the Replacement Tax rates for direct-connect customers upon the replacement of the property tax on their own natural gas assets rather than the property tax assessed on the asset base of the LDCs. *See* Iowa Code § 437A.5. Because the discriminatory tax system proffered by the Replacement Tax, although possibly preferred, was not crucial, and because the legislature had before it more narrowly tailored and less discriminatory alternatives, Iowa Code § 437A.5(2) does not survive dormant Commerce Clause scrutiny.

C. *The Replacement Tax Violates the Extraterritoriality Doctrine.*

In addition to being discriminatory, the Replacement Tax also violates the extraterritoriality doctrine of the dormant Commerce Clause. The U.S. Supreme Court has noted that when considering whether a law violates the dormant Commerce Clause, "the practical effect of the statute must be evaluated not only by considering the consequences of the statute itself, but also by considering how the challenged statute may interact with the legitimate regulatory regimes of other States and what effect would arise if not one, but many or every, State adopted similar legislation." *Healy v. Beer Institute, Inc.*, 491 U.S. 324, 336 (1989). If every state taxed natural gas transactions involving non-residents at rates higher than similar transactions involving their LDCs, then the national natural gas market would quickly become re-fragmented on state lines. *See Hunt v. Washington State Apple Advertising Com'n*, 432 U.S. 333, 350 (1977) (emphasizing the importance of "the Commerce Clause's overriding requirement of a national 'common market'"); *Baldwin v. Seelig*, 294 U.S. 511 (1935) (finding a New York law requiring minimum pricing for milk produced out-of-state was invalid due to the risk that interstate commerce would be impaired if every milk-producing state adopted a similar law).

The dormant Commerce Clause as it applies in this case is easily summarized:

a. The Replacement Tax is subject to dormant Commerce Clause scrutiny because Little Sioux's out-of-state suppliers and the Local Distribution Companies compete in the same market for sales and services to Iowa large general service customers such as Little Sioux.

b. Strict scrutiny applies because, together with Iowa Code § 476.6(19), Iowa Code § 437A.5(2) discriminates against the customers of out-of-state suppliers like Little Sioux.

c. Because direct-connect large general service natural gas consumers such as Little Sioux pay more Replacement Tax per therm than do large general service natural gas customers of LDCs, Iowa Code § 437A.5(2) violates the dormant Commerce Clause.

In other words, the litmus test is whether Iowa direct-connect natural gas consumers pay more per therm because of the Replacement Tax than do the customers of LDCs. Because Iowa direct-connect natural gas consumers pay more per therm, Iowa Code § 437A.5(2) violates the dormant Commerce Clause.

CONCLUSION

For all of these reasons, the Court should declare that Iowa Code §§ 437A.5(2) and 437A.14(1)(b) violate the United States and Iowa Constitutions and hold that Little Sioux is entitled to the refunds and its attorneys fees claimed in its refund requests.

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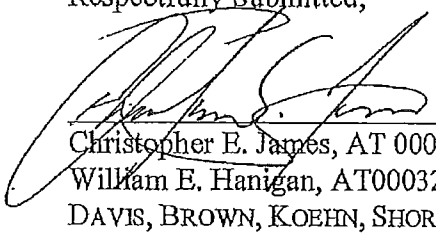
REQUEST FOR ORAL ARGUMENT

The Appellant, LSCP, LLLP, respectfully requests the opportunity to be heard in oral argument with respect to its appeal.

Respectfully Submitted,



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I hereby certify that on the 16th day of October, 2014, I will file this document by delivering eighteen (18) copies of Petitioner-Appellant's Final Brief to the Clerk of the Iowa Supreme Court, 1111 East Court Avenue, Des Moines, Iowa.

I further certify that on the 16th day of October, 2014, one (1) copy of Petitioner-Appellant's Final Brief was served on:

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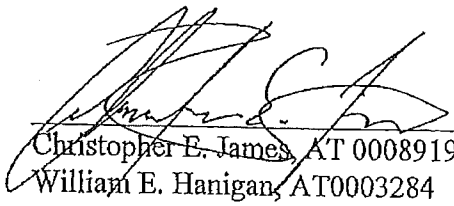

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IN THE SUPREME COURT OF IOWA

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CLERK SUPREME COURT

No. 14-0494

LSCP, LLLP,

Petitioner-Appellant,

v.

COURTNEY M. KAY-DECKER, DIRECTOR,
IOWA DEPARTMENT OF REVENUE,

Respondents-Appellees.

APPEAL FROM THE DISTRICT COURT OF POLK COUNTY
THE HONORABLE REBECCA GOODGAME EBINGER, JUDGE

BRIEF OF APPELLEES
AND
NOTICE OF ORAL ARGUMENT

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FINAL BRIEF

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STATEMENT OF ISSUES PRESENTED FOR REVIEW

I. **WHETHER THE REPLACEMENT TAX PROVISIONS OF CHAPTER 437A BEING CHALLENGED BY LITTLE SIOUX VIOLATE THE EQUAL PROTECTION PROVISIONS OF EITHER THE IOWA OR UNITED STATES CONSTITUTIONS?**

Iowa Code chapter 437A

NextEra Energy Res. LLC v. Iowa Utilities Board, 815 N.W.2d 30 (Iowa 2012)

Qwest Corp. v. Iowa St. Bd. of Tax Review, 829 N.W.2d 550 (Iowa 2013)

United States Constitution, Amendment XIV

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Ames Rental Property Ass'n v. City of Ames, 736 N.W.2d 255 (Iowa 2007)

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Varnum v. Brien, 763 N.W.2d 862 (Iowa 2009)

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Federal Land Bank of Omaha v. Arnold, 426 N.W.2d 153 (Iowa 1988)

Koppes v. Pearson, 384 N.W.2d 381 (Iowa 1986)

Conner v. Fettkether, 294 N.W.2d 61 (Iowa 1980)

Krupke v. Witkowski, 256 N.W.2d 216 (Iowa 1977)

Argenta v. City of Newton, 382 N.W.2d 457 (Iowa 1986)

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II. WHETHER THE REPLACEMENT TAX VIOLATES THE DORMANT COMMERCE CLAUSE?

Iowa Code chapter 476

City of Postville v. Upper Explorerland Regional Planning Com'n., 834 N.W.2d 1 (Iowa 2013)

NextEra Energy Res. LLC v. Iowa Utilities Board, 815 N.W.2d 30 (Iowa 2012)

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Iowa Code section 423.2

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ROUTING STATEMENT

Courtney M. Kay-Decker, Director, and the Iowa Department of Revenue (Department), Respondents-Appellees, agree that this is a case of first impression and should be considered by the Iowa Supreme Court.

STATEMENT OF THE CASE

The Department agrees with Little Sioux Corn Processors' or LSCP, LLLP (Little Sioux) statement of the case. The Department

would also add that through the District Court proceedings, Little Sioux had raised three additional constitutional issues that it no longer is raising. Those three issues were that the replacement tax was unconstitutional because it discriminates between Little Sioux and natural gas consumers located in the MidAmerican natural gas competitive service area; the exemption contained in Iowa Code section 437A.5(7), commonly referred to as the "grandfather" provision, unconstitutionally discriminated between similarly situated taxpayers; and that the replacement tax is unconstitutional because it violates the substantive due process clause. (Little Sioux's Brief in Support of Judicial Review to Polk County District Court, pp. i and ii, Table of Contents, App. 69, 70)

Statement of Facts

The facts of this case are largely without dispute and were correctly set forth in the Administrative Law Judge's Findings of Fact, pages 1-6 (App. 13-18) and the District Court's Background Facts, pages 1-6 (App. 141-146). The Department also does not dispute the factual background relating to Little Sioux's ethanol manufacturing facility and that it consumes a large quantity of natural gas in this

process. Little Sioux obtains the natural gas that it requires by directly connecting to the interstate pipeline owned by Northern Natural Gas (NNG) and which is located within what is commonly known as the MidAmerican natural gas competitive service area. In doing so, it bypasses the local distribution company (LDC), in this case MidAmerican Energy (MidAmerican), that would otherwise deliver the natural gas being transported by NNG to the final customer or end-user. According to Mr. Whelan, Little Sioux's expert, it is not uncommon for larger consumers of natural gas to threaten to bypass the LDC in an attempt to negotiate a better rate or discount for the gas being purchased from the LDC. (Exhibit L, Whelan presentation; Whelan, Tr. Vol. II, p. 49, l. 16 - p. 50, l. 25, App. 356-360; 390)

Little Sioux purchases its natural gas from out-of-state producers and then has that gas transported by NNG whereby it takes delivery of the gas through its own pipeline. In 2002, Little Sioux obtained a permit under chapter 479 from the Iowa Utilities Board (IUB) giving it authority to construct, operate and maintain a pipeline for the intrastate transportation of natural gas from the point of

interconnection with NNG to its ethanol facilities. (Exh. B, attachment Exhibit 2, Docket No. P-847, Proposed Decision and Order Granting Permit, pp. 1-8, App. 348-355) Little Sioux entered into a contract with U.S. Energy Engineering to perform the engineering design, the construction management and to act as agent for Little Sioux for the purchases of natural gas. (Exh. B, attachment Exhibit 2, Docket No. P-847, Proposed Decision and Order, p. 2, App. 349); (Exh. B, attachment Exhibit 1, Direct Written Testimony of Kurt Garst, founder of U.S. Energy Engineers and U.S. Energy Services, pp. 7-9, App. 345-347) Mr. Whelan, Little Sioux's expert witness, is currently Vice-President of Strategic Initiative at U.S. Energy Services. (Exh. 33, Whelan expert report, p. 4, App. 244)

Little Sioux chose to construct its ethanol facility near Marcus in Cherokee County based upon the availability of corn supplies, transportation infrastructure, and ample electric, natural gas and water supplies. Little Sioux also sought and obtained property tax relief and road construction from the county as additional incentive to build where it did. Specifically, Cherokee County granted Little Sioux property tax relief for five years that started out at 70 to 75

percent as well as paved the main road to the plant. (Ex. 38, Grothjohn dep. Tr. p. 20; Grothjohn Tr. Vol. I, p. 153, l. 15 - p. 154. l. 17, App. 296, 297; 377) Also, in making a presentation to the Plymouth County Board of Supervisors seeking similar incentives to build an ethanol plant in Akron, Little Sioux officials represented that the plant would generate in excess of $250,000 a year in replacement taxes that would go directly to the county. (Exh. 38, Grotjohn dep. Tr. p. 45, l. 1 - p. 48, l. 6; Grotjohn Tr. Vol. I, p. 156, l. 19 - p. 159, l. 8, App. 304-307; 377, 378)

A. Replacement Tax System For Natural Gas Under Chapter 437A.

In 1998, the Iowa legislature passed what is commonly called the replacement tax, codified as Iowa Code chapter 437A. This Act was the result of concerns of numerous stakeholders regarding the competitiveness of the electric and natural gas utility industry in Iowa that deregulation and restructuring of that industry would or could bring about. The concerns and findings were set forth in detailed legislative findings at 1998 Iowa Acts, 77th G.A. ch. 1194, § 1, which are set forth in total, as follows:

The general assembly finds that with the advent of restructuring of the electric and natural gas utility industry, a competitive environment will replace the current regulated monopoly environment. Currently, utility companies are subject to property taxes which are levied in various amounts with respect to utility property located in areas serviced by the utility companies. If the property tax, as currently levied, continues, the property tax costs in Iowa will become a factor among competitors in the pricing of electricity and natural gas. Moreover, non-Iowa located electricity and natural gas suppliers do not have property in Iowa subject to property tax and to the extent that they are located in a low property tax state, such property tax costs would grant to such non-Iowa suppliers an unfair tax advantage over Iowa-based utility companies.

The general assembly also finds that restructuring may result in the loss of in-lieu-of-tax transfers from surplus funds made by a municipal utility to the city. These transfers take the place of a property tax and are recognized in this Act as such.

Therefore, the general assembly finds that a need exists to replace the current Iowa property tax system levied on electric and natural gas utility companies located in Iowa. However, any replacement tax needs to be revenue neutral so as not to harm the fiscal stability of local governments which depend upon such utility property taxes and municipal transfers, and further, so as to negate tax costs as a factor in a competitive utility industry environment. Additionally, such replacement tax must allow fair and competitive prices for consumers of electric and natural gas services, and minimize the impact on the cost of such services to consumers.

The general assembly, therefore, finds that the replacement tax should be imposed on the generation,

transmission, and delivery of electricity and natural gas. Statewide generation and transmission taxes are necessary to ensure that in the event such functions are conducted by stand-alone generation and transmission companies, such companies will continue to contribute to the tax base. However, imposition of a single statewide delivery tax rate would unfairly increase tax costs for some taxpayers while reducing such costs for others. Such a result would impede a competitive environment and disrupt the tax continuity for taxpayers, and has the potential to unnecessarily increase costs for consumers of gas and electricity. Therefore, to maintain tax continuity and tax revenues for local government and to maintain tax continuity and negate tax costs as a factor in a competitive environment for taxpayers and consumers, the delivery tax rates should be fixed by geographic service areas which are designed and structured to accomplish these goals.

The current property tax valuation process for utility companies is complex and time-consuming to administer. The replacement tax eases this administrative burden on state government.

Replacing the current system of property taxes levied on electric and natural gas utility companies located in Iowa with a system of excise taxes associated with electricity and natural gas represents a significant change in the method of taxing electric and natural gas utility companies. Due to the importance of the revenues generated by these taxes to local taxing districts, the general assembly finds it desirable to implement this new system of taxation in advance of the impending restructuring of the electric and natural gas industry to ensure that the new system of taxation performs as intended.

(Emphasis added). The goals as set forth in these findings were properly summarized by the District Court as follows:

> (1) preventing competitive disadvantages that may arise if the existing tax structure was maintained; (2) continuing to allow city-operated municipalities to transfer surplus funds to the city, in lieu of property taxes; (3) maintaining revenue neutrality for local governments, utilities, and consumers; and (4) reducing administrative burdens by eliminating the complex and time-consuming property tax valuation process.

(District Court Order, page 3, App. 143)

The replacement tax became effective January 1, 1999 and replaced the existing ad valorem property tax system that had been in place for electric companies, natural gas companies, electric cooperatives and municipal utilities with an excise tax system imposing a replacement tax on the delivery, generation and transmission of electricity as well as the delivery of natural gas. *See* §§ 437A.4, 437A.5, 437A.6 and 437A.7. Section 437A.2 reiterated the legislative findings by providing that

> The purposes of this chapter are to replace property taxes imposed on electric companies, natural gas companies, electric cooperatives, and municipal utilities with a system of taxation which will remove tax costs as a factor in a competitive environment by imposing like generation, transmission, and delivery taxes on similarly situated competitors who generate, transmit, or deliver

> electricity or natural gas in the same competitive service area, to preserve revenue neutrality and debt capacity for local governments and taxpayers, to preserve neutrality in the allocation and cost impact of any replacement tax among and upon consumers of electricity and natural gas in this state, and to provide a system of taxation which reduces existing administrative burdens on state government.

(Emphasis added). Section 437A.3(26) defines "Replacement tax" to mean "the excise tax imposed on the generation, transmission, delivery, consumption, or use of electricity or natural gas under section 437A.4, 437A.5, 437A.6, or 437A.7." (Emphasis added).

Section 437A.5 imposes a replacement delivery tax on all therms of natural gas delivered or consumed in Iowa. In particular, section 437A.5(1) provides, in part, that

> 1. A replacement delivery tax is imposed on every person who makes a delivery of natural gas to a consumer within this state. The replacement delivery tax imposed by this section shall be equal to the sum of the following:
>
> a. The number of therms of natural gas delivered to consumers by the taxpayer within each natural gas competitive service area during the tax year multiplied by the natural gas delivery tax rate in effect for each such natural gas competitive service area. . . .

(Emphasis added). As seen in paragraph "a" the amount of delivery tax imposed is based on the number of therms of natural gas delivered by the taxpayer to a consumer within a designated

competitive service area by the delivery tax rate in effect for that competitive service area.

The incidence of this tax falls upon the "taxpayer" which is defined in section 437A.3(30) to mean "an electric company, natural gas company, electric cooperative, municipal utility, or other person subject to the replacement tax imposed under section 437A.4, 437A.5, 437A.6 or 437A.7." (Emphasis added). If natural gas is being delivered to consumers within this State and it is not subject to the delivery tax set forth in subsection 1, then the incidence of the delivery tax falls directly upon the consumer much in the same manner that a use tax falls upon a consumer when the purchase transaction is not subject to sales tax. The circumstances surrounding the consumer's liability for the delivery tax are set forth in subsection 437A.5(2) which states the following:

> If natural gas is consumed in this state, whether such natural gas is purchased or transferred, and the delivery, purchase or transference of such natural gas is not subject to the tax imposed under subsection 1, a tax is imposed on the consumer at the rates prescribed under subsection 1.

(Emphasis added).

Interstate pipeline companies like NNG which transport natural gas from the supply source to destinations throughout the country are not subject to the replacement delivery tax on any natural gas they deliver into the state of Iowa. This is true whether the deliveries are to investor-owned utilities, such as LDCs, municipal utilities, or to direct connect or bypass customers, like Little Sioux.[1] Specifically, with respect to the direct connect customers of interstate pipelines, paragraph 437A.5(7)(c), states that

> Subsection 1 does not apply to natural gas which is delivered, by a pipeline that is not permitted pursuant to chapter 479, into a facility owned by or leased to a person, other than an electric company, natural gas company, electric cooperative, or municipal utility, if the person who consumes the gas uses the gas for the purpose of bypassing the local natural gas company or municipal utility regardless of whether such facility existed on January 1, 1999.

(Emphasis added).

This paragraph pertains to interstate pipeline companies because they are not permitted under chapter 479 by the IUB.

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[1]As used in this brief, the terms "direct connect customers" and "bypass customers" refer to those entities that directly connect to the interstate pipeline company and which will then bypass the local utility company, or LDC, for purposes of receiving their natural gas. These terms will be used interchangeably in this brief.

Chapter 479 pertains only to intrastate pipelines that transport natural gas within Iowa, such as those owned or leased by the LDCs and municipal utilities. It also includes pipelines owned by direct connect customers like Little Sioux that utilize their own pipelines to transport natural gas from the interconnection point to the manufacturing or processing location. The deliveries of natural gas that interstate pipeline companies make to local LDCs and municipal utilities are not subject to tax because LDCs and municipals are not "consumers" as defined under section 437A.5(1)(a). The term "consumer" is defined in section 437A.3(5) to be "an end user of electricity or natural gas used or consumed in this state." (Emphasis added). LDCs and municipal utilities deliver natural gas to the actual end-users and are not considered to be the end-users of the gas themselves. On the other hand, the natural gas delivered by interstate pipelines to their direct connect or bypass customers, such as Little Sioux, are deliveries to end-users. Therefore, if it was not for the exclusion set forth in section 437A.5(7), interstate pipeline companies would be subject to replacement delivery tax for any natural gas they deliver directly to their direct connect customers.

Interstate pipelines remain centrally assessed by the Department for property tax purposes on the fair market value of all of their operating property, including any pipeline property used to deliver natural gas directly to their bypass customers. (Simmons Vol. II, Tr. pp. 69, l. 9 - p. 70, l. 3, App. 394) Because of this, the Legislature specifically excluded them from also being subject to the replacement delivery tax on those deliveries. Otherwise, the interstate pipeline company not only would be subject to central assessment based on the fair market value of its entire operating property, but it would also be subject to replacement tax on the deliveries of natural gas to its direct connect customers. This would be contrary to the treatment given to LDCs or other taxpayers which no longer have their operating property assessed at fair market value for property tax purposes.

Because interstate pipeline companies like NNG are not subject to delivery tax, subsection 437A.5(2) imposes the delivery tax directly on the bypass customer at the same rate in effect for the service area in which the customer is located. If this was not the case, the natural gas delivered to the bypass customer would be free of any delivery

tax, unlike the natural gas delivered into the same service area by the local LDC or by any other entity making deliveries into that service area. While the bypass customer is subject to delivery tax, it is not subject to either local assessment or central assessment on the fair market value of any of the operating property that it utilizes for taking delivery of the natural gas from the interstate pipeline or for transporting that gas through its pipeline to its facilities. This affords the same property tax treatment given to the operating property of LDCs. Section 437A.16 specifically provides that the replacement tax assessment on such property is exclusive by stating that

> All operating property and all other property that is primarily and directly used in the production, generation, transmission, or delivery of electricity or natural gas subject to replacement tax or transfer replacement tax is exempt from taxation except as otherwise provided by this chapter.

(Emphasis added).

The other tax provided for in chapter 437A which is alluded to in section 437A.16 is the statewide property tax found in section 437A.18. This is a property tax on the operating property referred to in section 437A.16 and is assessed at a tax rate of three cents per thousand dollars of assessed value. The assessed value is statutorily

determined to be the book value of such property with "book value" being defined specifically for this purpose as the "acquisition cost less accumulated depreciation determined under general accounting principles." *See* § 437A.19(1)(b)(1). This is not fair market value nor does it equate to fair market value as acknowledged by Little Sioux's designated expert, its chief financial officer and Mr. Roland Simmons.[2] (Exh. 39, Whelan dep. p. 71, l. 9 - p. 72, l. 25; Exh. 38, Grotjohn dep. p. 40, l. 4 - p. 41, l. 25; Simmons, Vol. II, Tr. p. 74, l. 25 - p. 75, l. 13, App. 309, 310; 302-304; 395)

The purpose of the statewide property tax is two-fold. First, it is necessary for an ad valorem property tax to remain on the operating property of the utilities subject to replacement tax in order that the bonding base of the local jurisdictions be maintained at levels similar to that prior to the enactment of the replacement tax. It is a requirement of the Iowa Constitution, art. XI, sec. 3, that local governments cannot

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[2]Mr. Simmons is the Department employee responsible for determining the fair market value of numerous centrally assessed utilities and is also responsible for administering the replacement tax regarding deliveries of natural gas in this state. (Simmons, Vol. II, Tr. pp. 60-63, App. 391, 392)

> be allowed to become indebted in any manner . . . exceeding five per centrum on the value of the taxable property within such county or corporation – to be ascertained by the last state and county tax lists, previous to the incurring of such indebtedness.

Without the statewide property tax being imposed on this operating property, local governments would have lost millions of dollars to their tax base and their bonding ability would have been substantially impaired.

The second reason for the statewide property tax was to establish a system of allocation for the replacement tax money back to the local jurisdictions in a manner that would closely equate to the monies received by local governments, including school districts, under the old property tax system. Replacement taxes are assessed by the Department based on the number of therms delivered into a service area but are directly paid by all taxpayers to the local taxing districts where the taxpayer's operating property is located. The percent of allocation of replacement tax to a local jurisdiction will vary from year to year depending on any increase or decrease in the yearly amount of the assessed value of the taxpayer's operating property in the local district. (Simmons, Vol. II, Tr. p. 75, l. 23 - p.

78, l. 2; p. 91, l. 4 - p. 92, l. 15, App. 395, 396; 398) The statewide property tax is also assessed by the Department but is paid to the state's general fund and is to be used for the administration of the replacement tax. In Little Sioux's case, this property tax on its operating property amounted to $6.43 for the 2007 assessment year based on an assessed or book value of $214,443. (Exh. 53, Little Sioux's Response to Department's First Set of Interrogatories, Exhibit A, App. 322)

The assessed value of a taxpayer's operating property for statewide property tax purposes is unrelated to the taxpayer's replacement tax assessment. As set forth in section 437A.5(1)(a), the replacement delivery tax is determined exclusively by multiplying the number of therms delivered to or consumed by end-users within each natural gas competitive service area by the delivery tax rate in effect for that service area. The amount of delivery tax assessed to a taxpayer is solely a function of the therms actually delivered by or consumed by a taxpayer, irrespective of the increase or decrease in the value of that taxpayer's operating property.

In order to achieve revenue neutrality between the old property tax system and the new replacement tax system for both local governments and taxpayers, the Legislature set the initial delivery rates for each competitive service area based upon the

> average centrally assessed property tax liability allocated to natural gas service of each taxpayer, other than a municipal utility, principally serving a natural gas competitive service area for the assessments years 1993 through 1997 based on property tax payments made. In the case of a municipal utility, the average centrally assessed property tax liability allocated to natural gas service is the centrally assessed property tax liability of such municipal utility allocated to natural gas service for the 1997 assessment year based on property tax payments made. For purposes of this subsection, taxpayer does not include a pipeline company defined in section 479A.2.

(Emphasis added). *See* § 437A.5(3)(a). The Legislature had to independently establish each natural gas competitive service area as determined by the area in which the current utility was primarily operating because the IUB maintained no such natural gas service areas for its purposes. (Exh. Q, Truesdell email; Exh. R, Lynch email, App. 361, 362; 363) This resulted in 52 natural gas service areas being defined in section 437A.3(22) with paragraph 437A.3(22)(a)(1) describing the municipal service areas and paragraph 437A.3(22)(a)(2) through (7) describing the remaining service areas.

The service area described in paragraph 437A.3(22)(a)(2) is commonly called the MidAmerican service area because that was the area being primarily served by MidAmerican prior to January 1, 1999. This is the service area in which Little Sioux is located. The Director then determined for each taxpayer within that service area the number of therms that would have been subject to delivery tax in 1998 had the replacement tax been in effect for that year. *See* § 437A.5(3)(b). Finally, the initial delivery rate for each service area in which the taxpayer principally operated was determined by dividing the centrally assessed property tax liability of that taxpayer by the number of therms delivered by that taxpayer to consumers within that service area. *See* § 437A.5(3)(c). Bypass customers were not included in this calculation because they were not subject to central assessment nor were they a municipality.

This rate calculation was a one-time snapshot of the initial replacement tax rate for each competitive service area using the actual property tax liability of the utility that primarily operated in that service area. Centrally assessed values were not used in determining the delivery rates. By using the actual liability, the

Legislature intended to equate as closely as possible the taxpayer's prior property tax liability with its future replacement tax liability at the time the replacement tax went into effect. In this way the act would be revenue neutral for both the taxpayer and the local taxing jurisdiction.

One of the arguments made by Little Sioux is that these different rates among the competitive service areas are unconstitutional. However, the legislative findings state a clear reason why a separate rate for each competitive service area had to be established versus a single statewide rate by stating, in part, the following:

> However, imposition of a single statewide delivery tax rate would unfairly increase tax costs for some taxpayers while reducing such costs for others. Such a result would impede a competitive environment and disrupt the tax continuity for taxpayers, and has the potential to unnecessarily increase costs for consumers of gas and electricity. Therefore, to maintain tax continuity and tax revenues for local government and to maintain tax continuity and negate tax costs as a factor in a competitive environment for taxpayers and consumers, the delivery tax rates should be fixed by geographic service areas which are designed and structured to accomplish these goals.

(Emphasis added). 1998 Iowa Acts, 77th G.A. ch. 1194, § 1.

The Legislature also found that municipal utilities were subject to restructuring that could "result in the loss of in-lieu-of-tax transfers from surplus funds made by a municipal utility to the city. These transfers take the place of a property tax and are recognized in this Act as such." 1998 Iowa Acts, 77th G.A. ch. 1194, § 1. As a result, municipal utilities also have municipal natural gas transfer replacement tax rates calculated on an annual basis under subsection 437A.5(4) in addition to any delivery replacement tax calculated under section 437A.5(1). However, a municipal utility was not subject to central assessment unless it was serving customers outside the municipal city limits. If the municipal utility was serving such a customer, there would be a property tax liability and a delivery tax rate would be calculated. If it was not serving rural customers, it would have had no central assessed property tax liability and its delivery tax rate would be zero. (Simmons, Vol. II, Tr. p. 64, l. 20 - p. 65, l. 12, App. 392, 393)

After 1999, the replacement delivery tax rate for each competitive service area could decrease or increase based upon changes in the prior year's total deliveries into that service area if

such a change reached a designated level to trigger a threshold adjustment. *See* subsection 437A.5(8). Generally speaking, if the total therms delivered into a service area increased to the point that a threshold adjustment is required, the delivery tax rate for that service area will go down. Conversely, if delivered therms into the service area are decreased, the delivery tax rate will go up. (Simmons, Vol. II, Tr. p. 66, l. 3 - p. 67, l. 25, App. 393) The change in deliveries applies to all deliveries made into the service area by any taxpayer coming into existence after January 1, 1999 as well as those deliveries made by the original utility serving that service area. The calculation of total therms for a service area includes all therms consumed by any consumer subject to delivery tax under section 437A.5(2), including bypass customers like Little Sioux. If therms consumed by bypass customers are removed from consideration, the delivery tax rate will increase if the removal of those therms are sufficient to trigger a threshold adjustment required by subsection 437A.5(8).

Contrary to Little Sioux's assertions at page 8 of its brief, there is not a different rate for each investor-owned utility in the State. Rather, there is a unique rate for each service area regardless of

which utility is making deliveries into that service area. If MidAmerican delivered natural gas to customers located in a different service area, the delivery tax rate of those deliveries would be based on the rate applicable for that service area. Likewise, if another LDC or municipal utility delivered into the MidAmerican service area defined in paragraph 437A.3(22)(b)(2), those entities would be subject to the delivery rate in effect for the MidAmerican service area. There is no prohibition against another provider delivering natural gas into the MidAmerican service area.

ARGUMENT

I. THE REPLACEMENT TAX PROVISIONS OF CHAPTER 437A BEING CHALLENGED BY LITTLE SIOUX DO NOT VIOLATE THE EQUAL PROTECTION PROVISIONS OF EITHER THE IOWA OR UNITED STATES CONSTITUTIONS.

A. Error Preservation

The Department agrees with Little Sioux that with regard to the equal protection challenge being raised the issues have been preserved.

B. Standard of Review

The Department agrees with Little Sioux's standard of review analysis in that the Court will review constitutional issues de novo and will give no deference to the agency determination. *NextEra Energy Res. LLC v. Iowa Utilities Board*, 815 N.W.2d 30, 44 (Iowa 2012) and *Qwest Corp. v. Iowa St. Bd. of Tax Review*, 829 N.W.2d 550, 557 (Iowa 2013).

C. Burden of Proof and Standard for Evaluating Little Sioux's Equal Protection Claims

Little Sioux's constitutional challenge includes the alleged violation of the equal protection clause of the United States Constitution, Amendment XIV, and the uniformity clause of the Iowa Constitution, art. I, sec. 6, which guarantees that "[a]ll laws of a general nature shall have a uniform operation; the general assembly shall not grant to any citizen, or class of citizens, privileges or immunities, which, upon the same terms shall not equally belong to all citizens." The Iowa Supreme Court has interpreted that "this provision 'means similarly situated persons must receive similar treatment under the laws.' *Grovijohn* , 643 N.W.2d at 203-204."

Ames Rental Property Ass'n v. City of Ames, 736 N.W.2d 255, 259 (Iowa 2007). While an equal protection analysis "under the federal Equal Protection Clause is persuasive, it is not binding on this court as we evaluate the City's ordinance under the Iowa Constitution." *Id.* at 258, 259.

The burden of proof is on Little Sioux to prove "clearly, palpably and without doubt" that Iowa's replacement delivery tax scheme as set forth in Iowa Code section 437A.5 regarding Little Sioux is unconstitutional in all aspects. *Avery v. Peterson*, 243 N.W.2d 630, 633 (Iowa 1976). Such a scheme will not be found "unconstitutional unless it is so clearly and plainly in contravention of the constitutional limitation and its guarantees as to leave no reasonable doubt as to its unconstitutionality." *Camacho v. Iowa Dept. of Rev. and Finance*, 666 N.W.2d 537, 543 (Iowa 2003), quoting *Hope Evangelical Lutheran Church v. Iowa Dept. of Rev. & Fin.*, 463 N.W.2d 76, 79 (Iowa 1990). "[E]very reasonable doubt must be resolved in favor of constitutionality." *Hearst Corp. v. Iowa Dept. of Rev. and Finance*, 461 N.W.2d 295, 301 (Iowa 1990).

See also City of Waterloo v. Seldon, 251 N.W.2d 506, 508, 509 (Iowa 1977), where the Iowa Supreme Court stated that

> The remedy of those who contend legislation which is within constitutional bounds is unwise or oppressive is with the legislature. . . . Plaintiffs have the burden to demonstrate beyond a reasonable doubt the act violates the constitutional provision invoked and to point out with particularity the details of the alleged invalidity. To sustain this burden plaintiffs must negate every reasonable basis which may support the statute. *Dickinson v. Porter*, 240 Iowa, 393, 399, 400, 35 N.W.2d 66, 71 (1949). Every reasonable doubt is resolved in favor of constitutionality. *Avery v. Peterson*, 243 N.W.2d 630, 633 (Iowa 1976). . . . An iron rule of equal taxation is neither attainable nor necessary.

(Emphasis added).

Especially in the field of taxation, the State has a broad power to impose and collect taxes. In *Madden v. Commonwealth of Kentucky*, 309 U.S. 83, 87-88 (1940), the United States Supreme Court held that

> The broad discretion as to classification possessed by a legislature in the field of taxation has long been recognized. This Court fifty years ago concluded that the fourteenth amendment was not intended to compel the states to adopt an iron rule of equal taxation, and the passage of time has only served to underscore the wisdom of that recognition of the large area of discretion which is needed by a legislature in formulating sound tax policies. It has, because of this, been pointed out that in taxation, even more than in other fields, legislatures possess the

> greatest freedom in classification. Since the members of a legislature necessarily enjoy a familiarity with local conditions which this Court cannot have, the presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes. The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it.

(Emphasis added, footnotes omitted). *See Hearst*, 461 N.W.2d at 304 citing to this same passage.

In analyzing a taxpayer's constitutional challenge, "the first step of an equal protection claim is to identify the classes of similarly situated plaintiffs singled out for differential treatment." *Grovijohn v. Virjon, Inc.*, 643 N.W.2d 200, 204 (Iowa 2002). "Dissimilar treatment of persons dissimilarly situated does not offend equal protection." *City of Coralville v. Iowa Utilities Bd.*, 750 N.W.2d 523, 531 (Iowa 2008). In *Timberland Partners v. Iowa Dept. of Revenue*, 757 N.W.2d 172, 175 (Iowa 2008), this Court held that

> If a plaintiff fails to articulate, and the court is unable to identify, a class of similarly situated individuals who are allegedly treated differently under the challenged statute, the plaintiff "has not satisfied the first step of an equal protection analysis," and the court need not address whether the "statute has a rational relationship to a legitimate government interest." *Grovijohn*, 643 N.W.2d at 204; *see also Glen Haven Homes, Inc. v. Mills County*

> *Bd. of Rev.*, 507 N.W.2d 179, 183 (Iowa 1993) (noting equal protection does not require dissimilar entities be treated similarly).

However, in the recent case of *Qwest Corp. v. Iowa State Board of Tax Review*, 829 N.W.2d 550 (Iowa 2013), the Iowa Supreme Court cautioned against deciding an equal protection claim on this ground as "[n]o two groups are identical in every way, and 'nearly every equal protection claim could run aground onto the shoals of a threshold analysis if the two groups needed to be a mirror image of one another.'" (Citing to *Varnum v. Brien*, 763 N.W.2d 862, 883 (Iowa 2009)). *Qwest* at 561. Instead, the *Qwest* court focused its analysis on the rational basis standard applicable to challenges of taxing statutes. That standard was set forth in *Qwest*, at 558 as follows:

> Social and economic legislation, such as the tax provisions at issue here, is reviewed under the rational basis test. *See King v. State*, 818 N.W.2d 1, 27 (Iowa 2012); *accord Sanchez v. State*, 692 N.W.2d 812, 817 (Iowa 2005). This is "a very deferential standard." *Varnum*, 763 N.W.2d at 879; *accord King*, 818 N.W.2d at 27; *Ames Rental Prop. Ass'n v. City of Ames*, 736 N.W.2d 255, 259 (Iowa 2007). "Under rational-basis review, the statute need only be rationally related to a legitimate state interest." *Sanchez*, 692 N.W.2d at 817-18. "[T]he [s]tate does not have to produce evidence, and only a plausible justification is required," *King*, 818 N.W.2d at 28; *see also*

Varnum, 763 N.W.2d at 879. The challenging party "has the heavy burden of showing the statute unconstitutional and must negate every reasonable basis upon which the classification may be sustained." *Varnum*, 763 N.W.2d at 879 (citation and internal quotation marks omitted); *accord King*, 818 N.W.2d at 28; *Sperfslage v. Ames City Bd. of Review*, 480 N.W.2d 47, 49 (Iowa 1992) ("The statute will . . . be upheld under the rational basis standard if we find the legislature could reasonably conclude that the classification would promote a legitimate state interest."). The fit between the means and the end can be "far from perfect" so long as the relationship "is not so attenuated as to render the distinction arbitrary or irrational." *Varnum*, 763 N.W.2d at 879 & n.7 (citation and internal quotation marks omitted); *see also King*, 818 N.W.2d at 28.

When we have applied the rational basis test to tax laws, they have generally been upheld without much difficulty. "The rational basis standard is easily met in challenges to tax statutes." *Hearst Corp. v. Iowa Dep't of Revenue & Fin.*, 461 N.W.2d 295, 306 (Iowa 1990); *accord Heritage Cablevision*, 436 N.W.2d at 38 ("It is widely recognized that the rational basis standard is easily satisfied in challenges to tax statutes,"); *City of Waterloo v. Selden*, 251 N.W.2d 506, 508-09 (Iowa 1977) ("An iron rule of equal taxation is neither attainable nor necessary.").[5] In *Hearst*, we held that it violated neither federal nor state equal protection guarantees for the legislature to exempt newspapers but not magazines from Iowa's sales and use tax. 461 N.W.2d at 304-06, We noted that "in tax matters even more than in other fields, the legislature possesses the greatest freedom in classification." *Hearst*, 461 N.W.2d at 305. Among other things, we accepted the state's argument that Iowa's tax scheme served the state's interest in "enhancing the general knowledge and literacy of its citizenry." *Id.* at 306.

(Emphasis added, footnote omitted).

Qwest merely reiterated the traditional rational basis test which historically has been the cornerstone of an equal protection analysis in Iowa. This includes a more lenient standard when tax classifications are being challenged. *See Heritage Cablevision v. Marion County Board of Supervisors*, 436 N.W.2d 37, 38 (Iowa 1989) in which the Court held that

> Where, as here, the challenged tax classifications do not adversely affect a fundamental interest and are not based upon suspect criteria, they are tested under the more lenient standard of rationality, traditionally applied in evaluating equal protection challenges to regulation of economic and commercial matters. . . . It is widely recognized that the rational basis standard is easily satisfied in challenges to tax statutes.

(Emphasis added).

The State "does not have to produce evidence, and only plausible justification is required" to show a legitimate state interest. *Ames Rental Prop.*, 736 N.W.2d at 259. There is no requirement of proof required of the state, but the Court will look at the "credibility of the asserted factual basis for the challenged classification rather than simply accepting it at face value." *Qwest* at 560. The Court "also reiterated that a party bringing a rational basis challenge must

'negate every reasonable basis that might support the disparate treatment.'" *Qwest*, at 560, 561.

D. The Replacement Tax is Not Unconstitutional Because it Applies Different Delivery Tax Rates to Taxpayers Located in Other Natural Gas Service Areas

1. Little Sioux is not Similarly Situated to Other Large Direct Connect Ethanol Plants Located in Other Natural Gas Service Areas.

Little Sioux claims to be similarly situated to all other large direct connect ethanol plants located in other natural gas service areas.[3] A taxpayer bringing an equal protection challenge still must prove that it is similarly situated to "individuals who are allegedly treated differently under the challenged statute. . . ." *Timberland*, 757 N.W.2d at 175.

Little Sioux argues at page 23 of its brief that the only distinction in the comparison class that the Department draws is that each is located in different natural gas service areas and that such distinction

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[3]In its argument before the District Court, the comparison class Little Sioux was advocating included "large general service consumers of natural gas" which is a larger class than just direct connect ethanol plants. *See* Little Sioux brief to District Court, p. 16, App. 91.

is not sufficient to cause them to be dissimilar under *Racing Ass'n of Central Iowa v. Fitzgerald*, 648 N.W.2d 555, 559 (Iowa 2002). (*RACI I*). *RACI I* did not involve taxpayers paying a property tax at different rates based upon different geographic locations. Rather, the Court applied an equal protection analysis based upon the main activity being taxed, slot machine gambling, which was identical whether done at land-based race tracks or river boats. *RACI I*, at 559. It was not based upon taxing similar property located in different jurisdictions at different levy rates.

The Iowa Supreme Court in *City of Coralville*, 750 N.W.2d at 531 rejected the city's argument that the Iowa Constitution's uniformity clause requires that citizens served by different public utilities be subject to the same tariff rates. In finding that the Constitution did not require uniform rates, the Court also found that the two groups were not "similarly situated," by stating that

> The Iowa Constitution "requires 'uniform operation throughout the State', not uniformity of consequences resulting from such operation." *Cook v. Dewey*, 233 Iowa 516, 519, 10 N.W.2d 8, 10 (1943). The City's uniformity clause claim is in substance a misplaced argument for uniformity of consequences rather than uniformity of operation. Chapter 476 and the regulations implementing it provide a uniform system for filing and approval of

> tariffs setting rates based on costs of the individual public utility. Iowa Code § 476.4 ("Every public utility shall file with the board tariffs showing the rates and charges for its public utility services. . . ."). Iowa Admin. Code r. 199-20.10(2) (requiring that public utility rates "reasonably reflect the costs of providing electric service to the class"). All public utilities are required to file tariffs with the IUB reflecting the costs unique to their service area. Iowa Code § 476.4; Iowa Admin. Code r. 199-20.10(2); *see Fleur de Lis Motor Inns, Inc. v. Bair*, 301 N.W.2d 685, 689 (Iowa 1981) (holding amendments to local option hotel-motel tax statute that did not single out certain classes or entities and applied equally to all municipalities were valid under the uniformity clauses "even though when applied they incidentally affect some entities differently due to differing fact situations"). Dissimilar treatment of persons dissimilarly situated does not offend equal protection. *In re Det. of Hennings*, 744 N.W.2d 333, 339 (Iowa 2008). Citizens serviced by different public utilities are not similarly situated, and consequently the City cannot sustain a constitutional challenge based on the fact that customers of different utilities may pay different rates.

(Emphasis added). *City of Coralville* at 530, 531.

City of Coralville is indistinguishable from the present case for finding that Little Sioux is not similarly situated to other taxpayers that are direct connect ethanol plants located in different service areas. Just as citizens served by different public utilities with different tariff rates are not similarly situated, taxpayers who choose to do business in different legislatively designated service areas that have different tax rates are not similarly situated. Such an argument is akin

to a taxpayer raising an equal protection challenge in Polk County based upon the fact that the levy rate for property taxes is lower in Ringgold County than Polk County. There would be no basis to bring such a challenge because the taxpayers of the two counties are not similarly situated. Here, as long as the delivery tax rate applies equally to all therms of natural gas being delivered into or consumed in the same service area, the tax is being applied uniformly. Uniform consequences from such application as is being complained of by Little Sioux is not required.

The District Court found that *City of Coralville*, 750 N.W.2d 523, provided strong support for the Department's argument that large direct connect consumers located in different service areas were not similarly situated to Little Sioux. However, the Court for purposes of its analysis assumed Little Sioux was similarly situated to the other large consumers of natural gas located in different service areas. (District Court Order, pp. 12 and 13, App. 152, 153) Contrary to Little Sioux's assertion at page 23 of its brief, the District Court did not assume in its analysis that Little Sioux was claiming to be similarly situated to other municipal providers of natural gas.

2. **Even Assuming that Little Sioux is Similarly Situated to Other Direct Connect Ethanol Plants Located in Other Natural Gas Service Areas, a Rational Basis Exists for Different Delivery Tax Rates.**

The Legislature set forth legitimate state interests for having different competitive service areas and a different delivery tax rate for each service area. As discussed, *supra*, the Legislature made specific findings as to why there was a need for different rates within defined service areas throughout the State. These included the fact that the "imposition of a single statewide delivery tax rate would unfairly increase tax costs for some taxpayers while reducing such costs for others. . . ." Varying rates were also needed "to maintain tax continuity and tax revenue for local government." 1998 Iowa Acts, 77th G.A. ch. 1194, § 1. This is why competitive service areas were established based upon the territory in which the original public or municipal utility was providing service for that area and why the initial rate for that service area was tied to the actual centrally assessed property tax liability or the in-lieu-of tax transfers of the utility. Establishing separate service areas was necessary to preserve revenue neutrality for both the taxpayer and local government at the

time of the changeover to the replacement tax system. A rational basis for different rates being applied to different service areas clearly exists and the District Court found "this justification to be reasonable." (District Court Order, p. 13, App. 153)

Prior to the replacement tax, utilities were able to recoup their property tax expenses through the rates they charged their customers. Even under the ad valorem property tax system, the tax costs varied among utilities and the rates charged to customers of utilities with low or nonexistent property tax expenses would reflect these varying tax costs. In other words, if a customer was receiving its natural gas from a municipal utility that did not service customers outside of the municipal boundaries, the utility would have no centrally assessed tax liability and the cost of natural gas passed on to customers by the municipal utility would not reflect any property tax costs.

To assess a statewide delivery tax rate on deliveries of natural gas made by municipal utilities to their customers when they previously had paid little or no property tax on the same service would unfairly increase tax costs to those utilities and to their customers. As stated above, one of the objectives of the replacement tax was to

maintain revenue neutrality for taxpayers and local government. Another objective was to preserve neutrality in the allocation and cost impact of any replacement tax "among consumers of natural gas." Section 437A.2. If a statewide delivery tax rate was applied to municipal utilities, not only would tax costs for the utility and its customers be higher as a result of the replacement tax, but so would delivery tax revenues going to the municipality. There clearly is a rational basis to prevent this from happening.

The District Court also found justification for the differences in municipal utility service area rates by recognizing that

> the legislature could reasonably favor municipal utilities as a means to support local government. The legislature gave a substantial role to city governments in setting rates for municipal utilities. Iowa Code § 437A.5(3)-(4). And in the legislative findings, the legislature acknowledged the unique relationship between municipal utilities and the communities they serve. Little Sioux cannot meet the high burden of establishing an equal protection violation on these grounds.

(District Court Order, pp. 13, 14, App. 153, 154)

Little Sioux chose to build its facilities in the MidAmerican service area knowing that the gas it consumed as a bypass customer would be subject to the same delivery rate as all other therms

delivered into that service area. In *C.I.R. v. National Alfalfa Dehydrating and Milling Co.*, 417 U.S. 134, 149, 94 S. Ct. 2129, 2137 (1934), the United States Supreme Court held "[t]his court has observed repeatedly that, while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice." Little Sioux's choice to operate in this service area was freely given and it cannot now argue that its equal protection rights have been violated because other service areas may have lower delivery rates. It knew this fact at the time it was deciding on a location in which to operate and it can only be presumed that its business model considered the fact that it would owe delivery tax on the therms it consumed. It can only be assumed that this was but one of many factors considered in deciding to locate where it did, including consideration of the incentives it received from local governments such as tax abatements and paved roads paid for by the local jurisdictions. (Exh. 38, Grotjohn dep. Tr. p. 20; Grothjohn Tr. Vol. I, p. 153, l. 15 - p. 154, l. 17, App. 296, 297; 377)

Little Sioux argues that because it chose to operate in a service area with a higher rate than some others, it is entitled under the

constitution to consume the natural gas that it utilizes in its business free of any delivery tax obligation. Such a result would defeat one of the purposes of the replacement tax which was "to negate tax costs as a factor in a competitive environment for taxpayers and consumers. . . ." 1998 Acts, 77th G.A. ch. 1194, § 1. Allowing bypass customers like Little Sioux the right to receive their natural gas free from delivery tax while subjecting all other natural gas delivered into the same service area to the tax is exactly the scenario the Legislature intended to prevent. Instead of removing tax costs as a factor in a competitive environment, Little Sioux's proposed outcome would do just the opposite. The District Court recognized this when it stated that

> Interstate pipelines are exempt from the Replacement Tax. If the Replacement Tax did not apply to direct-connect customers, the gas used by direct-connect customers would not be subject to tax. This could create an economic incentive to bypass local distributors, making tax costs a major factor in the competitive environment. It also could negatively impact the tax base, reducing revenue for local governments.

(District Court Order, p. 16, App. 156)

Little Sioux now attempts to argue that the Legislature did not foresee direct connect ethanol plants taking gas from an interstate

pipeline, and therefore, the application of the replacement delivery tax had unintended circumstances for those taxpayers. Little Sioux brief, p. 30. There is no basis to assume that the Legislature did not foresee that direct connect customers would be bypassing the local LDCs and significantly weaken the tax base of local government. *See General Motors Corp. v. Tracy*, 519 U.S. 278, 117 S. Ct. 811 (1997). Whether the Legislature specifically had a particular group of bypass customers in mind, such as the ethanol industry, when chapter 437A was passed is irrelevant. The fact is that bypass customers were already bypassing the local LDCs and directly connecting to the interstate pipelines for their natural gas. The five grandfathered companies that fall under 437A.5(7) had already started purchasing their natural gas in this manner and, as such, were able to purchase their gas free of the tax costs that the LDC could pass on to its customers. As stated by the District Court, the Legislature could reasonably conclude that the continued expansion of direct connect customers

> after 1999 would undermine the tax base and could negatively affect local governments. . . . But for the inclusion of the end-consumer backstop in section 437A.5(2), the natural gas that passed directly from an interstate pipeline to a consumer would not have been subject to <u>any</u> delivery tax. The legislature could

> reasonably conclude that allowing for this disparate treatment of the distribution of gas would result in a decrease in the available tax base for the excise tax and reduced revenue for local governments.

(Emphasis original). (District Court Order, pp. 17, 18, App. 157, 158)

Little Sioux also argues that the volatility of the tax rate within a service area illustrates the lack of any rational basis. Little Sioux brief, pp. 36-40. As discussed previously, the Legislature established a statutory mechanism setting forth the exact conditions which would trigger an increase or decrease in that service area's delivery tax rate. *See* § 437A.5(8) and pages 24 and 25 of this brief. Little Sioux knew at the time it went into operation that the rate could vary by year for each service area depending on total therms delivered into a particular service area for the prior year. The threshold rate was allowed to fluctuate on a gradual basis to reflect increases or decreases in growth of total natural gas usage in the service area in order to smooth out the affects of any changes so as to avoid large scale yearly fluctuations that otherwise could occur.

Some of the fluctuations complained of could be the result of a gain or loss of major gas consuming customers in smaller service areas. Also, Mr. Simmons testified that the Iowa Electric and

Interstate Power service areas experienced a significant decrease in delivery rates because it was discovered that both LDCs from those service areas were not properly reporting transport deliveries in the calculation of their overall deliveries. Once those deliveries were properly included, the delivery tax rates in both areas went down accordingly. (Simmons, Tr. Vol. II, p. 68, l. 1 - p. 69, l. 8, App. 393, 394)[4]

Little Sioux also complains that it individually cannot affect the delivery rates and points to its expansion of gas usage as a case in point. Little Sioux brief, p. 38. Since the delivery rate for a service area is dependent upon the total of all therms delivered into a service area, it is conceivable that deliveries attributable to a single entity like Little Sioux will have little or no impact on the overall delivery tax rate for any particular area.

Based on the above, a rational basis clearly exists for the existence of separate competitive service areas with delivery rates linked to those particular service areas. The tax system in place

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[4]Transport deliveries are deliveries of natural gas to a customer by a LDC whereby the natural gas has already been purchased by the customer and transported into Iowa by an interstate pipeline. (Whelan, Tr. Vol. II, p. 58, l. 21 - p. 59, l. 5, App. 391) The LDC is liable for delivery tax on those deliveries to the end-users.

guarantees that every therm of natural gas delivered into or consumed in that service area will be taxed at the same rate. Nothing could be more uniform in operation. There is also a mechanism in place that will allow the rate to fluctuate in a manner that will alleviate wild swings from year to year. Section 437A.5, and the provisions therein, do not violate the equal protection provisions of the United States or Iowa Constitutions and both the Administrative Law Judge and the District Court applied the correct rational basis standard in arriving at that conclusion.

E. The Statute of Limitations Contained in Section 437A.14(1)(b) Is Not Unconstitutional.

Little Sioux argues that the shorter statute of limitations of 90 days from when the tax payment is due for appealing constitutional issues as compared to three years for other issues is a violation of its equal protection rights. Section 437A.14(1)(b)(1) states, in part, the following.

> Claims for refund or credit of replacement taxes paid shall be filed with the director. A claim for refund or credit that is not filed with the director within three years after the replacement tax payment upon which a refund or credit is claimed became due, or one year after the replacement tax payment was made, whichever time is

> later, shall not be allowed. A claim for refund or credit of tax alleged to be unconstitutional not filed with the director within ninety days after the replacement tax payment upon which a refund or credit is claimed became due shall not be allowed. As a precondition for claiming a refund or credit of alleged unconstitutional taxes, such taxes must be paid under written protest which specifies the particulars of the alleged unconstitutionality. Claims for refund or credit may only be made by, and refunds or credits may only be made to, the person responsible for paying the replacement tax, or such person's successors. The director shall notify affected county treasurers of the acceptance or denial of any refund claim. Section 421.10 applies to claims denied by the director.

(Emphasis added). There is nothing unconstitutional about creating two classes of taxpayers seeking refunds by differentiating between those challenging errors pertaining to a specific return as compared to those raising constitutional issues affecting an entire legislative enactment.

In *McKesson Corp. v. Div. of Alcoholic Beverages and Tobacco of Florida*, 496 U.S. 18, 45, 110 S. Ct. 2238, 2254, 2255 (1990), the United States Supreme Court found that reducing the statute of limitations for constitutional challenges reduces the state's exposure and promotes fiscal planning. As stated by the Court

> A State's freedom to impose various procedural requirements on actions for postdeprivation relief sufficiently meets this concern with respect to future cases.

> The State might, for example, provide by statute that refunds will be available only to those taxpayers paying under protest or providing some other timely notice of complaint; execute any refunds on a reasonable installment basis; enforce relatively short statutes of limitations applicable to such actions;. . . . The State's ability in the future to invoke such procedural protections suffices to secure the State's interest in stable fiscal planning when weighed against its constitutional obligation to provide relief for an unlawful tax.

(Emphasis added). *Id.*

In *American States Ins. Co. v. State of Michigan Dept. of Treasury*, 220 Mich. App. 586, 597, 560 N.W.2d 644, 650 (1996) the Michigan Court upheld a 90 day statute of limitations for claiming a refund to a constitutional claim as compared to a general four year period. The Court found a rational basis to exist because a shorter limitation period relating to constitutional claims was necessary to protect the state's treasury from potentially enormous claims. "Protection of the state treasury is certainly a legitimate state purpose." *Id. See also Dickinson v. Porter*, 240 Iowa 393, 406, 35 N.W.2d 66, 75 (1949) where the Iowa Supreme Court also held that providing "for the necessary funds with which to carry on a governmental function" is a proper basis for classification.

Court rulings that a statute is unconstitutional can involve large numbers of taxpayers and can have a devastating effect on the government treasury, especially local governments. This contrasts with claims involving an erroneous return which generally are limited to a single taxpayer and may involve a mistake that may not be obvious for several years after the initial filing. The fiscal impact in a situation involving an erroneous return will generally be far less devastating to the fiscal stability of state or local governments than will a refund involving a constitutional claim. In *Kentucky, Revenue Cabinet v. Gossum*, 887 S.W.2d 329, 335 (Ky. 1994), the Kentucky Supreme Court upheld a shorter two-year statute of limitations period for constitutional challenges to income tax statutes versus other income tax claims. The Court found that

> This case stands as a clear example of the distinction that the state legislature has drawn between refunds of taxes paid under a statute (equivalent to a tax scheme) held unconstitutional and of taxes paid under a constitutional statute which is rationally related to a legitimate state interest. Revenue Cabinet acknowledges that refunds under a constitutional statute should normally involve individual taxpayers and nominal payments, whereas refunds under an unconstitutional statute will involve multitudes of taxpayers and millions of dollars.

(Emphasis added). A rational basis clearly exists for the shorter statute of limitations for constitutional claims. The District Court confirmed that the State has a legitimate interest "for the differential treatment of constitutional challenges." (District Court Order, p. 18, App. 158)

For the first time, Little Sioux is arguing that the rational basis standard for determining a shorter statute of limitations involving constitutional claims is not appropriate and that the Court should apply a strict scrutiny analysis. It bases this argument on the allegation that it is being denied its fundamental right of access to the Court to bring a constitutional claim. Little Sioux brief, p. 44. Little Sioux cites to *Federal Land Bank of Omaha v. Arnold*, 426 N.W.2d 153, 156 (Iowa 1988) as authority to use a strict scrutiny analysis. That case does not stand for such a proposition and, in fact, the Court made its ruling using the rational basis standard as the distinction being "drawn involves neither a fundamental right nor an inherently suspect classification. . . ." *Id.*

Cases routinely have rejected a strict scrutiny analysis as "[s]tatutes of limitation do not implicate or affect fundamental rights."

Koppes v. Pearson, 384 N.W.2d 381, 384 (Iowa 1986). *See Conner v. Fettkether*, 294 N.W.2d 61, 62 (Iowa 1980), where the Court stated that "[s]tatutes of limitations go to matters of remedy which are not fundamental rights." In *Krupke v. Witkowski*, 256 N.W.2d 216, 224 (Iowa 1977), the Court stated the following:

> Our opinion today is but another recognition that statutes of limitations go to matters of remedy and not to destruction of fundamental rights." (Citations omitted). The Supreme Court many years ago in *Chase Securities Corp. v. Donaldson*, 325 U.S. 304, 314, 65 S.Ct. 1137, 1142, 89 L. Ed. 1628, 1635 aptly summarized the law in this regard as follows:
>
> > Statutes of limitation find their justification in necessity and convenience rather than logic. . . . They are by definition arbitrary, and their operation does not discriminate between the just and the unjust claim, or the avoidable and unavoidable delay. They have come into the law not through the judicial process but through legislation. They represent a public policy about the privilege to litigate. Their shelter has never been regarded as what now is called a "fundamental" right or what used to be called a "natural" right of the individual. He may, of course, have the protection of the policy while it exists, but the history of pleas of limitation shows them to be good only by legislative grace and to be subject to a relatively large degree of legislative control.

The Michigan Court in *American States Ins.*, 222 Mich. App. at 596, 560 N.W.2d at 649, also applied the rational basis test after concluding that a strict scrutiny analysis was not warranted in its determination that the 90 day statute of limitations was not a violation of equal protection.

In *Argenta v. City of Newton*, 382 N.W.2d 457 (Iowa 1986), the Supreme Court examined the equal protection challenge to the municipal tort claim act which required either an action to be filed within six months of the alleged tort or that written notice be given to the municipality within 60 days with a subsequent action filed within two years. The plaintiffs in that case sought to have the Court apply the strict scrutiny standard. The Court declined this invitation by stating that

> This statute does not bar the courtroom doors but instead requires early notice of an intention to seek access to the courtroom. We follow our own precedent in applying the traditional rational basis test to the classification created by Iowa Code section 613A.5.

Id. at 461. The Iowa Supreme Court eventually struck this provision as violating equal protection but did so using a rational basis standard. *Miller v. Boone County Hospital*, 394 N.W.2d 776 (Iowa 1986).

Little Sioux cites *Miller v. Boone County Hospital, id.* for support that the 90 day statute at issue lacks any rational basis. In *Miller*, at 779, the Court determined that singling out victims of government torts for a shorter notice period was arbitrary as there was no rational basis for the different periods to continue to exist.

Here, there is continued justification for providing a shorter period to claim a refund of taxes based on constitutional issues. In *Miller*, the Court rejected the argument that the shorter period protected the municipal treasury because most municipals are now covered by liability insurance. That is not the case involving tax refund claims which must be paid directly from the government treasury. The District Court agreed that the justifications offered for the shorter statute of limitations were credible, and thus, did not violate equal protection provisions. (District Court Order, p. 19, App. 159)

Little Sioux also argues in its Summary of Argument, page 14, that the precondition to filing a refund claim which requires the taxes be paid under written protest setting forth the particulars of the alleged unconstitutionality amounts to an instantaneous statute of

limitations. Little Sioux's allegation is incorrect. The 90 day statute of limitations does not begin to run until the taxes actually become due. Section 437A.14(1)(b)(1). The replacement tax return, however, is due six months prior to the actual due date of the tax payment. Section 437A.8(1). For instance, for 2007 deliveries taking place during the year ending December 31, 2007, a taxpayer's replacement delivery tax return is not due until March 31, 2008. The first half installment of the taxes payable involving the 2007 tax year is not due until September 30, 2008, with the second installment of the 2007 taxes not due until March 31, 2009. *See* § 437A.8(4)(a). The timing of this payment is intended to coincide with the property tax payments being paid to local government. In addition, section 437A.19(6)(e) also requires the taxpayer to file with the Director by October 1, 2007 an estimate of expected deliveries for the 2007 tax year anticipated by a taxpayer in a particular service area. The Director then provides this information to the Department of Management by October 31, 2007, so that local governments can proceed with budgetary planning requirements.

A taxpayer, therefore, has a one year window from when the initial estimate of deliveries is due to be filed with the Director before the first installment of the actual tax is required to be paid. In addition, there is a six month window between when the actual return is due to when the first installment of tax is paid. The precondition requirement allows the State additional time to correct legitimate constitutional deficiencies and still allows the taxpayer ample time to formulate any constitutional objections before actual payment of the tax.[5] A rational basis exists for the time periods to file a refund claim.

II. THE REPLACEMENT TAX DOES NOT VIOLATE THE DORMANT COMMERCE CLAUSE.

A. Error Preservation

The Department agrees that Little Sioux has raised the dormant Commerce Clause issue before the agency and the District Court. However, now for the first time it is raising the tariff setting

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[5]For the 2010 tax year which was timely filed, Little Sioux met the precondition requirements set forth in section 437A.14(3)(b)(1). Therefore, the precondition requirement did not prevent Little Sioux from timely filing its 2010 refund claim. The 2007, 2008 and 2009 refund claims were untimely because they were filed beyond the 90 day statute of limitations of when the replacement tax payment became due.

procedures of the IUB through chapter 476 as a basis for its challenge. At page 56 of its Brief, Little Sioux asserts that "the test is whether the collection of state laws applied by one or more state agencies charges a greater excise tax on transactions involving non-resident suppliers." The IUB has never been made a party to this proceeding and the District Court was never presented with this issue to review. In *City of Postville v. Upper Explorerland Regional Planning Com'n.*, 834 N.W.2d 1, 8 (Iowa 2013), this Court stated that "[w]e do not decide issues presented to us on appeal that a party did not present to the district court."

B. Standard of Review

The Department agrees with Little Sioux's standard of review analysis in that the Court will review constitutional issues de novo and will give no deference to the agency determination. *NextEra Energy Res. LLC v. Iowa Utilities Board*, 815 N.W.2d 30, 44 (Iowa 2012) and *Qwest Corp. v. Iowa St. Bd. of Tax Review*, 829 N.W.2d 550, 557 (Iowa 2013).

C. Little Sioux Lacks Standing to Bring This Dormant Commerce Clause Challenge.

Little Sioux raises a dormant Commerce Clause claim which not only is frivolous on the merits, but which Little Sioux also lacks the necessary standing to raise the issue. Little Sioux is assessed a replacement delivery tax at the same rate which is imposed upon other taxpayers with an Iowa nexus that either deliver natural gas to end-users located in the same service area or are themselves the end-user of natural gas that is not otherwise subject to tax. There is no tax being imposed upon out-of-state suppliers of natural gas just as there is no delivery tax being imposed on interstate pipeline companies for transporting that gas into Iowa. The out-of-state suppliers have no nexus so they are not taxed and the interstate pipeline companies are specifically exempted from delivery tax for any therms they deliver directly to end-users. The only tax imposed on the interstate pipeline companies is a property tax assessed on the fair market value of their Iowa operating property and that tax passes all four prongs of the test put forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 278, 97 S. Ct. 1076, 1078 (1977).

Little Sioux argues that it has standing to bring this challenge based upon the United States Supreme Court decision in *General Motors Corp. v. Tracy*, 519 U.S. 278, 117 S. Ct. 811 (1997). There, the Court ruled General Motors had standing because it was a customer of the class that ultimately was being discriminated against by the State "where the customer is liable for payment of the tax and as a result presumably pays more for the gas it gets from out-of-state producers and marketers." *Id.* at 286. General Motors, similar to Little Sioux, was a bypass customer and took its gas directly from the interstate pipeline, bypassing the local LDC. Ohio imposed a general 5% sales and use tax on the purchase of natural gas from all sellers except regulated public utilities that met the definition of "natural gas company." Gas purchased from a natural gas company was exempt from sales or use tax. *Id.* at 281, 282. The marketer that General Motors purchased its gas from did not meet this definition so General Motors was subject to the 5% use tax on its purchases of natural gas from the out-of-state marketer. In other words, the gas sold by the out-of-state marketer was subject to a use tax while gas sold by the in-state LDC was exempt from sales tax. The Court found that as a

customer of the out-of-state marketer, General Motors had standing to raise a dormant Commerce Clause issue because it was subject to a use tax on its purchases of gas from an out-of-state supplier as opposed to having purchased gas from the local LDC.

That is in contrast to the situation here where all therms of gas delivered into the same service area are subject to the same tax. Contrary to Little Sioux's assertion at page 52 of its brief, the replacement delivery tax is not a sales tax as defined in Iowa Code section 423.2 where the incidence of the tax falls upon the purchaser and is collected by the retailer. Here, the incidence of the tax falls directly on the person delivering the gas to the end-user or directly on the end-user if the gas being delivered is not otherwise subject to tax under section 437A.5(1). There is no differential tax rate being experienced by out-of-state marketers on the gas they sell into Iowa. They are not subject to a delivery tax and each therm of gas they sell into the same service area in Iowa will be subject to the same delivery tax rate regardless whether it is purchased for resale by an LDC or municipal utility or delivered directly to the customer by an interstate pipeline. That is a far different situation from the general sales and

use tax regime in place in Ohio where only General Motor's purchases of gas from the out-of-state marketers were subject to a use tax.

Little Sioux's complaint, as evidenced by its new objection to the IUB tariff procedures, is with how MidAmerican passes its replacement delivery tax costs onto its customers, not the imposition of the replacement tax itself. As recognized by the District Court as part of its equal protection analysis

> The result Little Sioux claims is discriminatory is not caused by the Replacement Tax, but by the action of a private entity, MidAmerican, acting under the regulation of the Iowa Utilities Board. [E]qual protection claims require state action." *King v. State*, 818 N.W.2d 1, 25 (Iowa 2012) .

(District Court Order, p. 15, App. 155) Because each therm of natural gas being sold and delivered into a particular service area is subject to the same delivery tax rate, Little Sioux's out-of-state supplier is not being discriminated. As a result, Little Sioux, being a customer of that out-of-state supplier, suffers no discrimination or injury attributable to the replacement tax violating the dormant Commerce Clause, and therefore, lacks standing to raise this challenge.

D. Even Assuming Little Sioux Has Standing, The Replacement Tax Does Not Violate The Dormant Commerce Clause.

The dormant Commerce Clause is a legal doctrine that prohibits states from enacting legislation that improperly burdens or discriminates against interstate commerce. When a state tax affects interstate commerce, the tax must meet each requirement of a four-prong test to be constitutional. *Complete Auto Transit*, 430 U.S. at 278, 97 S. Ct. at 1078. A state tax does not violate the dormant Commerce Clause when (1) there is a substantial nexus between the state and taxpayer to impose a tax, (2) the tax is fairly apportioned to the activities of the taxpayer within the state, (3) the tax does not discriminate against interstate commerce, and (4) the tax is fairly related to the services provided by the state. *Id.* As detailed in the District Court Order, pages 25 and 26, App. 155, 156, the replacement tax passes all four tests.

To prove discrimination under the Commerce Clause, there assumes a comparison of substantially similar entities. *General Motors*, 519 U.S. at 298. There, the Court compared the LDC and the out-of-state marketer and found them to be dissimilar because the

LDC was required to provide a product consisting of gas and bundled services. The out-of-state marketer had no such required service to provide. It was this added requirement of the LDC to service the small captive market incapable of negotiating the buying of natural gas directly from out-of-state suppliers that made the two entities dissimilar for purposes of finding a dormant Commerce Clause violation. *Id.* at 307. The Court recognized the need to protect LDCs in their ability to continue to serve their captive customers and that maintaining their ability to compete was a proper state action in exempting the purchases of gas from LDCs from sales and use tax.

This also was a factor leading to the passage of the replacement tax. The Legislature recognized the potential loss of large customers choosing to bypass the LDC in order to purchase their gas free of any tax costs attributable to the LDC's centrally assessed tax liability. Any significant loss of high volume customers would not only weaken the LDC's ability to service its residential customers but would weaken the tax base of local government. To avoid this from occurring, the Legislature implemented the replacement tax system whereby tax costs were removed as a factor in a competitive environment. *See*

§ 437A.2. The factors that led the *General Motors* Court to find that the LDCs and interstate marketers were dissimilar entities exist here as well. The differences between the Ohio sales tax scheme and Iowa's replacement tax does not change this analysis.

Little Sioux argues throughout that it pays a replacement tax at a higher rate than MidAmerican's customers. This is not the case, as the incidence of the tax does not fall upon MidAmerican's customers, but rather falls directly on MidAmerican. MidAmerican and all other public utilities are allowed to pass all or a part of their costs to their customers through the use of tariffs approved by the IUB. *See City of Coralville*, 750 N.W.2d at 528-530. A utility recouping all or part of its tax expenses from a customer does not put the incidence of the tax on that customer. It still lies with the utility making the delivery of natural gas. *See Cedar Valley Leasing v. Iowa Dept. of Revenue*, 274 N.W.2d 357, 361 (Iowa 1979) where the Court found that "the ultimate legal incidence of the tax is on Cedar Valley for the acquisition transaction, and on the farmer for the rental transaction." The LDC passing on these expenses is no different than when Little Sioux passes its expenses, including its tax expenses, onto its customers as

part of the bidding process of the ethanol or byproducts that it sells. In passing on those expenses, Little Sioux does not itemize its replacement tax costs in the bidding process or in the billings to its customers, nor is its customer liable for that tax. (Exh. 38, Grotjohn dep. Tr. p. 33, l. 7 - p. 34, l. 2, App. 299, 300) As with the LDC, the replacement delivery tax obligation lies with Little Sioux, not with its customers.

The replacement tax is not assessed to out-of-state suppliers and it is not assessed to the interstate pipelines. The extraterritoriality doctrine discussed in Little Sioux's brief, page 65, is not violated as every other state could impose this same tax on all deliveries of therms of natural gas into their state without interstate commerce being burdened as each therm would only be taxed once. *Complete Auto*, 430 U.S. at 278. Nothing in this record supports a finding that the replacement tax discriminates against interstate commerce.

CONCLUSION

The District Court correctly concluded that Little Sioux wholly failed to carry the heavy burden of proof that is necessary to prove that any provision of chapter 437A is unconstitutional. Little Sioux

has failed to prove that it is in a similarly situated class of taxpayers for which it claims disparate treatment and it has failed to prove the lack of any rational basis for the existence of the replacement tax and the manner in which it is implemented. It has also failed to prove that chapter 437A violates the United States Constitution's dormant Commerce Clause. As a result, the Supreme Court should sustain in full the conclusions reached by the Administrative Law Judge and District Court and also affirm that Little Sioux's petition for judicial review should be dismissed in its entirety.

REQUEST FOR ORAL ARGUMENT

In the event Appellant is granted request for oral argument, the Appellees respectfully request the opportunity to also be heard in oral argument with respect to this appeal.

COST CERTIFICATE

We hereby certify that the actual cost of printing the foregoing Final Brief of Appellees was the sum of $92.50.

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CERTIFICATE OF FILING AND SERVICE

I certify that on this 21st day of October, 2014, I delivered eighteen copies of the Final Brief of Appellees to the Clerk of the Supreme Court, Iowa Judicial Branch Building, 1111 East Court Avenue, Des Moines, Iowa 50319.

I further certify that on this 21st day of October, 2014, I caused one true and correct copy of the Final Brief of Appellees to be forwarded by U.S. Mail to the following person(s):

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1. This brief complies with the type-volume limitation of Iowa R. App. P. 6.903(1)(*g*)(1) or (2) because:

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Jan. Miller
Signature

10-21-14
Date

IN THE SUPREME COURT OF IOWA

No. 14–0494

Polk County No. CVCV009671

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NOTICE OF ORAL ARGUMENT

LSCP, LLLP,
Petitioner-Appellant,

vs.

COURTNEY M. KAY-DECKER, Director, **IOWA DEPARTMENT OF REVENUE,**
Respondents-Appellees.

After screening it has been determined pursuant to Iowa Rule of Appellate Procedure 6.908(3) that oral arguments will be permitted on this matter. Accordingly, this case has been assigned for oral argument to the Iowa Supreme Court on **Wednesday, January 21, 2015, at 1 p.m.** Each side will have 15 minutes and the applicant will have an additional 5 minutes for reply. Multiple applicants or resisters, if any, must share the time allotted.

Changes in the above-stated oral argument date and time will not be made absent a verified showing of a most unusual and compelling circumstance.

If you require the assistance of auxiliary aids or services to participate in court because of a disability, immediately call the ADA coordinator at (515) 281-5911. If you are hearing impaired, call Relay Iowa TTY at 1-800-735-2942. Conference room 116 on the first floor and the media room on the first floor, if not in use by media personnel, are available for private attorney/client discussion and preparation the day of oral argument.

If the court of appeals is not in session, the attorney preparation room on the third floor will also be available for this purpose. Of course, the attorney preparation room on the fourth floor will continue to be open for attorney preparation when the supreme court is in session.

This is the only notice you will receive from the court.

Dated this 5th day of December, 2014.

SUPREME COURT OF IOWA

Mark S. Cady

Mark S. Cady, Chief Justice

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