Approved:_____

Date 2/13/97

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairperson Don Myers at 9:00 a.m. on January 29, 1997 in Room 514-S of the Capitol.

All members were present.

Committee staff present: Lynne Holt, Legislative Research Department
Mary Shaw, Committee Secretary

Conferees appearing before the committee: Louis Stroup, Jr., Executive Director, Kansas Municipal Utilities, Inc.
Jon Miles, Director, Administrative and Governmental Relations, Kansas Electric Cooperatives, Inc.

Others attending: See attached list

Chairperson Myers mentioned that the Committee will need to adjourn promptly at 9:50 a.m. due to the House convening at 10:00 a.m. The Chair reported that the Committee will hear two briefings on electric retail wheeling.

The Chair introduced Louis Stroup, Jr., Executive Director of the Kansas Municipal Utilities, Inc., who described the function of Municipal Utilities. Mr. Stroup provided copies of the Kansas Municipal Utilities and when they were established, and a Summary of Revenues per kilowatt hour compiled by American Public Power from data supplied by each utility to the Department of Energy (Attachment #1). In conclusion, Mr. Stroup expressed that there is no "crisis" in Kansas that requires a rush into retail wheeling. He said Kansas is not a high cost power state. He further mentioned that if retail wheeling is found to be in the best interests of all Kansans, and that may or may not be the case, then it must be done right. He mentioned the municipal electric cities stand ready to aid the Legislature in helping shape the debate as well as seeking the solutions. The Chair thanked Mr. Stroup for the information he presented to the Committee.

The Chair introduced Mr. Jon Miles, Director of Administrative and Governmental Relations, Kansas Electric Cooperatives, Inc., who described the function of electric cooperatives (Attachment #2). In addition, more inclusive testimony was submitted (Attachment #3). In concluding, Mr. Miles mentioned that Kansas Electric Cooperative has not adopted a position for or against retail wheeling. He mentioned that if retail wheeling is inevitable, the cooperatives stand ready to work through that issue in an effort to protect the best interests of their consumer-members. He said their primary concern, and their focus in their debate before the Legislature, is the impact that retail competition will have on the consumers of electric cooperatives. The Chair thanked Mr. Miles for the information he presented to the Committee.

Questions and discussion followed.

Representative Aurand made a motion to introduce a committee bill dealing with energy efficiency standards and Kansas Corporation Commission's regulation. The motion was seconded by Representative Stone. Motion passed.

Staff distributed copies of a presentation of July 25, 1996, to the Kansas Legislature's Task Force on Gas Gathering by David E. Pierce, Professor of Law, Washburn University Law School, on the History of U.S. Federal Natural Gas Regulation (Attachment #4). The Chair asked Staff if they or any Committee members had any bills to introduce. There being none, the meeting was adjourned at 9:55 a.m.

The next meeting is scheduled for January 30, 1997.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: January 29, 1997

NAME	REPRESENTING
Mark Miles	Kansas Electric Cooperatives
Irvan W. Wyatt	Ks Farmers Union
Lester L. Murphy Jr.	Kansas-Electr Co-Op
Larry Holloway	KCC
Steve Miller	Sunflower
Kent L. Stewart	Sunflower
BRUCE GRAHAM	ICEPG
J.C. Long	UtiliCorp United, Inc.
JOE DICK	BPU KCK
Terry Leatherman	KCCI
Glenda Cafer	KCC
Leslie Kaufman	Kansas Farm Bureau
Bannie Lehmann	Western Resources
Philip Weiser	Washburn Law School
Louis Stroup Jr.	Kansas Municipal Utilities
ED SCHAUB	WESTERN RESOURCES
Don Schmacka	ICTOGA
DAVID B SCHLOSSER	PETE McGILL & ASSOC.
WALKER HENDRIX	CURB

BRIEFING ON MUNICIPAL UTILITIES IN KANSAS
Before House Utilities Committee
January 29, 1997

Mr. Chairman, members of the committee, I am Louis Stroup, Jr., executive director of Kansas Municipal Utilities, Inc., a statewide association of municipal electric, gas and water cities which was founded in 1928 and whose member cities provide utility services to more than 1 million Kansans.

Types of municipal utilities

Water -- a majority of the state's 625 cities operate their own water systems.
Gas distribution -- there are 71 municipal gas distribution cities.
Electric -- there are 121 municipal electric cities of which 64 generate all or part of their energy needs and the remaining 57 cities operate electric distribution facilities and purchase their energy needs from another city, a rural electric cooperative or investor-owned utility.

History of municipal electric cities

The first municipal electric system established in Kansas was nearly 109 years ago -- in 1888. That first city was Herington. Next came Beloit and Osage City in 1890 and LaHarpe in 1899. Then, at the turn of the century, municipal electric systems began popping up all across the state. (A list of the electric cities is attached). Our electric cities range in size from the Kansas City, Kansas Board of Public Utilities which has nearly 66,000 electric customers to Radium in Stafford County which has 20 electric customers.

Electric industry make up today in Kansas

There are 3 types of retail electric suppliers in Kansas today: Municipals, rural electric cooperatives (RECs), and investor-owned (IOUs). Municipal electric cities serve 19.1% of the electric customers in the state, RECs 15.2% and IOUs 65.7% (list of number of customers per utility in Kansas is attached).

Revenue comparison of 3 segments

Attached is a summary of 1994 average revenues per kilowatt-hour for each electric utility in Kansas compiled by the American Public Power Association from data reported by each utility to the U.S. Department of Energy. This will give you a good indication as to rate differences and yet is much easier to compare than actual rate schedules. I do urge caution when looking at municipal rates -- in nearly all cases, municipal electric rates contain more than just energy costs (this discussed further later on).

House Utilities
1-29-97
Attachment 1

Differences

Municipal electric systems differ from RECs and/or IOUs in the following ways:

- Must operate and make decisions under the open meeting or sunshine laws
- Operated by locally elected officials who are much closer to the actual needs of the customers
- Profits (or ratepayer dividends) stay within the community
- Utilize tax-exempt financing for capital needs through issuance of electric revenue bonds paid from electric revenues, not tax monies
- Not under the Kansas Corporation Commission for rate-making purposes except outside the 3-mile limit, but are under KCC jurisdiction for such things as retail electric service territories and gas pipeline safety. City gas and or electric customers further than 3 miles out from the city limits are under the KCC for rates only. **Historically, KMU and the electric cities have strongly opposed KCC regulation of their affairs and continue to oppose any attempts to place municipal electric utilities under any additional KCC jurisdiction, including for the purpose of retail wheeling. The Senate Utilities Committee on January 21 voted to introduce a bill that would remove KCC's rate jurisdiction over municipal gas and electric customers outside the 3-mile limit. I think it is important to remember that the costs of municipal electric systems are often viewed by cities as a portion of the total fixed costs associated with providing city services, rather than as distinct cost figures.**
- Municipal electric systems exist to provide a value to their communities, not to generate corporate profits or stockholder profits for persons throughout the U.S.
- A majority of the cities use higher rates to reduce property taxes. Others also provide free or reduced cost electricity to city departments for park lighting, or to other entities such as hospitals and schools. Many cities provide free street lighting -- a major cost in non-municipal electric cities. Two examples:

The McPherson BPU has by far the lowest electric rates of any electric utility in Kansas, including RECs or IOUs; yet in 1995 BPU transferred $810,000 in cash from the electric utility fund to the general operating fund (plus another $28,000 from the water fund), thereby **reducing the property tax levy by 15.46 mills.**

The Kansas City BPU has very competitive rates, yet in 1995 made the following contributions to the city from electric revenues --

Payment in-lieu of tax reserve	$7,202,003
Street lighting/traffic signals	$3,378,942
Reductions from rates:	
City of Kansas City	$2,117,749
Wyandotte County	$ 54,126
Public schools	$ 367,674
Churches	$ 143,606
Water pollution abatement service	$ 893,760
Total	**$14,157,860**

Goals differ depending on type of utility

Successful goals for investor-owned utilities tend to be: Aggressively redeploying cash into acquisitions, utilizing huge advertising budgets, focusing all activities around marketing, and maximizing profits.

Successful goals for municipal electric systems tend to be: Providing the best possible service at the lowest possible price consistent with priorities established through a political process.

> **"As investor-owned utilities take steps to establish national (and even international) name recognition for their electricity, local public power utilities must work to strengthen and reinforce their identities where it really counts, with their customers in their own communities,"** Alan Richardson, executive director, American Public Power Association, Washington, D.C.

Changes are coming

Retail wheeling may not be a household word yet, but it's certainly a buzz word among policy makers and legislators on both the state and federal level. And it is just one part of the overall concept to deregulate the most capital intensive industry in the United States -- the electric power industry.

KMU participation in the debate

KMU is one of 2 participants from the municipal electric sector of the industry serving on the Kansas Legislative Retail Wheeling Task Force chaired by Representative Carl Holmes of Liberal. KMU's task force representative is Gilbert Hanson, Jr., general manager of the Kansas Municipal Energy Agency (KMEA), located in Overland Park. The other municipal representative is Leon Daggett, general manager of the Kansas City Board of Public Utilities.

Retail wheeling is about 'customer choice'

Proponents of retail wheeling cite "customer choice" as one of the guiding forces behind such restructuring of the retail electric industry. I think it is important to point out and remember that in the case of municipal electric cities, the customers have already made a choice -- the choice to self-provide. Long ago, when no one else would serve most of these communities, they took matters into their own hands and fashioned a solution which not only provided the needed electric service to their citizens, but also became an important asset in their communities. In many of our communities today, the electric department is the biggest business in town.

Concerns

KMU has many concerns about proposals to push Kansas into the retail wheeling world. There is not sufficient time today to get into this subject, but I would like to make a couple of comments.

First, before jumping into full competition, we must fully understand the impact such an environment would have on **all** Kansans -- small as well as large businesses, commercial customers, residential customers, and both rural and urban areas. Is there a positive or negative impact on all of Kansas? KMU is participating in 2 studies -- the one recommended by the legislative task force and our own independent study being conducted by Wichita State University's Hugo Wall School of Urban and Public Affairs.

The WSU study results will be provided to you once it is completed -- probably sometime in February. The 4 key points to the study are:

What are the policy issues and the alternatives available to the state for dealing with municipal electric utilities in a retail wheeling environment?

What is the economic impact of retail wheeling on the customers of a municipal electric utility?

What is the fiscal impact of retail wheeling on a municipality and its municipal electric utility, including any new regulatory burdens?

What is the extent of municipal electric utility stranded costs (including outstanding municipal bonds) in Kansas?

Secondly, I submit there is no "crisis" in Kansas that requires a rush into retail wheeling. Kansas is not a high cost power state. If retail wheeling is found to be in the best interests of **all** Kansans -- and that may or may not be the case -- then it must be done right. Our municipal electric cities stand ready to aid the legislature in helping shape the debate as well as seeking the solutions.

Date Kansas municipal electric systems established:

Cities in BOLD are electric generating cities

Non-bold cities are electric distribution cities

Alma - 1938
Altamont - 1934
Anthony - 1909
Arcadia - 1913
Arma - 1909
Ashland - 1909
Attica - 1915
Augusta - 1911
Axtell -
Baldwin City - 1906
Belleville - 1923
Beloit - 1890
Blue Mound -
Bronson - 1926
Burlingame - 1902
Burlington - 1935
Cawker City - 1913
Centralia - 1911
Chanute - 1903
Chapman - 1911
Chetopa - 1937
Cimarron - 1913
Clay Center - 1907
Coffeyville - 1901
Colby - 1910
Dighton - 1916
Ellinwood - 1948
Elsmore -
Elwood -
Enterprise - 1910
Erie - 1915
Eudora -
Fredonia - 1901
Galva - 1918
Garden City -
Gardner - 1918
Garnett - 1918
Girard - 1904
Glasco - 1910
Glen Elder - 1905
Goodland - 1937
Greensburg - 1911
Haven - 1908
Herington - 1888
Herndon - 1937
Hill City - 1900
Hillsboro - 1930
Hoisington - 1940
Holton - 1909
Holyrood - 1918
Horton - 1912
Hugoton - 1919
Iola - 1900
Isabel -
Iuka - 1916
Jetmore - 1914
Johnson City - 1938
Kansas City BPU - 1929
Kingman - 1913
Kiowa - 1976
La Crosse - 1906
La Harpe - 1899
Lakin - 1915
Larned - 1916
Lincoln Center - 1906
Lindsborg - 1904
Lucas -
Luray - 1915
Mankato - 1950
Marion - 1928
McPherson BPU - 1909
Meade - 1910
Minneapolis - 1921
Montezuma - 1921
Moran - 1900
Morrill - 1927
Moundridge - 1909
Mount Hope - 1920
Mulberry - 1915
Mulvane - 1902
Muscotah -
Neodesha - 1922
Norton - 1912
Oakley - 1910
Oberlin - 1901
Osage City - 1890
Osawatomie - 1913
Osborne - 1921
Ottawa - 1906
Oxford - 1923
Pomona - 1914
Pratt - 1910
Prescott - 1921
Radium - 1935
Robinson -
Russell - 1910
Sabetha - 1901
St. Francis - 1914
St. John - 1910
St. Marys - 1908
Savonburg - 1902
Scranton - 1919
Seneca - 1903
Severance -
Seward -
Sharon Springs - 1918
Stafford - 1910
Sterling - 1916
Stockton - 1908
Summerfield -
Toronto - 1917
Troy - 1911
Udall - 1939
Vermillion -
Wamego - 1908
Washington - 1938
Waterville -
Wathena - 1937
Webber - 1937
Wellington - 1902
Winfield - 1904

List of municipal electric system rates/revenues:

Attached is a summary of 1994 average revenue per kilowatt-hour compiled by the American Public Power Association showing:

(1) United States averages by type of ownership [Exhibit A]

(2) state averages for municipal, rural electric cooperatives and investor-owned utilities and [Exhibit A]

(3) individual averages for each utility in Kansas [Exhibit A].

The report shows average revenue per KWH for residential, commercial and industrial consumer classes, avverage for all classes, and an "adjusted" average for all classes. The "adjusted" average corrects for compositional differences in the customer classes served.

APPA calculated the report from information each utility reported to the U.S. Department of Energy (Energy Information Administration Form EIA-861).

Although these are not actual rates, they will closely follow rates and thus provide a comparision of how your city's rates compare with other utilities in Kansas.

Average Revenue Per kWh, 1994
(in cents)
United States and Kansas

	Residential Rev/kWh	Commercial Rev/kWh	Industrial Rev/kWh	All Classes Rev/kWh	All Classes Adjusted * Rev/kWh
U.S. Utilities					
Publicly Owned	6.7	6.7	4.9	6.0	6.1
Investor-Owned	8.8	7.9	4.9	7.1	7.2
Cooperative	7.8	7.4	4.7	7.0	6.6
Kansas					
Publicly Owned	7.3	6.3	4.5	6.0	6.1
Investor-Owned	7.7	6.4	4.9	6.4	6.4
Cooperative	9.8	9.5	6.3	8.8	8.6
Kansas					
Publicly Owned					
Alma City of	8.5	8.1	7.7	8.2	8.1
Altamont City of	7.5	0.0	0.0	7.5	(a)
Anthony City of	4.5	6.7	0.0	5.2	(a)
Arcadia City of	8.9	9.0	0.0	8.9	(a)
Arma City of	14.0	7.5	8.3	12.2	10.0
Ashland City of	8.0	7.1	0.0	7.6	(a)
Attica City of	6.1	6.5	6.2	6.2	6.3
Augusta City of	6.0	5.8	0.0	5.9	(a)
Axtell City of	8.2	5.8	0.0	7.5	(a)
Baldwin City City of	8.9	8.6	0.0	8.8	(a)
Belleville City of	8.6	6.3	0.0	7.2	(a)
Beloit City of	7.1	7.3	5.9	6.8	6.8
Blue Mound City of	8.2	0.0	0.0	8.2	(a)
Bronson City of	9.0	7.6	0.0	8.6	(a)
Burlingame City of	9.1	8.6	0.0	8.9	(a)
Burlington City of	7.6	7.1	5.9	7.2	6.9
Cawker City City of	7.6	13.4	0.0	8.9	(a)
Centralia City of	11.4	9.5	0.0	10.7	(a)
Chanute City of	7.1	6.7	5.0	6.0	6.3
Chapman City of	11.9	12.4	0.0	12.0	(a)
Chetopa City of	7.5	5.2	0.0	6.7	(a)
Cimarron City of	8.2	7.9	10.9	8.9	8.9
Clay Center City of	7.4	7.5	5.8	7.0	6.9
Coffeyville City of	7.3	6.1	0.0	6.5	(a)
Colby City of	6.6	6.1	5.5	6.0	6.1
Dighton City of	11.7	11.7	0.0	11.7	(a)
Ellinwood City of	8.4	8.4	0.0	8.4	(a)
Elsmore City of	9.5	18.8	0.0	9.9	(a)
Elwood City of	12.9	13.4	9.3	12.3	12.0
Enterprise City of	7.9	7.7	7.5	7.8	7.7
Erie City of	7.7	6.8	5.2	7.2	6.6
Eudora City of	8.0	2.9	n/a	8.1	n/a
Fredonia City of	9.9	9.7	0.0	9.8	(a)
Galva City of	8.3	8.4	0.0	8.4	(a)

Average Revenue Per kWh, 1994
(in cents)
United States and Kansas

	Residential Rev/kWh	Commercial Rev/kWh	Industrial Rev/kWh	All Classes Rev/kWh	All Classes Adjusted * Rev/kWh
Garden City City of	8.8	7.2	6.5	7.5	7.5
Gardner City of	7.7	7.0	4.9	6.8	6.6
Garnett City of	8.0	7.6	7.3	7.8	7.6
Girard City of	9.5	9.6	6.8	8.5	8.7
Glasco City of	8.3	11.1	0.0	8.9	(a)
Glen Elder City of	8.7	8.2	0.0	8.6	(a)
Goodland City of	7.2	7.5	6.7	7.2	7.1
Greensburg City of	8.1	6.5	0.0	7.5	(a)
Haven City of	8.5	8.2	0.0	8.3	(a)
Herington City of	7.9	7.3	3.2	7.1	6.2
Herndon City of	12.9	10.7	0.0	12.1	(a)
Hill City City of	10.9	10.3	0.0	10.6	(a)
Hillsboro City of	8.6	8.4	0.0	8.5	(a)
Hoisington City of	7.4	8.5	7.3	7.6	7.7
Holton City of	6.3	6.5	6.5	6.4	6.4
Holyrood City of	8.6	9.3	0.0	8.8	(a)
Horton City of	7.1	11.4	8.8	8.0	9.1
Hugoton City of	9.0	10.3	0.0	9.6	(a)
Iola City of	6.2	4.0	6.0	5.1	5.4
Isabel City of	9.6	11.5	0.0	10.3	(a)
Iuka City of	8.0	7.7	0.0	7.8	(a)
Jetmore City of	5.9	4.8	0.0	5.3	(a)
Johnson City of	8.1	8.6	5.7	7.5	7.5
Kansas City City of	6.3	5.6	4.0	5.2	5.3
Kingman City of	7.4	7.2	6.1	6.8	6.9
Kiowa City of	9.5	13.1	6.7	9.3	9.9
La Crosse City of	9.6	9.5	9.6	9.6	9.6
La Harpe City of	11.9	5.1	0.0	11.1	(a)
Lakin City of	13.7	14.0	0.0	13.9	(a)
Larned City of	9.0	7.6	10.1	8.5	8.9
Lincoln Center City of	7.1	7.9	7.3	7.4	7.4
Lindsborg City of	8.3	8.2	0.0	8.2	(a)
Lucas City of	9.0	9.9	0.0	9.3	(a)
Luray City of	8.8	7.8	0.0	8.5	(a)
Mankato City of	7.4	9.0	7.0	7.8	7.8
Marion City of	7.9	9.5	8.3	8.1	8.6
McPherson City of	4.6	4.4	3.0	3.5	4.0
Meade City of	9.7	9.2	7.8	8.9	8.9
Minneapolis City of	7.0	5.6	3.6	6.4	5.5
Montezuma City of	7.9	9.4	0.0	8.7	(a)
Moran City of	7.0	6.3	0.0	6.8	(a)
Morrill City of	7.9	9.6	0.0	8.1	(a)
Moundridge City of	8.1	7.2	6.6	7.3	7.3
Mount Hope City of	9.5	10.0	0.0	9.6	(a)
Mulberry City of	11.7	4.0	0.0	10.0	(a)
Mulvane City of	7.7	7.8	0.0	7.7	(a)
Muscotah City of	8.5	9.4	0.0	8.5	(a)
Neodesha City of	9.3	9.7	8.1	8.7	9.1
Norton City of	8.5	7.6	0.0	8.0	(a)

Average Revenue Per kWh, 1994
(in cents)
United States and Kansas

	Residential Rev/kWh	Commercial Rev/kWh	Industrial Rev/kWh	All Classes Rev/kWh	All Classes Adjusted * Rev/kWh
Oakley City of	7.4	7.2	5.5	7.0	6.7
Oberlin City of	9.4	9.0	0.0	9.2	(a)
Osage City City of	6.6	6.6	5.4	6.5	6.2
Osawatomie City of	8.3	6.9	13.2	7.8	9.3
Osborne City of	8.1	9.7	7.4	8.1	8.4
Ottawa City of	8.3	8.8	7.0	7.7	8.1
Oxford City of	6.9	6.9	9.1	7.7	7.6
Pomona City of	7.1	5.6	0.0	6.6	(a)
Pratt City of	7.3	7.6	6.5	7.3	7.2
Prescott City of	8.3	7.2	0.0	7.9	(a)
Radium City of	10.5	12.0	0.0	11.4	(a)
Robinson City of	8.0	7.6	0.0	7.9	(a)
Russell City of	6.8	7.1	6.3	6.8	6.7
Sabetha City of	6.5	6.6	5.4	5.8	6.2
Savonburg City of	10.3	12.0	0.0	10.5	(a)
Scranton City of	8.5	8.5	0.0	8.5	(a)
Seneca City of	6.7	5.0	6.1	6.2	5.9
Severance City of	7.0	0.0	0.0	7.0	(a)
Seward City of	8.7	7.2	0.0	8.3	(a)
Sharon Springs City of	12.2	11.6	11.3	11.9	11.7
St Francis City of	12.9	11.9	0.0	12.4	(a)
St John City of	9.8	9.3	0.0	9.6	(a)
St Marys City of	7.9	8.7	0.0	8.3	(a)
Stafford City of	8.5	8.4	0.0	8.5	(a)
Sterling City of	9.6	8.2	0.0	8.9	(a)
Stockton City of	6.9	10.5	0.0	7.9	(a)
Summerfield Town of	7.3	7.6	0.0	7.4	(a)
Toronto City of	8.6	9.0	0.0	8.7	(a)
Troy City of	8.2	7.8	0.0	8.0	(a)
Udall City of	8.5	8.7	0.0	8.6	(a)
Vermillion City of	9.2	8.9	0.0	9.1	(a)
Wamego City of	8.0	7.9	5.6	7.4	7.2
Washington City of	8.5	8.4	0.0	8.5	(a)
Waterville City of	9.2	7.3	0.0	8.2	(a)
Wathena City of	9.1	8.1	0.0	8.8	(a)
Wellington City of	8.1	7.8	6.4	7.4	7.5
Winfield City of	7.4	7.2	4.7	5.5	6.5
Kansas					
Investor-Owned					
Empire District Electric Co	5.8	6.2	4.7	5.6	5.6
KG&E a Western Resources Co	9.2	8.1	5.4	7.3	7.6
Kansas City Power & Light Co	7.5	6.9	5.5	7.0	6.7
Southwestern Public Service Co	6.5	6.2	3.9	5.7	5.6
UtiliCorp United Inc	7.8	7.1	4.0	6.1	6.4
Western Resources, Inc	6.4	5.0	4.2	5.3	5.2
Kansas					
Cooperative					
Alfalfa Electric Coop Inc	7.0	8.5	0.0	7.8	(a)

Average Revenue Per kWh, 1994
(in cents)
United States and Kansas

	Residential Rev/kWh	Commercial Rev/kWh	Industrial Rev/kWh	All Classes Rev/kWh	All Classes Adjusted * Rev/kWh
Ark Valley Elec Coop Assn Inc	11.6	10.7	8.7	10.9	10.4
Brown-Atchison E C A Inc	9.3	10.5	0.0	9.4	(a)
Butler Rural El Coop Assn Inc	10.7	9.0	0.0	10.4	(a)
C & W Rural Elec Coop Assn Inc	9.7	12.4	6.2	9.3	9.6
CMS Electric Coop Inc	9.9	9.1	10.8	9.5	9.9
Caney Valley El Coop Assn Inc	11.9	11.4	0.0	11.7	(a)
D S & O Rural E C A Inc	8.5	8.3	6.9	8.4	7.9
Doniphan Elec Coop Assn Inc	7.6	7.6	0.0	7.6	(a)
Flint Hills Rural E C A Inc	9.7	9.0	0.0	9.5	(a)
Jewell-Mitchell Coop Elec Inc	10.0	10.5	5.2	10.0	8.7
Kaw Valley Elec Coop Co Inc	8.6	8.2	6.8	8.3	7.9
Lane-Scott Electric Coop Inc	10.3	9.4	0.0	9.7	(a)
Leavenworth-Jefferson E C Inc	10.5	11.2	0.0	10.6	(a)
Lyon County Electric Coop Inc	10.2	10.4	9.9	10.2	10.2
Midwest Energy Inc	8.1	8.3	6.6	7.3	7.7
N C K Electric Coop Inc	11.7	11.9	9.0	11.2	10.9
Nemaha-Marshall E C A Inc	7.3	7.6	0.0	7.4	(a)
Ninnescah Rural E C A Inc	10.2	9.3	5.2	8.8	8.3
Northwest Kansas E C A Inc	11.5	11.3	9.0	10.8	10.7
Norton-Decatur Coop El Co Inc	10.9	10.4	0.0	10.6	(a)
P R & W Electric Coop Assn Inc	12.0	10.1	0.0	11.8	(a)
Pioneer Electric Coop Inc	10.4	9.8	5.9	8.9	8.8
Radiant Electric Coop Inc	10.5	7.9	0.0	9.4	(a)
Sedgwick Cnty El Coop Assn Inc	9.5	9.6	13.8	9.6	10.9
Sekan Electric Coop Assn Inc	10.6	8.4	0.0	10.0	(a)
Smoky Hill Elec Coop Assn Inc	10.2	9.3	8.1	9.5	9.2
Sumner-Cowley Elec Coop Inc	10.7	10.0	0.0	10.5	(a)
Twin Valley Electric Coop Inc	11.6	12.0	0.0	11.7	(a)
United Electric Coop Inc	11.3	10.3	0.0	11.0	(a)
Victory Electric Coop Assn Inc	9.3	9.1	5.4	7.4	8.0
Western Coop Electric Assn Inc	10.2	8.6	9.2	8.9	9.3
Wheatland Electric Coop Inc	11.2	10.8	5.4	7.9	9.3

* This is a standardized average that adjusts for compositional differences in the customer classes served. For each utility, the average is calculated by multiplying the average rev/kWh for each class by the average proportion of sales for that class for the state (for the nation for U.S. averages) and then summing the results.

(a) Adjusted total not computed unless sales in all customer classes are greater than zero.

Source: U.S. Department of Energy, Energy Information Administration, Form EIA-861.
Prepared March 1996 by the American Public Power Association, Department of Statistical Analysis.

Utilities Serving Customers in Kansas

from Electrical World Directory

	Electric Customers	Kansas Electric Customers	Percent of Total Kansas Customers Served
Investor Owned Utilities			
Kansas City Power and Light (KS and MO)[1]	424,262	141,419	11.8%
Western Resources	593,951	593,951	49.6%
Westplains (Kansas and Colorado)[1]	140,847	46,949	3.9%
Empire District Electric [2]	NA	4,700	0.4%
TOTAL	1,159,060	787,019	65.7%
Rural Electric Cooperative Systems			
Midwest Energy Inc.	34,129	34,129	2.9%
Sunflower Electric Cooperative			
Lane-Scott Electric Cooperative Inc.	2,451		
Northwest Kansas Electric Coop. Assn. Inc.	2,007		
Norton-Decatur Cooperative Electric Co. Inc.	5,909		
Pioneer Electric Cooperative Inc.	12,046		
Victory Electric Cooperative Assoc. Inc.	3,583		
Western Cooperative Electric Assn. Inc.	4,338		
Wheatland Electric Cooperative Inc.	15,098		
	45,432	45,432	3.8%
Others	101,888	101,888	8.5%
TOTAL	181,449	181,449	15.2%
Municipal Systems			
Kansas City Board of Public Utilities	**65,836**	**65,836**	**5.5%**
Kansas Municipal Energy Agency	**71,840**	**71,840**	**6.0%**
Others	91,180	91,180	7.6%
TOTAL	228,856	228,856	19.1%
GRAND TOTAL KANSAS CUSTOMERS		1,197,324	100.0%

[1] Kansas customer totals estimated at one third of total customers

[2] Kansas customer total estimated

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from Electrical World Directory

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[1] Kansas customer totals estimated at one third of total customers
[2] Kansas customer total estimated

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Utilities Serving Customers in Kansas

from Electrical World Directory

Rural Electric Cooperative Systems

Ark Valley Electric Cooperative Assn. Inc	4,549
Brown Atchison Electric Cooperative Assn. Inc.	2,891
Butler Rural Electric Coop Assn. Inc.	5,717
C&W Rural Electric Coop. Assn. Inc.	2,791
Caney Valley Electric Coop Assn. Inc.	5,202
The CMS Electric Cooperative Inc.	4,320
Doniphan Electric Coop. Assn. Inc.	1,467
DS&O Rural Electric Coop. Assn. Inc.	6,561
Flint Hills Rural Electric Coop Assn. Inc.	5,819
Jewell-Mitchell Coop. Electric Co. Inc.	4,602
Kansas Electric Power Cooperative Inc.	
Kaw Valley Electric Cooperative Co.	6,465
Lane-Scott Electric Cooperative Inc.[1]	2,451
Leavenworth-Jefferson Electric Cooperative Inc.	6,480
Lyon-Coffey Electric Cooperative Inc.	6,341
Midwest Energy Inc.	34,129
NCK Electric Cooperative Inc.	2,992
Nemaha Marshall Electric Coop Assn Inc.	3,162
Ninnescah Rural Electric Cooperative	3,140
Northwest Kansas Electric Coop. Assn. Inc.[1]	2,007
Norton-Decatur Cooperative Electric Co. Inc.[1]	5,909
Pioneer Electric Cooperative Inc.[1]	12,046
PR&W Electric Cooperative Assn. Inc.	3,020
Radiant Electric Cooperative Inc.	3,424
Sedgwick County Electric Cooperative	4,179
Sekan Electric Cooperative Assn. Inc.	4,171
Smoky Hill Electric Cooperative Inc.	2,870
Sumner-Cowley Elec. Cooperative Inc.	4,027
Sunflower Electric Power Corp.	
Twin Valley Electric Cooperative Inc.	2,241
United Electric Cooperative Inc.	5,457
Victory Electric Cooperative Assoc. Inc.[1]	3,583
Western Cooperative Electric Assn. Inc.[1]	4,338
Wheatland Electric Cooperative Inc.[1]	15,098
	181,449

[1] Sunflower Electric Power Corp. members

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Utilities Serving Customers in Kansas

from Electrical World Directory

Municipal Energy Agencies

Kansas Municipal Energy Agency

Municipal Systems

Alma Electric System	480
Atlamount Municipal Electric Dept.	547
Anthony Electric Dept.	2,006
Arcadia Municipal Electric Dept	208
Arma Electric Dept	803
Ashland Municipal Power Plant	690
Attica Municipal Water & Light Plant	458
Augusta Municipal Electric Dept.[1]	3,642
Axtell Electric Dept.	245
Baldwin City Municpal Light & Water Dept.[1]	1,200
Belleville Municipal Electric Dept[1]	1,487
Beloit Municipal Power Plant	1,918
Blue Mound Elec Light Dept.	160
Bronson Municipal Light & Power	181
Burlingame Power & Light Dept.	1,498
Burlington Municipal Light Dept.[1]	1,498
Cawker City Municipal Light & Water Dept.	434
Centralia Municipal Electric Dept.	341
Chanute Municipal Electric Dept.[1]	5,519
Chapman Municipal Electric Light Dept.	616
Chetopa Municipal Power Plant	730
City of Cimarron	895
Clay Center Municipal Electric & Water Dept.[1]	2,749
Coffeyville Munic. Power & Light System	7,879
Colby Dept. of Public Power[1]	2,749
DeSoto Electric Light Dept.	861
Dighton Municipal Light & Water Dept.	807
Ellinwood Electric Utility Dept.	1,263
City of Elsmore	60
Ellis[1]	-
Elwood Electric Dept	435
Enterprise Munic. Lighting Sys	355
Erie Municipal Light & Power[1]	696
Eudora Municipal Electric System	1,481
Fredonia Water & Light Dept.[1]	1,728
Galva Electric Dept.	340

Garden City Municipal Utilities	10,262
Gardner Municipal Electric System	2,162
Garnett Municipal Electric Dept[1]	1,814
Girard Municipal Light & Water Dept.[1]	1,593
Glasco Electric Dept.	405
City of Glen Elder	390
Goodland Electric Dept.	2,909
Greensburg Power & Light System[1]	1,028
Haven Light & Water Power Plant	607
Herington Water & Electric Dept.[1]	1,538
Herndon Municipal Power Plant	152
City of Hill City	1,047
Hillsboro Electric Utility	1,336
Hoisington Municipal Electric Utility[1]	1,766
Holton Municipal Electric Utility	1,991
Holyrood Electric Dept.	340
Horton Electric Dept.	965
Hugoton Water & Light Dept.	1,819
Iola Electric Dept[1]	3,954
Isabel Electric Dept.	81
Iuka Electric Dept.	120
Jetmore Municipal Electric & Water Dept.	571
Johnson Municipal Power Plant	688
Kansas City Board of Public Utilities	65,836
Kingman Municipal Light Dept.	1,916
Kiowa Electric Dept.	853
La Crosse Municipal Electric Dept.	822
La Harpe Electric Dept.	410
Lakin Electric Dept.	983
Larned Electric Light Dept.[1]	2,602
Lincoln Light Plant	867
Lindsborg Water & Light Dept.	1,456
Lucas Light Dept	310
Luray Municipal Water & Light Dept.	165
Mahaska Electric Dept.	70
Mankato Electric Utility	660
Marion Municipal Power Dept.	1,103
McPherson Board of Public Utilities	7,465
Meade Municipal Light & Water Dept.[1]	911
Minneapolis Light, Water and Power Dept.	1,066
Montezuma Water & Light Dept.	446
Moran Water & Electric Dept.	294
Morrill Electric Dept.	156
Moundridge Water & Light Dept.	861

Mount Hope Municipal Electric System	343
Mulberry City Utilities	295
Mulvane Municipal Light & Water Dept.[1]	1,851
Muscotah Electric Dept.	105
Neodesha Light & Power[1]	1,702
Norton Dept of Utilities[1]	1,771
Oakley Municipal Power Plant	1,265
Oberlin Electric Dept.[1]	1,308
Osage City Municipal Light Plant	1,510
City of Osawatomie[1]	2,072
Osborne Municipal Light & Water Plant	1,398
Ottawa Utility Dept.[1]	5,370
Oxford Municipal Electric Dept.	621
Pomona Light Dept.	520
Pratt Municipal Electric Dept.[1]	3,868
Prescott Electric Dept.	153
City of Radium	20
Robinson Electric Dept	168
Russell Municipal Power & Light	3,273
Sabetha Municipal Light Dept.	1,535
St. Francis Municipal Water & Light Dept.[1]	1,077
St. John Municipal Light Dept.	869
St. Mary's Light & Water Dept.	928
Savonburg Electric Light Dept.	59
Scranton Municipal Electric Dept.	305
Seneca City Electric	1,213
City of Severance	58
City of Seward	383
Sharon Springs Municipal Light & Power Dept.[1]	569
Stafford Municipal Power Plant	824
Sterling Municipal Light & Power[1]	1,158
Stockton Municipal Light & Power[1]	1,014
Toronto Electric Dept.	231
Troy Water & Light Dept.	598
Udall Water & Light Dept.	382
Vermillion Light Dept.	92
City of Wamego	1,808
Washington Municipal Light Plant[1]	784
Waterville Municipal Light Plant	438
Wathena Municipal Electric Lighting System	633
Wellington Municipal Utilities[1]	4,375
Winfield Municipal Electric Utility[1]	8,161
	228,856

[1] Kansas Municipal Energy Agency (KMEA) Member Cities

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Planning the Future of Sterling and its Electric Utility

July 5, 1996

Dear Electric Utility Owner/Customer:

In an effort to help the community better understand our local business of selling electricity, we've put together a three-part series that is appearing in the *Bulletin* and is being mailed to all electrical users. This is installment number two. If you missed number one, check last week's paper or call the City office at 278-3423 for a copy.

Municipally-owned Power Provides Investments in Community

By having its own power plant, Sterling is able to help subsidize the city's general fund. The general fund is partially supported with property tax and pays for police and fire protection, swimming pool, parks and street repairs. By contributing some "profits" to the general fund, property taxes are kept lower. In addition, electric fund "profits" pay for a variety of services the community enjoys such as:

Street lights • city service building and fire station electrical services • library building electrical services • city hall and police station electricity • lake bathhouse/shelter houses electricity and sprinkler system electricity • cemetery lighting • lake tennis court lights • ball park lights (near high school) • lake walkway lights.

Over the years the governing bodies of the City of Sterling have realized the value of local control for the municipal power plant. Neighbors of yours, serving as City Commissioners, have spent long months of study to understand the intricacies of being a power plant owner. Since 1914 the verdict has been the same -- the citizens of Sterling should continue to reap the benefits of public power and insure that the community's desire to improve our quality of life is reflected in the utility's operation.

The ability to make electricity for the community has given our city independence and provided options in solving local problems. This is because the profits stay in the municipally owned utility funds for community investment. Being able to meet electrical needs locally has made the city eligible to purchase lower-cost energy from Kansas Power and Light (Western Resources.)

Financial Impact of Public Power

Cities with municipal power systems realize a financial benefit. The following chart specifically shows the dollars invested into city operations and the community in 1994 and 1995. Where applicable, the chart shows how many mills of property tax rate were saved on behalf of property owners. (Tax exempt entities in town, like churches, the college and public properties, use city services. Utility rates are one way they help pay for those services.)

STERLING MUNICIPAL ELECTRIC UTILITY
SUMMARY OF 1994 & 1995 DONATIONS OF CASH, ELECTRICITY & SERVICE
FROM ELECTRIC CUSTOMERS TO PROPERTY TAX PAYERS & OTHER UTILITIES

	$	1994 Tax Rate Equivalent	$	1995 Tax Rate Equivalent
GENERAL FUND OPERATIONS				
ELECTRICITY				
LAKE	$5,981		$8,076	
FIRE DEPT.	$851		$896	
STORM SIRENS	$835		$834	
STREET LIGHTS	$25,468		$25,079	
TRAFFIC LIGHTS (BDWY & MAIN)	$1,162		$1,138	
SUBTOTAL	$34,296	9.63	$36,024	9.49
CASH CONTRIBUTION				
"FRANCHISE FEE"	$23,166	6.5	$36,000	9.49
PERSONAL SERVICES				
GEN. FUND OPERATIONS	$25,870		$25,217	
SALARIES	$41,382		$52,269	
SUBTOTAL	$67,252	18.88	$77,486	20.42
GEN. FUND TOTALS	$124,714	35.01	$149,510	39.4
OTHER GOVERNMENT				
ELECTRICITY				
CEMETERY	$1,616		$2,465	
SERVICE BLDG	$2,606		$2,488	
LIBRARY	$3,394		$3,548	
BALL DIAMOND	$2,750		$2,248	
CITY OFFICE	$5,775		$6,142	
SUBTOTAL	16,140	4.53	$16,890	4.45
UTILITIES				
SEWER LIFT STATION	424		$475	
WATER TOWER	1091		$1,342	
SUBTOTAL	1515		$1,817	
JEFFERSON PLAZA ELECTRICITY	13,350		$12,994	
TOTAL $	$155,720		$181,211	
TOTAL MILL EQUIV.		39.54		43.85

What does this mean to me as a property owner?

Here is a comparison of actual 1995 city property taxes vs. property taxes supporting the same activities without the electric system investment.

Assessed Value of Home	Home's Taxable Value (11.5%)	1995 Tax Rate Actual	City Property Tax Actual	1995 Tax rate without Electric Funds	Property tax (plus) items supported by Electric
$25,000	$2,875	61.4 mills	$176	105.25 mills	$303
$50,000	$5,750		$353		$605
$75,000	$8,625		$530		$908
$100,000	$11,500		$706		$1,210

It is obvious a significant impact has been realized by our property owners. A mill rate of 105.25 mills would be stifling to the economy, prohibitive and many services would need to be cut rather than increasing the mill levy rate to that outrageous level.

Summary and Upcoming Information

We believe this information is an important component of the set of facts that must be included in our deliberations.

Next week we'll focus on the chain of events that helped create our current status and understandings. Also, a brief review of the studies of our electric system completed in recent history will be included.

Thank you for reading this information. By better understanding our home-owned utility, we'll make decisions as a community that focus on a positive future and provide successors with options and flexibility.

Sincerely,

Sterling City Commission
Tom Simpson, Mayor • Al Kruse, Commissioner • Rod Willis, Commissioner

KMU Task Force on Retail Wheeling:

Appointed in August by KMU President Carol Bloodworth of Cheney to act as a sounding board for KMU staff and the Kansas Municipal Energy Agency staff to discuss the multitude of issues that will confront Kansas municipal electric cities as the electric industry proceeds towards deregulation and possible retail wheeling in the future. Members of the Task Force are:

Randy Riggs, city manager - Sterling
Jim James, director of electric and gas utilities - Chanute
Arlyn Bradford, electric superintendent - Pratt
Ron Sandusky, electric utility director - Coffeyville
Jim Bradley, director of utilities - Ottawa
Colin Whitley, director of electric utilities - Winfield

Kansas Legislative Retail Wheeling Task Force:

Created in 1996 by the Kansas Legislature with the passage of HB 2600. Members of the 23-member committee are:

Gil Hanson, general manager, Kansas Municipal Energy Agency, Overland Park (representing KMU)
Leon Daggett, general manager, Kansas City Board of Public Utilities
Gene Argo, Mid-West Energy, Great Bend
Randy Burleson, Empire District Electric, Joplin, Missouri
David Bybee, Kansas Department of Commerce & Housing, Topeka
Steven Cattron, Kansas City Power & Light
Jon Empson, WestPlains Energy (UtiliCorp)
Joe Hamman, consumer representative, Topeka
Larry Holloway, Kansas Corporation Commission, Topeka
Dennis Lane, technical expert, University of Kansas
James Martin, Western Resources, Inc.
John Miles, Kansas Electric Cooperatives, Topeka
Stephen Parr, Kansas Electric Power Cooperative, Inc., Topeka
Randy Rohlfing, Farmland Industries, Dodge City
Mike Vess, Vess Oil Corp., Wichita
Earl Watkins, Sunflower Electric Power Corp., Hays

Rep. Carl Holmes of Liberal, Chair
Rep. Richard Alldritt of Harper
Rep. Tom Sloan of Lawrence
Sen. Don Sallee of Troy, Vice-chair
Sen. Janis Lee of Kensington
Sen. Nick Jordan of Shawee

Testimony to the House Utilities Committee

January 29, 1997

Mr. Chairman and members of the Committee, my name is Jon Miles, and I am the Director of Governmental Relations for Kansas Electric Cooperatives, Inc. (KEC).

KEC is a statewide service organization made up of thirty rural electric cooperatives in the state of Kansas and one rural electric cooperative headquartered in Oklahoma, but serving consumers in Kansas. KEC performs the responsibilities of providing services to its members in areas where they could not cost-efficiently perform the service on their own. KEC has a professional staff that provides legislative representation and research, public and member relations, consumer information, communications, printing and publishing, technical services, and other advocacy before governmental bodies, environmental regulatory support, power line equipment servicing and testing, and loss control and safety training.

Two of KEC's members are Sunflower Electric Power Corporation in Hays, and Kansas Electric Power Cooperative (KEPCo) headquartered in Topeka. These two members are classified as generation and transmission cooperatives. These cooperatives are responsible for generating and transmitting electricity at wholesale for use by the remainder of our members who are distribution electric cooperatives. KEPCo serves approximately 300,000 rural consumers and provides wholesale power to twenty-two rural electric member systems located in the eastern two-thirds of Kansas. KEPCo owns a six-percent share of the Wolf Creek Generation Station. Sunflower Electric Power Corporation provides wholesale power supply to six western Kansas rural electric cooperatives. The six Sunflower members distribute energy to approximately 150,000 consumers. Sunflower owns and operates a coal-fired generation station near Holcomb, Kansas. Western Resources provides wholesale power to three of our member distribution electric cooperatives. The wholesale suppliers deliver the

House Utilities
1-29-97
Attachment 2

energy to specified metering points where it is delivered to the ultimate consumer by distribution electric cooperatives. There are thirty-one distribution electric cooperative members of KEC located throughout the state.

I have also been asked to comment briefly on the regulation of electric cooperatives in the state. As all of you are aware, the Legislature adopted a bill in the 1992 session that allowed distribution electric cooperatives with fewer than 15,000 consumers to deregulate from most of the jurisdictional controls of the Kansas Corporation Commission. This law allows local distribution cooperatives to formulate operating policies and design rates that are responsive to their members' needs. These decisions are made by trustees elected to the board by the membership of the cooperative. With that in mind, it made sense to allow the cooperatives to deregulate--the persons making the operational policies and rates are required to abide by them as consumers of the cooperative. Regulation served an economic hardship on the rural electric cooperatives. In many instances, the revenue to be gained from a rate case was eliminated due to the cost of the rate case. Often times, the Corporation Commission staff disagreed with rate design or cost of service calculations made by the cooperative. In some cases, the needed rate relief was delayed, causing operational hardships. In short, local option deregulation gives cooperatives the opportunity to address concerns. To date, twenty-six electric cooperatives have elected to deregulate from the Corporation Commission. The remainder are still regulated. It should be noted, however, that even deregulated cooperatives are still subject to Commission jurisdiction for such things as service territory, charges for transmission services, sales of power for resale, wire-stringing and transmission line siting. Also, cooperative members have the right to petition the KCC to review cooperative rates if five percent of the cooperative's customers or three percent of any one rate class believe that review is needed.

KEC has not adopted a position for or against retail wheeling. The term "retail wheeling" or "retail competition" means different things to different people. Not every proposal is good, nor is every proposal bad. Our primary concern, and our focus in our debate before the Legislature, is the impact that retail competition will have on the consumers of electric cooperatives.

I trust this gives the Committee an overview of the electric cooperative program in Kansas. I would be happy to answer any questions.

Testimony to the House Utilities Committee

January 29, 1997

Mr. Chairman and members of the Committee, my name is Jon Miles, and I am the Director of Governmental Relations for Kansas Electric Cooperatives, Inc. (KEC). I want to take this opportunity to thank you for the opportunity to speak to you today concerning the rural electric cooperatives in Kansas. We are pleased to be a part of the debate that will shape the electric industry of tomorrow. In my testimony today, I plan to explain who we (cooperatives) are, why we exist, explain our relationship with the Kansas Corporation Commission and give you an idea of some of the concerns with retail wheeling.

KEC is a statewide service organization made up of rural electric cooperatives in the state of Kansas and one rural electric cooperative headquartered in Oklahoma, but serving consumers in Kansas. KEC performs the responsibilities of providing services to its members in areas where they could not cost-efficiently perform the service on their own. KEC has a professional staff that provides legislative representation and research, public and member relations, consumer information, communications, printing and publishing, technical services, and other advocacy before governmental bodies, environmental regulatory support, power line equipment servicing and testing, and loss control and safety training.

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House Utilities
1-29-97
Attachment 3

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Both KEPCo and Sunflower have investments in generation to serve their respective memberships. The investments have been strongly criticized over the past several years. The investments were made to last for at least thirty-five years to serve the present day and future projected consumer growth. For this investment and under what is known as the regulatory compact, utilities were guaranteed a return on their investments through rates charged for electricity. The Energy Fuels Use Act of 1978 did not allow Sunflower's plant to be gas fired. Because of a perceived shortage of gas by Congress, the Act did not allow the use of gas for electric generation. This is a bit ironic, since Sunflower's plant near Holcomb happens to sit on top of the largest gas field in this country. In addition, numerous regulatory and safety changes occurred during construction causing significant increases in the cost of construction for both Wolf Creek and Sunflower. Most of the changes that amounted to millions of dollars were mandated by the federal government and therefore, beyond our control.

The cooperatives in Kansas were established as non-profit. Any margins earned above the cost of providing service are returned back to their members as capital credits. Unlike the investor-owned

utilities, we do not have shareholders/stockholders. The members are our owners and they elect a board of trustees to set policy and hire a manager to run the day-to-day operations of the business. The cooperatives are locally-owned and operated. Cooperatives are of great value to the communities in which they are located with significant benefits to the communities. The cooperatives' nearly 1,000 employees participate in local activities with great pride. Many of these employees can be found serving on city councils, economic development groups, church boards, civic and club leaders, coaching baseball, and so on. Most often cooperative employees receive calls from city leaders requesting assistance in hanging Christmas lights or holiday banners. The point is, cooperative people located in these small towns truly care about the community in which they live and work. Cooperatives don't pull up stakes and leave town. Cooperatives are committed to their communities.

The generation and transmission and distribution program alone amounts to a $1.3 billion investment in local plant. They pay nearly $20.5 million in property taxes. We serve 450,000 consumers in 103 Kansas counties, and over 64,000 miles of distribution and 800 miles of transmission line built and operated in the state.

The cooperative movement began in 1935 when President Franklin Roosevelt signed the executive order creating the Rural Electrification Administration. At that time, there were over five million homes without electric service, which was being enjoyed in towns and cities across the country. The rural areas did not receive service because they were unprofitable. Because electric companies could not make any money, they were left out, leaving them with no choice. The rural areas today still remain unprofitable to serve. Since the 1930's, rural population has declined. For example, the number of customers nationally per mile of line today is approximately six as compared to the municipals' 48 and investor-owned 35. This is a key point that concerns us when talking about retail wheeling. The rural areas were not profitable enough to bring service to and provide for competition back in the

1930's and 1940's and certainly today, the most current census indicates a continuing decline in most rural counties which raises the question, What has changed in the rural areas that now make them profitable enough for utilities across this country to compete for their business?

The electric cooperatives are supportive of fair competition and free markets for goods and services. Free markets are the economic foundation of the United States. Competition eliminates inefficient producers from the marketplace and rewards the efficient with profits. However, competition is ruthless in the allocation of resources. No matter what the product may be, areas with fewer customers see little competition which translates into the potential for high prices and poor service. Evidence of this can be found by looking at what deregulation of the railroads, motor carriers, airlines and telephones has done to rural areas. True competition occurs only when consumers have sufficient market power to ensure that economic options are available. Unfortunately, small consumers cannot compete with the big dogs of business and industry. Large industries have the market clout and savvy to negotiate contracts.

Since the legislative session began, there has been a tremendous amount of discussion about the propane and natural gas industry and how the recent price increases have customers very upset. Under a competitive market, demand drives the price. That's how the free market works. Certainly, the telecommunications legislation passed last year has left many unanswered questions and we are seeing that it is not an easy road to a free market, and the market doesn't necessarily mean lower prices.

Retail wheeling, deregulation, re-regulation, industry restructuring or customer choice all sound good at first blush, but it is difficult to apply fairly and equally among all customers. How will you decide who gets the benefit of low-cost power and who is left with the remaining cost when the large loads get the energy they need? Also, what happens if Kansas opens its doors to competition, but the neighboring states do not, leaving the state vulnerable. And, how does the issue of taxation fit in to this

issue? The field has to be level not only in the state but for out-of-state competition . Some customers will win and some will lose as the same costs that now exist are simply shifted from one class of customer to another. Until we can determine that the regulatory scheme proposed by retail wheeling is better than the regulatory policy currently in place, then the state should not be in a hurry to change it. In whatever decision is made, one group of electric consumer should not benefit at the expense of another.

I have also been asked to comment briefly on the regulation of electric cooperatives in the state. As all of you are aware, the Legislature adopted a bill in the 1992 session that allowed distribution electric cooperatives with fewer than 15,000 consumers to deregulate from most of the jurisdictional controls of the Kansas Corporation Commission. This law allows local distribution cooperatives to formulate operating policies and design rates that are responsive to their members' needs. These decisions are made by trustees elected to the board by the membership of the cooperative. With that in mind, it made sense to allow the cooperatives to deregulate--the persons making the operational policies and rates are required to abide by them as consumers of the cooperative. Regulation served an economic hardship on the rural electric cooperatives. In many instances, the revenue to be gained from a rate case was eliminated due to the cost of the rate case. Often times, the Corporation Commission staff disagreed with rate design or cost of service calculations made by the cooperative. In some cases, the needed rate relief was delayed, causing operational hardships. In short, local option deregulation gives cooperatives the opportunity to address concerns. To date, twenty-six electric cooperatives have elected to deregulate from the Corporation Commission. The remainder are still regulated. It should be noted, however, that even deregulated cooperatives are still subject to Commission jurisdiction for such things as service territory, charges for transmission services, sales of power for resale, wire-stringing and transmission line siting. Also, cooperative members have the right to petition the KCC to review

cooperative rates if five percent of the cooperative's customers or three percent of any one rate class believe that review is needed.

In conclusion, KEC has not adopted a position for or against retail wheeling. If retail wheeling is inevitable, as some say, the cooperatives stand ready to work through this issue in an effort to protect the best interests of our consumer-members. The term "retail wheeling" or "retail competition" means different things to different people. Not every proposal is good, nor is every proposal bad. Our primary concern, and our focus in our debate before the Legislature, is the impact that retail competition will have on the consumers of electric cooperatives.

I trust this gives the Committee an overview of the electric cooperative program in Kansas. I would be happy to answer any questions.

THE HISTORY OF U.S. FEDERAL NATURAL GAS REGULATION*

by

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THE KANSAS LEGISLATURE'S

TASK FORCE ON GAS GATHERING

"It is the sense of the Congress that natural gas consumers and producers, and the national economy, are best served by a competitive natural gas wellhead market."

Energy Policy Act of 1992, § 202
Public Law No. 102-486, 106 Stat. 2866
(October 24, 1992)

I. THE COMMERCE CLAUSE AND NATURAL GAS

The U.S. Congress is given the authority:

"To regulate commerce with foreign nations, and among the several States, and with the Indian Tribes."

*This outline material is taken from a presentation titled "The New U.S. Natural Gas Regulatory Regime" I presented on February 9, 1995 in Calgary, Alberta while the Chair of Natural Resources Law, Faculty of Law, The University of Calgary.

House Utilities
1-29-97
Attachment 4

A. States Cannot Restrict Interstate Commerce in Natural Gas

1. An Oklahoma law prohibited the transportation of natural gas to any point outside the State of Oklahoma.

2. Kansas Natural Gas Co. wanted to build a pipeline from its wells in Oklahoma to Kansas so it could market its gas in Kansas and Missouri.

3. The United States Supreme Court, in West v. Kansas Natural Gas Co., 221 U.S. 229 (1911), held the Oklahoma law violated the Commerce Clause of the U.S. Constitution. The court stated:

   "[N]o state can by action or inaction prevent, unreasonably burden, discriminate against, or directly regulate, interstate commerce or the right to carry it on."

   West, 221 U.S. at 262.

B. States Unable to Regulate Interstate Sale of Natural Gas

1. Kansas Natural Gas Co. transported gas from Oklahoma for sale to local distribution companies (LDCs) in Kansas and Missouri. The LDCs would then resell the gas to the local communities in which they operate.

2. The sale by Kansas Natural to the LDC was essentially a wholesale transaction. The sale by the LDC to its customers was a retail transaction.

3. Kansas Natural increased its sales price to its customers (the LDCs) without obtaining the consent of the state public utility commission. The United States Supreme Court, in Missouri v. Kansas Natural Gas Co., 265 U.S. 298 (1924), held the transaction was:

   "[F]undamentally interstate from beginning to end . . . . The paramount interest is not local but national, --admitting of and requiring uniformity of regulation."

   Missouri, 265 U.S. at 309-310.

4. Although Congress had not addressed the matter, the Court held the states could not act. The fact Congress had not regulated the area suggested, by

negative implication, that it should remain unregulated. The Court articulated this "negative commerce clause" analysis stating:

"The contention that, in the public interest, the business is one requiring regulation, need not be challenged. But Congress thus far has not seen fit to regulate it, and its silence, where it has the sole power to speak, is equivalent to a declaration that that particular commerce shall be free from all regulation."

Missouri, 265 U.S. at 308.

C. Filling the "Regulatory Gap"

1. Since wholesale rates were unregulated (states couldn't regulate and the federal government had not acted to regulate this area), consumers were at the mercy of the interstate pipeline.

2. State regulation of the LDC (the retail transaction) would not help since the state commission would have to permit the LDC to pass through its purchased gas costs (what it paid the pipeline for gas in the wholesale transaction) in the LDC's retail consumer rates-- otherwise the LDC would go out of business.

3. The negative commerce clause analysis left a regulatory gap which Congress would act to fill with the Natural Gas Act of 1938.

II. NATURAL GAS ACT OF 1938 (NGA)

A. Filling the Regulatory Gap

1. Although a state may lack authority to regulate an interstate matter, Congress can confer jurisdiction upon the states to act.

2. The NGA recognized the areas states were thought to have regulatory authority under the interpretation of the Commerce Clause in vogue in the 1930s. Therefore, the first section of the NGA defines the

scope of federal and state jurisdiction over natural gas activities.

3. NGA § 1(b), 15 U.S.C. § 717(b), provides, in part:

"The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to the natural gas companies engaged in such transportation or sale . . . ."

4. Immediately following the express grant of federal authority in § 1(b), is the following grant of residual authority to the states:

"The provisions of this Act . . . shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

NGA § 1(b), 15 U.S.C. § 717(b).

5. Therefore, the federal government has exclusive regulatory jurisdiction under the NGA over the following:

   a. Transportation of natural gas in interstate commerce;

   b. Sale in interstate commerce of natural gas for resale;

   c. Companies engaged in such transportation and sales; and

   d. Facilities used to conduct the regulated interstate activities.

6. The states are given exclusive regulatory jurisdiction under the NGA over the following:

   a. Production of natural gas;

   b. Gathering of natural gas;

   c. Transportation of natural gas in intrastate commerce;

d. Sale in interstate commerce of natural gas for direct use by the purchaser and not for resale; and

e. Local distribution of natural gas.

7. The NGA defines interstate commerce as:

"[C]ommerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commerce takes place within the United States."

NGA § 2(7), 15 U.S.C. § 717a(7).

B. The Regulatory Agencies

1. Although the NGA recognizes in § 1(b) that states can regulate certain natural gas activities, the NGA does not purport to establish any sort of regulatory program for states to implement. It merely acknowledges their power to act.

a. Therefore, any matter reserved for state regulation will be addressed by each state's law and administered by the state's regulatory agency.

b. The state regulatory agency, depending upon the state, will be called either the public utility commission, public service commission, or corporation commission (as in Kansas with the "Kansas Corporation Commission").

c. Many states divide the regulation of the production and gathering functions from the transportation and distribution functions and place them in separate agencies. Others merely have separate divisions addressing these functions within a single agency.

2. Federal regulatory authority under the NGA is divided among various administrative agencies.

a. Initially, the Federal Power Commission (FPC) was given authority to administer the NGA. However, under the Department of Energy Organization Act of 1977, 42 U.S.C. §§ 7101 to 7352, the authority of the FPC was transferred

to the Department of Energy (DOE) and the Federal Energy Regulatory Commission (FERC).

b. The FERC is an independent regulatory agency within the DOE; the DOE has no review authority over the FERC's actions. The FERC's members are appointed for fixed terms by the President, subject to Senate confirmation. Judicial review of final actions of the FERC is in the United States Courts of Appeal. 42 U.S.C. §§ 7171, 7172, 7192; 15 U.S.C. § 717r (b) [NGA § 19(b)].

c. 42 U.S.C. § 7172(a) gives the FERC authority to establish, review, and enforce rates and charges under the NGA, and the authority to issue certificates of public convenience and necessity, and abandonment certificates, and to control the establishment of physical connections under § 7 of the NGA.

d. Although the FERC is given authority over any construction activity that requires a NGA § 7 certificate, 42 U.S.C. § 7172(f) provides:

"No function described in this section which regulates the exports or imports of natural gas or electricity shall be within the jurisdiction of the Commission unless the Secretary [of Energy] assigns such function to the Commission."

e. The Secretary of Energy initially delegated approval authority for exports and imports to the Economic Regulatory Administration (ERA). However, in 1989 the Secretary delegated the authority previously exercised by the ERA to the Assistant Secretary of Fossil Energy in the DOE (Fossil Energy).

f. Following the 1989 delegation order, the NGA authority over exports and imports is divided as follows:

(1) When the project requires the construction of jurisdictional facilities in the U.S., the FERC does not approve the import decision, but merely exercises jurisdiction over the siting and construction of the necessary facilities.

(2) Fossil Energy determines whether the import is "consistent with the public interest" under NGA § 3 and determines the conditions that will be imposed and issues the order authorizing the importation of the gas.

C. The "Public Utility" Regulatory Model

1. Transportation of natural gas in interstate commerce is viewed as a classic natural monopoly that should be encouraged, but regulated.

2. The goal of regulation: to ensure consumers receive quality service, upon fair terms, at a reasonable price.

3. The public utility model relies upon comprehensive regulation of industry participants to provide a desired level of service at a controlled price.

   a. The need for comprehensive control is premised on the ability of one or more of the industry participants to monopolize the commodity being sold or the service being provided.

   b. If it is more efficient to provide the commodity or service through a monopoly, then the monopoly will be permitted to operate--but it will be regulated as to the activities it can (or must) pursue, the level of service it must provide, and the amount it can charge for the service or commodity.

   c. In return the monopoly is generally given what often amounts to an exclusive franchise to provide the service and an opportunity to earn a regulated rate of return on its investment.

D. The NGA Utility Model: Entry, Exit, Service, and Rates

1. **Entry:** The "§ 7(c)" Certificate Requirement controls entry into the federally regulated NGA activities. NGA § 7(c), 15 U.S.C. § 717f, provides, in part:

   "No natural-gas company . . . shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission [FERC], or

undertake the construction of extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations . . . ."

a. To qualify for a certificate, the FERC must find:

"[T]he applicant is able and willing properly to do the acts and to perform the service proposed . . . and that the proposed service . . . is or will be required by the present or future public convenience and necessity . . . The Commission shall have the power to attach to the issuance of the certificate . . . such reasonable terms and conditions as the public convenience and necessity may require."

b. The certificate requirement has traditionally served as a considerable regulatory barrier to new entrants into NGA-regulated activities.

c. Many of the revolutionary changes made by the FERC and Congress in recent years have been designed to either eliminate, or streamline, the certificate process. These changes will be discussed later in this Outline.

2. **Exit:** Under the utility model you must obtain permission to enter and exit the business. This is closely related to the "service" obligation. Since you are engaged in activities "affected with a public interest" the public will determine when you will enter the business and whether it is appropriate for you to get our of the business. NGA § 1(b), 15 U.S.C. § 717(b), provides:

"No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service in unwarranted, or that the present or future public convenience or necessity permit such abandonment."

a. For example, in Sunray Mid-Continent Oil Co. v. Federal Power Comm'n, 364 U.S. 137 (1960), the Court held that when Sunray entered into a 20-year gas sales contract with United Gas Pipeline Company it had undertaken a service obligation under NGA § 7(c). Therefore, Sunray could not quit providing the service at the end of the 20-year contract, unless it obtained an abandonment of its service obligation from the FPC under NGA § 1(b).

b. Many of the revolutionary changes made by the FERC and Congress in recent years have been designed to either eliminate, or streamline, the abandonment process. These changes will be discussed later in this Outline.

3. **Service:** An important component of the NGA § 7 certificate process is ensuring that the entity requesting a certificate is capable of rendering the "service" that will promote the "public convenience and necessity." NGA § 7(e), 15 U.S.C. § 717f(e), provides the certificate will be granted only:

"[I]f it is found that the applicant is able and willing properly to do the acts and provide the service proposed."

a. NGA § 7(a) provides the Commission with authority to order the natural gas company to extend services to others when "necessary or desirable in the public interest." However, the Commission cannot compel the natural gas company to extend service "when to do so would impair its ability to render adequate service to its customers."

b. A major concern as the NGA's traditional entry and exit requirements are modified or eliminated is determining how the "service" obligation will be addressed. Who is going to make sure there is gas to burn on the coldest day of the year? This question is addressed later in this Outline.

4. **Rates:** Rates charged for a certificated service must be "just and reasonable" and cannot be "unduly discriminatory, or preferential." NGA §§ 4 & 5.

a. Under NGA § 4(c) the natural gas company must file all:

"[S]chedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services."

b. NGA § 4(b) provides:

"No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service."

c. As will be noted in later sections of this Outline, as the FERC and Congress reduce the areas in which there is a certificate requirement, it also reduces the instances in which FERC must set rates for a service or commodity. Instead, the rate will often be set by market forces.

E. Regulation of Independent Producers Under the NGA

1. In 1954 the United States Supreme Court, in Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954), held that the sale of gas by an independent producer (unaffiliated with the pipeline purchaser) to an interstate pipeline, was a "sale for resale" subject to regulation under the NGA.

2. The court thought it was necessary to have federal jurisdiction over the gas producer because a major component of the pipeline's recoverable costs (operating costs) was the price it paid for gas at the wellhead.

3. However, note that the production of gas is not a natural monopoly--the producing segment of the gas industry is, and always has been, structurally competitive.

4. It should also be noted that Congress, in the NGA, gave the pipeline companies a powerful tool to ensure they were able to purchase gas from producers at a reasonable price: Congress gave the interstate pipelines monopsony purchasing power by refusing to make them common carriers of gas. Instead, they could, and would for fifty years, deny access to the pipeline's transportation services.

5. Since the pipeline could control access to its facilities, this resulted in a monopoly not only over the transportation function, but also over the merchant function of buying and reselling gas.

   a. Since gas producers could not gain access to the interstate pipelines, they were forced to sell gas at or near the field of production to an available pipeline.

   b. The pipeline would then take title to the gas and resell it to its customers.

   c. However, as a regulated cost-of-service activity, the pipeline could not buy low and sell high. Instead, the prices paid for gas would be rolled-in to the pipeline's overall cost of providing the service and consumers would be charged a rate reflecting the pipeline's weighted average cost of gas (the "WACOG"), transportation costs, and the cost of meeting its service obligations.

6. After the Court's ruling in the Phillips case, the contract price negotiated between the pipeline and producer was subjected to federal price regulation to ensure the producer recovered only its cost-of-service plus a reasonable rate of return.

7. As a result of the Phillips decision, the FPC was forced to regulate thousands of gas producers as public utilities.

   a. The FPC initially attempted to use the traditional cost of service rate making approach applied to interstate pipelines. This proved unworkable.

   b. Shifted to area-wide rate making. See Permian Basin Area Rate Cases, 390 U.S. 747 (1968).

c. Eventually shifted to nation-wide rate making. See Shell Oil Co. v. Federal Power Comm'n, 520 F.2d 1061 (5th Cir. 1975), cert. denied, California Co. v. Federal Power Comm'n, 426 U.S. 941 (1976).

d. However, each time the FPC came up with a new approach to the ratemaking process, it proved to be too little, too late, to entice producers to sell their gas into the interstate market.

e. Severe shortages of gas serving the interstate markets caused Congress to pass the Natural Gas Policy Act of 1978.

III. CONGRESSIONAL RESPONSES TO THE NGA: 40 & 50 YEARS LATER

A. Natural Gas Policy Act of 1978 (NGPA)

1. Regulation under the NGA tended to keep gas prices below the value of gas as reflected by the unregulated intrastate market. This caused producers to sell to the intrastate market whenever possible while consumers in the interstate market demanded more low-priced gas.

2. Since the interstate market was unable to attract adequate supplies of gas to meet the demand, Congress passed the NGPA to extend price regulation to the intrastate market, providing for phased deregulation of some gas sold in the interstate market, and to provide price incentives to encourage the discovery and development of new gas reserves.

3. The NGPA abandoned cost-of-service rate making for setting gas prices. Instead, the NGPA established a schedule of "maximum lawful prices" that could be charged for various types and vintages of gas.

4. Except for certain categories of gas, the NGPA maximum lawful prices would expire between 1979 and 1987.

5. The NGPA also removed NGA certificate (entry/exit) regulation for certain categories of gas.

6. The NGPA exempted certain gas sales and transportation transactions from NGA jurisdiction.

   a. § 311 of the NGPA attempted to integrate the intrastate, interstate, and LDC gas transportation systems by permitting each segment (interstate pipeline, intrastate pipeline, LDC) to haul gas for one another without pursuing burdensome regulatory procedures.

   b. However, it remained purely optional with each segment whether it desired to deal with one or more of the other segments.

B. Natural Gas Wellhead Decontrol Act of 1989 (WDA)

1. Phased out all natural gas price regulation as of January 1, 1993.

2. Phased out all NGA certificate (entry/exit) regulation, as it applies to natural gas sales, as of January 1, 1993.

3. The WDA completes the deregulation of natural gas sales began by the NGPA.

IV. THE LEGACY OF THE NGA/PHILLIPS/AND THE NGPA

A. Combined Impact of the NGA and the Phillips Decision

1. Divided the industry into three distinct segments:

   a. **Production:** oil and gas companies explore for and extract gas which they sell at or near the field where it is produced.

   b. **Transportation/Resale:** pipeline buys gas from producer at or near the field where produced and transports and sells it to either:

      (1) Another pipeline;

      (2) A "local distribution company" (LDC); or

      (3) An "end user," such as a factory.

c. **Distribution:** an LDC buys the gas from the pipeline for resale to LDC customers.

2. Producers were seldom able to deal directly with end users and LDCs because they were dependent upon the pipeline to move their gas from the point of production to the point of ultimate consumption or resale.

3. Since the pipelines were not common carriers, they could refuse to transport gas even though the producer (or end user, LDC, or an upstream or downstream pipeline) was willing to pay a transportation charge and there was pipeline "capacity" (space) available to move the gas.

4. Pipelines were therefore able to maintain a regulated monopoly over the gas merchant function as well as the transportation function.

B. Impact of the NGPA

1. One goal of the NGPA was to provide price incentives to spur producers to find new reserves and contract for their sale to pipelines. The NGPA worked.

2. Coming off of a gas-short existence, pipelines entered into long-term contracts with producers that provided the pipeline would pay the NGPA "maximum lawful price" for the gas.

   a. Producers insisted that if their gas reserves were to be dedicated to a particular contract, the pipeline must agree to take a minimum quantity of gas--or pay for it if not taken.

   b. As pipelines scrambled to add gas to their dwindling supply portfolios, consumer prices began to rise gradually as the higher-cost gas was rolled-in with the pipeline's existing lower-priced gas.

   c. However, as the pipeline's weighted average cost of gas (WACOG) increased, some consumers, particularly high-load high-volume industrial customers, began to switch to lower-cost substitutes for gas, such as fuel oil.

3. As supplies were being aggressively acquired by the pipelines, and as prices continued to escalate

under the formula prescribed by the NGPA, the demand for gas fell precipitously.

a. Pipelines were unable to resell, at regulated prices, all the gas they had contracted to take.

b. Producers had made investment decisions based, in part, upon the NGPA pricing mechanism and their gas contracts with pipelines which agreed to take stated volumes of gas, or pay for them, at NGPA prices.

c. This gave rise to the torrent of take-or-pay litigation which has occupied some of the nation's best legal talent for over a decade while effecting the transfer of billions of dollars among the impacted parties--and their attorneys.

V. RESTRUCTURING FOR EFFECTIVE COMPETITION

A. The FERC's Prescription for an Ailing Regulatory System

1. The FERC's responses to a regulatory system out of sync with reality (the market), would aggravate the pipelines' problems. FERC's "cure" would kill some of the patients, but the Commissioners felt they had to commence treating an ailing regulatory system.

2. The cure was to inject competition into the system where the natural monopoly rationale for regulation did not apply.

   a. The one remaining natural monopoly requiring public utility regulation would be the interstate <u>transportation</u> of natural gas.

   b. The <u>merchant</u> role of the interstate pipeline would not be subject to public utility regulation (or protection) and, for all practical purposes, pipelines would cease serving a merchant function and focus solely on providing transportation services.

3. The merchant function would be provided by gas producers, marketers, brokers, and end-users, in a new competitive environment.

4. To achieve its goal, the FERC had to attack existing regulatory enclaves that impeded demand, supply, and access to transportation.

B. Liberating the Demand Side of the Equation

1. FERC attempted to address the demand bottleneck by eliminating regulatory and contractual restrictions which, directly or indirectly, prevented an end user or LDC from seeking alternative gas supplies.

2. FERC Order No. 380

   a. FERC found that minimum charges imposed upon a pipeline's gas sales customers, regardless of their gas purchase levels, made it economically impossible for such customers to shop around for lower priced gas supplies.

   b. Order 380 focused on the imposition of a "minimum commodity bill" for variable costs (those that vary with the level of service - the primary variable cost being purchased gas costs). The customer had to pay for a minimum amount of gas even though they didn't take any gas.

      (1) The minimum bill was designed to compensate the pipeline for having the reserves available to provide the full contracted service.

      (2) The pipeline would generally contract with producers for the reserves necessary to provide the level of service its customers demanded.

      (3) The minimum bill mechanism was the primary means used by pipelines to recoup their take-or-pay payments to producers.

3. FERC Order No. 436

   a. Provided the firm sales customers of a pipeline the option to convert firm sales service to firm transportation service.

   b. Order 436 also allowed firm sales customers to reduce the amount of gas they had contracted to purchase from the pipeline (contract demand "CD" reduction vs. contract demand "CD" conversion).

4. FERC Order No. 500

   a. Recognizing the value of having pipelines provide backup gas supply service to its customers (sales and transportation customers), pipelines were given the authority to impose a charge for maintaining gas supplies for backup service (identified by many different names: e.g. future gas supply charge, gas inventory charge).

   b. This is essentially a minimum bill. FERC described the difference between this minimum bill and the Order 380 situation as follows:

      "The minimum commodity bill was an attempt to deal with this (take-or-pay) problem, but its design did not work well as competition increased. One central problem was that the minimum bill was not the result of voluntary selection from a menu of services that enabled the customer to obtain exactly the level of supply security it desired at a charge known in advance. The principles underlying future gas supply charges, as adopted here, are intended to remedy this problem."

5. Congress has acted to reduce the demand bottleneck by:

   a. Eliminating restrictions on the use of gas for certain purposes. See Pub. L. No. 100-42, 101 Stat. 310 (1987) (repealing portions of the Powerplant and Industrial Fuel Use Act of 1978 (PIFUA), Pub. L. No. 95-620, 92 Stat. 3289 (1979), which restricted the use of gas to generate electricity and as a fuel for other major fuel burning facilities).

b. Eliminating pricing mechanisms which discouraged industrial use of gas as a fuel source. See Pub. L. No. 100-42, 101 Stat. 310 (1987). In 1978, as part of the Natural Gas Policy Act, Congress required the imposition of "incremental pricing" to raise the cost of gas to levels that approached the "appropriate alternative fuel costs."

C. Liberating the Supply Side of the Equation

1. Even though FERC was able to open up new markets for gas (Demand), and provide access to such new markets (Transportation), two impediments on the Supply end of the pipeline had to be addressed:

   a. Gas reserves tied-up by long-term contracts; and

   b. Gas reserves tied-up by the service and abandonment requirements of NGA § 7(b) & (c).

2. Abandonment: Exit and Re-Entry

   a. Traditional Approach - gas subject to service obligation even though the gas sales contract terminated (or the underlying oil and gas lease terminated). To obtain abandonment of the service obligation, must initiate proceeding under NGA §7(b) and demonstrate the needs of the new (proposed) gas sale customers are greater than the needs of the existing customers.

   b. FERC attempted to reduce the regulatory burden of the abandonment requirement by:

      (1) Using pre-granted abandonment when the service is certificated.

      (2) Granting limited-term abandonments.

      (3) Authorizing abandonment "legislatively" by rule when certain conditions exist.

   c. The test for determining whether the public convenience and necessity would be served by abandonment was changed by FERC to compare the needs of existing customers with the benefits

freeing-up the gas would offer to the market as a whole.

(1) FERC took the view that the market benefits will, in most every case, exceed the needs of the existing customers.

(2) This permits a generic (legislative vs. adjudicatory) approach to abandonment.

d. FERC Order No. 490 - permit party to an expired contract to abandon the service without a §7(b) proceeding - merely give 30 days notice to other party and "report" the abandonment to FERC within 30 days after it occurs.

(1) Applied to expired or terminated contracts where there was a NGA service obligation.

(2) Applied to contracts to the extent a pipeline had exercised its contractual authority to reduce takes below the specified level.

(3) Applied to contracts where the parties mutually agreed to abandonment.

(4) Producers were granted blanket certificates to resell the abandoned gas.

e. FERC Order No. 451 - authorized abandonment if the "good faith negotiation" procedure resulted in a termination of the gas contract. Also gave producers blanket sales certificates.

f. FERC Order No. 436 - authorized expeditious Commission action on abandonment requests to facilitate take-or-pay settlements between producers and pipelines.

3. Long-Term Contracts - FERC Order No. 451

a. Order 451 permits producers with old low-priced gas contracts (NGPA §§ 104 & 106) to force their pipeline purchaser into negotiations to raise the price of the gas to

an amount which more nearly represents the current market value of the gas.

b. Pipeline has a reciprocal right, against the producer triggering the GFN process, to bring to the table any high-priced gas which is sold with old gas. Pipeline can force the producer to negotiate to reduce the high-priced gas to a price which more nearly represents the current market values.

c. Effect of Order 451 will be to arrive at new contracts which reflect the current market environment or the termination of existing contracts to permit the parties to bargain with others.

d. Order 451 grants abandonment of old sales where the parties fail to agree and provides blanket certification of new sales.

D. Opening Access to Transportation so Supply can Meet Demand

1. "Special Marketing Programs" (SMPs) were early attempts by FERC to provide access to pipeline transportation facilities.

   a. Designed to permit producers and pipelines to compete for customers which could readily switch to competing fuels.

   b. Designed to permit producers to market increased gas volumes while providing pipeline benefits in the form of:

      (1) Reduced take-or-pay liability; and

      (2) Increased throughput.

   c. Permit the sale of gas at discounted prices, or provide transportation services, to permit gas transactions at unit prices below the pipeline's weighted average cost of gas (WACOG).

      (1) Often the pipeline's WACOG exceeded the cost of competing fuels - such as #2 or #6 fuel oil.

(2) The pipeline's "captive customers," those that could not switch to alternative energy sources (most LDCs and their residential customers), generally had to purchase gas at the pipeline's WACOG - they were prohibited from purchasing SMP gas. Only customers currently using alternate fuels could buy SMP gas.

2. In Maryland People's Counsel v. FERC, 761 F.2d 768 (D.C. Cir. 1985) (MPC I) and 761 F.2d 780 (D.C. Cir. 1985) (MPC II), the court held SMPs which gave one class of customers discounted gas prices (MPC I) or access to transportation to facilitate direct sales (producer to end user) (MPC II), while denying it to another class of customers, violated the NGA's prohibition of "undue discrimination."

3. FERC responded with Order No. 436.

E. Eliminating the Transportation Bottleneck - FERC Order No. 436

1. Pipeline given the option to seek a "blanket certificate" to provide transportation services.

2. Under the non-Order 436 regime, FERC must approve all transportation transactions and specifically authorize the pipeline to provide the service.

3. Two types of transportation authorization:

   a. Certificate of public convenience and necessity issued under NGA § 7(c).

   b. "Self-implementing" transactions "on behalf of" intrastate pipelines or LDCs pursuant to NGPA § 311.

4. Primary benefit of an Order 436 (Part 284) Blanket Certificate:

   a. "Blanket" certificate of public convenience and necessity authorizing transportation by pipeline on behalf of others (e.g., interstate pipelines, end users, producers) without having to obtain a prior certificate for each transaction.

b. Generic authority to engage in NGA § 7(c) transactions and generic authority to abandon the service once the transaction is completed.

c. The Order 436 blanket certificate authorizes pre-granted abandonment upon the expiration of the underlying transportation agreement.

d. This reduction of regulatory review of transportation functions would allow the pipeline to react quickly to transportation requests and compete for gas sales and transportation business.

e. Other major Order 436 incentives:

(1) Freedom to discount transportation rates within a minimum and maximum rate band approved by FERC.

(2) Availability of "optional expedited certificates" to construct facilities necessary to provide transportation services. Eliminates the traditional protracted §7(c) certificate process - but the pipeline's stockholders must assume the risk that the new facility will not generate enough income to recoup their construction investment.

f. FERC fashioned its subsequent orders to provide pipelines with additional incentives to accept an Order 436 blanket certificate.

5. Public interests, previously protected by case-by-case review of § 7(c) transactions, were protected by the pipeline agreeing to specific blanket certificate conditions specified in Order 436.

6. The major condition is that pipelines must provide transportation on a non-discriminatory "open-access" basis.

7. Other Order 436 Conditions:

a. Pipeline must offer firm and interruptible service.

b. Pipeline capacity must be allocated on a "first-come, first-served" basis.

c. Employ generic rate conditions in developing their transportation rates with the primary goal that rates must be "cost-based".

VI. THE MOST RECENT CHAPTER IN FERC'S RESTRUCTURING: ORDER 636

A. Finishing the Work Began in its Previous Orders

1. Order 636 is the latest in FERC's attempts to ensure open access is provided to all shippers on an equal basis with the transporting pipeline.

2. Order 636 requires the "unbundling" of pipeline services so shippers can shop, package, and purchase the precise services they need.

3. The concern was that the pipeline "sales" service would not be comparable to a third party's sales service because the pipeline sale may include unidentified transportation-related services.

   a. Studies indicated that customers were relying primarily on pipeline sales to meet their peak demand periods and that they reserved firm capacity on the pipelines throughout the year to ensure access to gas during peak periods.

   b. Off-peak demand, however, was satisfied primarily through the purchase of gas from non-pipeline sources and moving the gas relying upon interruptible transportation.

4. The FERC's concerns regarding its post-Orders 436/500 creation were articulated as follows:

   "The Commission finds that the pipelines' bundled, city-gate firm sales service give pipelines an undue advantage over other gas sellers because of the superior quality of the 'no-notice' aspect of the transportation embedded within the bundled, city-gate, firm sales service when compared to the firm and interruptible transportation available for the gas of non-pipeline gas sellers. . . . In order to secure a more efficient marketplace, the Commission must address the lack of equality in transportation (and storage) services, the pipelines' dominance in the peak period sales, the lack of flexibility in pipelines' sales pricing,

and the pipelines' remaining service obligation simultaneously."

These are the issues addressed by Order 636.

5. The goal is to break out all transportation-related services, such as storage, and provide a menu with regulated rates at which services can be packaged and bought, or sold, by any party to ensure effective competition

   a. Once a complete menu of services is provided, the gas user can evaluate the level of service they desire.

   b. This is how the FERC plans to deal with the "service" obligation. It will be up to the gas user to package the supply and transportation services it desires to determine the level of risk they desire to accept--or not accept--regarding supply interruptions.

B. The Workings of FERC Order 636

1. Although Order 636 provides guidelines on how restructuring will take place, the details for each pipeline will be found in the orders pertaining to their individual restructuring proceeding, and reflected in their tariffs.

2. These pipeline-specific tariffs have been completed and all observers agree that the industry performed quite well under the new regime during the unusually cold winter of 1993-94. Gas got to where it needed to go at reasonable prices.

VII. PROBLEMS CREATED BY RESTRUCTURING

A. Costs Associated with Reliance on the Prior Regime

1. Pipeline gas supply contracts with producers were a major problem associated with Orders 380, 436, and 500.

   a. Order 636 authorizes pipelines to recover the full cost of all prudently incurred gas supply "realignment costs."

   b. Generally, the bulk of realignment costs (cost of terminating take-or-pay and other gas supply agreements) can be recovered from firm transportation shippers on the pipeline either in the form of an exit fee paid by a sales customer or a reservation fee surcharge paid by firm transportation shippers. Other options for the firm service holder include remaining a sales customer of the pipeline or take an assignment of the pipeline's existing contracts.

2. In addition to gas contract costs, Order 636 addresses the "stranded asset" problem.

   a. Pipelines will have assets they have acquired in the past to provide customers with the standard pre-Order 636 bundled sales service. For example, storage rights and capacity the pipeline holds on upstream pipelines.

   b. Stranded assets will be treated like other costs incurred by the pipeline and will be recoverable, if they were prudent, in a general rate filing under the NGA.

B. Realignment of Costs Through Cost Classification (Rate Design)

1. This will be a problem for the LDCs but a blessing for high load gas customers.

2. Order 636 adopts the "straight fixed variable" (SFV) method of classifying costs which means all of the pipeline's fixed transmission costs and storage costs will be billed to firm transportation customers as a "reservation charge" (if the

customer was receiving sales service instead of transportation, this would be called the "demand charge").

3. Prior to Order 636, U.S. pipelines used a "modified fixed variable" (MFV) method of cost classification which included some of the pipeline's fixed costs (return on equity and related taxes) in the "volume charge" (if the customer was receiving sales service instead of transportation, this would be called the "commodity charge").

   a. This meant that high volume customers were generally paying a disproportionate percentage of the fixed costs associated with the pipeline.

   b. In effect, high volume, industrial and commercial customers were subsidizing the cost of providing services to low volume customers, such as residential and small commercial consumers.

4. Reservation (demand) charges are typically based upon two components:

   a. The maximum daily (peak-day) entitlement to service (the "R-1" or "D-1" rate); and

   b. The maximum annual entitlement to service (the "R-2" or "D-2" rate).

5. Volume (commodity) charges are based upon the amount of gas that flows through the pipeline.

6. Consider the following rate schedule which would be indicative of the approach followed by interstate pipelines prior to Order 636:

MFV	R-1	$2.00 per MMBtu for maximum daily entitlement to service
	R-2	$0.20 per MMBtu for maximum annual entitlement to service
	V/C	$0.25 per MMBtu for actual volumes transported

   a. Assume a shipper wants to purchase firm transportation that will ensure they can move up to 10,000 MMBtu/day to meet their expected peak demands with a total annual entitlement

of 2,920,000 MMBtu. Note this indicates the shipper has an 80% "load factor" (2,920,000 divided by 365 days = 8000 MMBtu/day average).

b. During the month the shipper takes 240,000 MMBtus of gas (an 80% load factor for the month). Under the rate schedule, the shipper would be billed as follows:

R-1	$ 20,000	($2.00 x 10,000)
R-2	$ 48,667	($0.20 x 2,920,000 x 1/12)
V/C	$ 60,000	($0.25 x 240,000)
	$128,667	Total

7. A similar transaction under the post-Order 636 regime would employ a straight fixed variable cost classification where the "R-2" factor has been eliminated and instead all fixed costs are recovered in the daily capacity reservation charge --the "R-1" factor.

SFV

R-1 $6.00 per MMBtu for maximum daily entitlement to service

V/C $0.05 per MMBtu for actual volumes transported

R-1	$ 60,000	($6.00 x 10,000)
V/C	$ 12,000	($0.05 x 240,000)
	$ 72,000	Total

8. Our 80% load factor customer is a big winner in the shift from MFV to SFV. Their unit cost for the transportation of gas went from $0.54/MMBtu to $0.30/MMBtu.

9. However, consider the impact on a customer with a 20% load factor, such as an LDC which serves temperature-sensitive residential customers with a daily demand requirement of 10,000 MMBtu and an annual entitlement of 730,000 MMBtu. During the month they take 60,000 MMBtus (a 20% load factor for the month).

MFV

R-1	$ 20,000	($2.00 x 10,000)
R-2	$ 12,167	($0.20 x 730,000 x 1/12)
V/C	$ 15,000	($0.25 x 60,000)
	$ 47,167	Total

SFV

R-1	$ 60,000	($6.00 x 10,000)
V/C	$ 3,000	($0.05 x 60,000)
	$ 63,000	Total

a. Although their volume charge goes from $15,000 to $3,000, their reservation charge goes from $32,167 to $60,000.

b. Order 636 makes it more expensive to reserve space year-around to ensure the LDC is able to meet their service obligations on the coldest day of the year.

c. Our 20% load factor customer is a big loser in the shift from MFV to SFV. Their unit cost for the transportation of gas went from $0.79/MMBtu to $1.05/MMBtu.

10. Order 636 provides some flexibility to mitigate "significant" cost shifts for individual customers. If a customer "class" will ultimately suffer a 10% or greater increase, the SFV method can be phased-in over a four-year period.

11. Should the impact of these shifts be discounted by positive benefits received under other Orders such as Orders 380, 436, 500, etc.?

C. Meeting the "Service" Obligation Becomes a Matter of Choice for the LDC; No-Notice Transportation

1. The risk of having a choice is that you have the capacity to make the wrong choice. In the public utility arena the risk is even greater because the LDC's actions may (as a practical matter) be evaluated with the perfect vision of regulatory hindsight.

2. Making sure the LDC is able to supply their customers with all the gas they want on the coldest day of the year is now the responsibility of the LDC, not the interstate pipeline.

3. LDCs (and other large gas users) now have the ability to structure gas supply, storage, and transportation services to best fit the needs of their customers, at the most competitive price.

4. Prior to Order 636 LDCs relied upon the pipeline's bundled sales service which included the gas commodity and the pipeline's transportation and storage rights to move gas to the city gate of the LDC.

5. Under Order 636, pipelines that offered sales service prior to Order 636 are required to offer a "no-notice" transportation service to all firm shippers.

   a. No-notice transportation service allows the customer to purchase a daily contract entitlement that allows the customer to have delivered at any time a quantity of gas up to the contract entitlement.

   b. The gas commodity that is moved under the no-notice service can be purchased from the pipeline or a non-pipeline supplier.

   c. There are no nominations, scheduling penalties, or other limitations that are associated with traditional firm transportation services. However, the higher quality of this service is reflected in its cost.

   d. The LDC's ability to package their needed services will be enhanced by Order 636 provisions requiring pipelines holding firm capacity on upstream pipelines and contract storage to offer to assign these rights to their firm shippers.

D. Capacity Release and Reallocation Under Order 636

1. Order 636 permits shippers to reallocate their unneeded firm capacity by notifying the pipeline and having the availability of capacity advertised on the pipeline's electronic bulletin board.

2. The bidder making the best offer for the capacity (not to exceed the maximum tariff rate chargeable to the releasing shipper) will be assigned the capacity and revenues generated by the reassignment will be credited to the releasing shipper's account.

E. Market Centers and Pooling Areas

1. Pipelines are prohibited from imposing tariff conditions which inhibit the development of market centers and pooling areas.

2. A market center is created when there is an interconnection of two or more pipelines, thereby expanding the range of available gas supplies and gas purchasers.

3. Order 636 requires pipelines to provide firm shippers with flexible receipt points and delivery points--this should aid in the creation of market centers.

4. The straight fixed variable rate design should also assist in the creation of market centers since the variable cost component of the transportation charge will not reflect fixed costs (return on equity and taxes) that could vary markedly from pipeline to pipeline.

5. A pooling area is a point where gas is aggregated by merchants to effect sales and administer deliveries to the pipeline.

F. Competition for LDC Industrial Customers--The Bypass Problem

1. As end users of gas seek to exercise their new ability to buy gas directly from producers and have it transported to their facilities, conflicts have arisen between their current LDC supplier and the area interstate pipeline (or imported gas suppliers).

2. Bypass occurs when an existing LDC customer obtains a direct connection with an interstate pipeline (or an imported gas supply)-- bypassing the LDC.

3. The bypassing customer is able to contract with other gas suppliers and have the gas transported to them through their connection with the interstate pipeline.

4. The FERC now favors bypass and has used its jurisdiction over interstate transportation to facilitate bypass in the face of LDC and state public utility commission opposition.

5. The courts have upheld the FERC's actions in this area. See, e.g., Cascade Natural Gas. Corp. v. FERC, 955 F.2d 1412 (10th Cir. 1992).

6. Responding to this problem, many state public utility commissions are allowing their LDCs more flexibility in negotiating with their large customers to try and avoid a bypass.

   a. Many LDCs now offer transportation services in addition to a sales service.

   b. Many LDCs have the ability to discount their services to keep their customers on the system so they make some net contribution to system costs.

7. By-pass is one of the catalysts that will prompt state regulators to provide open-access services at the state and local level.

G. The Potential Gathering Bottleneck--Federal or State Jurisdiction?

1. To enjoy the benefits of Order 636, the producer or marketer must first get their gas to the interstate pipeline. This typically means the gas must travel through a gas gathering system that connects the wellhead to a pipeline receipt point.

2. Under the Natural Gas Act, jurisdiction over the "production or gathering of natural gas" is reserved to the states. NGA § 1(b), 15 U.S.C. §717 (b).

3. However, when the gathering is conducted by the interstate pipeline (which it often has been), the FERC has asserted jurisdiction over the pipeline's gathering activities since they were closely associated with the transportation function.

   a. The pipeline's gathering costs were typically included with the pipeline's transportation costs which were rolled into the sales rate charged to the local distribution company.

   b. To effectively control these costs the FERC exercised jurisdiction over the gathering function.

4. After Order 636, gathering costs cannot be rolled into the sales rate nor can they be rolled in with other transportation costs.

   a. The end result is that customers using the particular service (gathering) should bear all the costs associated with the service.

   b. Therefore, gathering costs cannot be recovered from customers using the pipeline solely for transportation. Only those who use the service can be charged for the service--and the rate will be set accordingly.

   c. One (unacknowledged) reason producers want FERC to continue their regulation over gathering is so FERC at least has the capacity to allow some gradual phase out of the cross-subsidization of gathering.

5. The interstate pipelines have wanted to be free of FERC jurisdiction so they can sell their systems to unrelated third parties (spin-off) or to an affiliated marketing entity (spin-down).

   a. The asset is more valuable if it is not subject to NGA regulation.

   b. In any event, the owner of the gathering system, in some situations, will be competing against unregulated gathering systems (those that have never had an ownership link with an interstate pipeline).

6. Order 636 requires pipelines offering gathering to provide a separate rate for gathering services.

7. The FERC's response to the spin-off and spin-down issue has been to require, as a condition to approving the transaction, that the shippers and pipeline negotiate new contracts to govern gathering services after the system is sold.

   a. If the parties are unable to agree upon a new contract, a "default contract" would apply.

   b. The default contract would be for a term not to exceed two years at rates no higher than the rate charged by the pipeline prior to selling the system (subject to an escalation formula).

8. The FERC has indicated its intention to get out of the gathering regulation business once a gathering system is sold by the interstate pipeline.

9. The dilemma for the producer is two-fold:

   a. The ability to gain any access to the gathering facility; and

   b. The fee that will be charged for use of the facility.

10. The producer's situation is made more difficult by inadequate (and in many cases a total absence of) state regulation to fill the void.

   a. Another reason producers don't want states to regulate the spun-off interstate systems is that it will probably result in state-wide regulation of all gathering systems--large and small. Many producers don't want <u>their</u> small systems regulated--only the larger systems they want to use.

   b. In many situations, ownership of a gathering system will give the gathering system owner the ability to control all the gas behind the gathering system.

      (1) If a producer wants to market their gas, they will have to do it on the gatherer's terms.

      (2) Often the gatherer will offer a net-back pricing mechanism to ensure they have a no-risk profit margin on gas they have under their control.

11. Effective regulation at the state level will require a guaranteed right of access to the system on reasonable terms.

"It is the sense of the Congress that natural gas consumers and producers, and the national economy, are best served by a competitive natural gas wellhead market."

Energy Policy Act of 1992

U.S. Constitution, article I, § 8

"The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

U.S. Constitution, article VI:

"Supreme law of land. This Constitution, and the Laws of the United States which will be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

West v. Kansas Natural Gas Co. (1911)

"[N]o state can by action or inaction prevent, unreasonably burden, discriminate against, or directly regulate, interstate commerce or the right to carry it on."

Missouri v. Kansas Natural Gas Co. (1924)

"Congress thus far has not seen fit to regulate it [sale of gas for resale], and its silence, where it has the sole power to speak, is equivalent to a declaration that that particular commerce shall be free from all regulation."

Natural Gas Act of 1938

* **Recognition of judicially-defined areas of federal and state jurisdiction.**

* **Creation of a federal program to fill the regulatory "gap".**

NATURAL GAS ACT § 1(b)

Federal government given authority over:

* **Transportation of natural gas in interstate commerce.**

* **Sale in interstate commerce of natural gas for resale.**

State governments given authority over:

* Transportation of natural gas in intrastate commerce.

* Sale of natural gas for consumption instead of resale.

* Local distribution of natural gas.

* Production of natural gas.

* Gathering of natural gas.

DELEGATION OF AUTHORITY TO ADMINISTER NATURAL GAS ACT JURISDICTION

* **Federal Power Commission (FPC)**

  1938 to 1977

* **Federal Energy Regulatory Commission (FERC)**

  1977 to present.

THE NGA's PUBLIC UTILITY REGULATORY MODEL

* **Entry**

  § 7(c) Certificate of Public Convenience and Necessity

* **Service Obligation**

  § 7(e) Ensure the entity is capable of providing the level of service required to satisfy the "public convenience and necessity."

* **Exit**

  § 7(b) Service cannot be abandoned without Commission approval and finding abandonment will serve the present or future public convenience and necessity.

* **Cost-of-Service Rate Regulation**

§§ 4 & 5 Must be "just and reasonable" and cannot be "unduly discriminatory, or preferential".

INTERSTATE PIPELINES WERE NOT MADE COMMON CARRIERS UNDER THE NGA

* Common carrier status resisted by the interstate pipelines.

* Gave pipelines considerable monopsony purchasing power over producers.

* Effectively gave pipeline a monopoly over not only the interstate transportation of gas but also the merchant function of buying and reselling gas.

CONTRAST THE OIL PIPELINE EXPERIENCE

* **Oil pipelines were made common carriers in 1906 under the Hepburn Act to counteract the Standard Oil Trust's control over oil pipelines.**

Phillips Petroleum Co. v. Wisconsin (1954)

* **Sale of gas by producer to pipeline deemed a "sale for resale" subject to NGA jurisdiction.**

* **The gas producer became a federal public utility subject to the NGA's entry, service, exit, and rate regulation.**

* **FPC attempted cost-of-service ratemaking for producers, shifted to area-wide rates, and ultimately shifted to nation-wide ratemaking.**

* **Unregulated prices for intrastate sales exceeded rates offered by the FPC resulting in severe gas shortages on interstate systems.**

NATURAL GAS POLICY ACT OF 1978 (NGPA)

* Price regulation extended to the intrastate market.

* Maximum lawful prices; incentive pricing.

* Remove entry/exit regulation for certain gas sales.

* Gradual deregulation of many categories of gas.

* Streamline transportation regulation to facilitate transactions between interstate pipelines, intrastate pipelines, and LDCs.

NATURAL GAS WELLHEAD DECONTROL ACT OF 1989

* **Phased out all natural gas price regulation as of January 1, 1993.**

* **Phased out all NGA certificate regulation of gas sales as of January 1, 1993.**

PRACTICAL IMPACT OF THE NGA & NGPA

* **Industry divided into three distinct functions:**

  - **Production**

  - **Transportation/Merchant**

  - **Local Distribution**

RESTRUCTURING FOR EFFECTIVE COMPETITION

* **In 1985 the FERC determined that the gas merchant function could be best served through a "competitive natural gas wellhead market."**

* **To achieve this goal, various supply, demand, and transportation bottlenecks created by the regulatory system would have to be addressed.**

DEMAND SIDE ACTIONS

* **Unleash potential gas purchasers that have been constrained by the existing regulatory regime.**

  - **FERC Order 380**

    Eliminate the LDC's "minimum bill".

    What about the pipeline's take-or-pay obligations that were incurred to meet the LDC's demand?

  - **FERC Order 436**

    Permit LDCs to convert firm sales service to firm transportation service.

* **Congress acted in 1987 to repeal laws enacted in 1978 that restricted the use of natural gas for industrial purposes.**

SUPPLY SIDE ACTIONS

* **Loosen the NGA exit (abandonment) restrictions so old gas supplies can be released and resold.**

  - **New FERC approach to NGA § 7(b) requests.**

  - **FERC Order 490.**

  - **FERC Order 436.**

  - **FERC Order 451.**

* **Create a mechanism by which producers can terminate the obligation to sell "old" vintage gas while providing pipelines a reciprocal right to terminate the obligation to purchase newer vintage (and higher priced) gas.**

  - **FERC Order 451**

PERMITTING SUPPLY TO MEET DEMAND

* The most important act by the FERC was to encourage interstate pipelines to accept a "blanket certificate" to provide "open access" transportation on their systems.

* FERC Order 436

  - Generic (blanket) certificate of public convenience and necessity to enter and exit a class of open access transportation transactions.

  - Blanket certificate conditions, coupled with the anticipated competition that would result, would take the place of case-by-case review of § 7(c) transactions.

* **FERC Order 436 began the open access transportation process--Order 636 completes the process (for now).**

FERC ORDER 636

* Order 636 fulfills the aspirations expressed by FERC in Order 436.

* Goal is to totally "unbundle" the components of traditional pipeline sales service so:

  - Each component can be separately offered on an open access basis; and

  - Customers can pick and package the services they desire.

THE GATHERING PROBLEM

The FERC is getting out of gathering regulation.

NGA § 1(b)

Jurisdiction over "production or gathering of natural gas" is reserved to the states.

4-60

Historically, many gathering systems have been owned and operated by interstate pipelines and the cost of providing this service has been rolled into the pipelines' other costs and reflected in a single sales rate for the gas.