

Approved: Carl Dean Holmes
Date 3-9-99

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Vice-Chairman Tom Sloan at 9:08 a.m. on February 15, 1999 in Room 522-S of the Capitol.

All members were present except: Rep. Carl Holmes

Committee staff present: Lynne Holt, Legislative Research Department
Mary Torrence, Revisor of Statutes
Jo Cook-Whitmore, Committee Secretary

Conferees appearing before the committee: Mary Torrence, Revisor
Bill Jarrell, Boeing
James Zakoura, KIC
Terry Keller, Boeing
Dennis Hanson, Raytheon
Walker Hendrix, CURB
Louis Stroup, KS Municipal Utilities
Larry Holloway, KCC
Chris McKenzie, KS League of Municipalities

Others attending: See Attached List

Hearing on HB 2045 - Electric Utility Restructuring Act

Vice-Chairman Sloan introduced Mary Torrence, Revisor, who provided background information and a summary of **HB 2025 (Attachment 1)**.

The Vice-Chair welcomed Bill Jarrell, Regional State Relations Director for Boeing, who introduced the three conferees following him. Mr. Jarrell stated that Boeing feels that the Retail Wheeling bill would be a quadruple win, a win for business, a win for consumers, a win for the utilities and a win for the state economy. He urged the committee to find that winning solution with some piece of legislation so that Retail Wheeling can move forward.

James P. Zakoura, on behalf of the Kansas Industrial Consumers, presented testimony in favor of **HB 2025 (Attachment 2)**.

Terry Keller, Manager of Resource Administration and Energy Management for the Boeing Company, next presented testimony in support of **HB 2025 (Attachment 3)**.

Dennis Hanson, Group Manager of Facilities and Equipment at Raytheon Aircraft, next provided testimony in favor of **HB 2025 (Attachment 4)**.

The next proponent of **HB 2025** who testified was Walker Hendrix, Consumer Counsel for the Citizens' Utility Ratepayer Board (**Attachment 5**).

Louise Stroup, Jr., Executive Director of Kansas Municipal Utilities, Inc., provided testimony in support of **HB 2025 (Attachment 6)**.

Vice-Chairman Sloan announced that Barbara A. Hueter, Director of Government Affairs for Enron Corp., had provided the committee with written testimony (**Attachment 7**) in favor of **HB 2025**.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES, Room 522-S Statehouse, at 9:08 a.m. on February 15, 1999.

Larry Holloway, Chief of Energy Operations for the Kansas Corporation Commission, testified in a neutral position on **HB 2025** (Attachment 8). Mr. Holloway also distributed copies of a map depicting the Kansas Average Electric Rates Cost per KWh (Attachment 9) and a booklet entitled "Kansas Electric Utility Information" compiled by the KCC Staff (Attachment 10).

Chris McKenzie, Executive Director for the League of Kansas Municipalities, next provided information on municipal tax issues and retail wheeling. Mr. McKenzie was neutral on **HB 2025** (Attachment 11).

Lynne Holt, Legislative Research, distributed copies of information she had received from Matthew Brown regarding the New Jersey legislature passing a restructuring bill (Attachment 12).

Conferees concluded testimony by responding to questions from the committee. Due to the time constraints they were asked to return the next day for additional questions. The hearing on **HB 2025** will continue tomorrow.

Meeting adjourned at 10:55 a.m.

Next meeting is Tuesday, February 16.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: 2/15/99

NAME	REPRESENTING
Whitney Damron	Empire District Electric Co.
ED SCHAUB	WESTERN RESOURCES
John Peterson	Raytheon Aircraft Co
Floyd Rumsey	KDOR-POD
Robert Badenoch	KDOR-POD
Lester Murphy	KEC
Jim Widener	KMEA
BRUCE GRAHAM	KEPCO
Jim Ludwig	Western Resources
Dave Hottam	Western Resources
BILL EICHMAN	EMPIRE DISTRICT ELEC. Co.
James P. Zakoura	Kansas Industrial Consumers Group Smithyman & Zakoura, Chartered
TERRY KELLER	THE BOEING COMPANY
DENNIS HANSON	RAYTHEON AIRCRAFT
David Miles	Associated Press

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: 2-15-99

NAME	REPRESENTING
Jon X Miles	KEC
BURTON CRAWFORD	KCPD
Steve Miller	Sunflower
J.C. LONG	UCU
Tom HESTERMANN	Sunflower
DICK CARTER	ENRON
Joe Dick	BPU KCK
Larry Holloway	KCC
Louis Stroup Jr.	KS Municipal Utilities
WALKER HENDRIX	to CURB
Sandy Braden	McGill, Gachas & Assoc.
Paul Byler	KDOCH
Bice Jancee	BOEING
Brandin Hall	Mulvane
Julie Hein	Hein & Keller

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: 2/15/99

NAME	REPRESENTING
Charles Benjamin	KS Sierra Club / KNRC

Office of Revisor of Statutes

300 S.W. 10th Avenue
Suite 322, Statehouse
Topeka, Kansas 66612-1592
Telephone 785-296-2321 FAX 785-296-6668

MEMORANDUM

To: House Committee on Utilities
From: Mary Torrence, Assistant Revisor of Statutes
Date: February 15, 1999
Subject: Summary of House Bill No. 2025

Institution of Competition (Sec. 3 & 4, p. 4-5)

Commencement 7/1/02

Distribution remains rate-regulated by the KCC, with distribution utilities monopolies within exclusive service territories

Distribution and transmission utilities are required to provide open, nondiscriminatory access to use of facilities by other utilities and competitive retail providers

Application to Utilities

Investor owned utilities (in)

- all required to compete

Municipal utilities (opt-in) (Sec. 5, p. 5-8)

- only required to compete within annexed territory where competition existed before annexation; otherwise not required to participate in competition
- may opt to participate in full competition or competition only within city limits and within 3 miles outside limits
- unless opt for full participation, may only sell within city limits and within 3 miles outside limits
- exercise of option
 - by election called by governing body
 - by election called by petition
 - by ordinance, subject to protest petition and election

Cooperatives (opt-out) (Sec. 6, p. 8-9)

- required to compete unless before 7/1/02 opt not to participate
- if opt out, may later opt to participate

HOUSE UTILITIES

DATE: 2-15-99

ATTACHMENT |

Stranded Costs ("competitive transition costs")

Background

- currently utility investments in generation facilities and generation contracts are recovered through rates set by the KCC
- under deregulation, market price for electricity might not be high enough to allow recovery of those investments (hence, "stranded")
- debate whether consumers or stockholders should pay
 - utilities argue that it is an unconstitutional "taking" of property if they are not compensated for investments that they made under a regulatory compact that guaranteed recovery of that investment
 - opponents argue that consumers shouldn't have to pay for utilities' bad business decisions
- a major reason why new generation facilities have not been built; utilities want to know what the rules will be—don't want to be stuck with stranded costs that they can't recover

Costs Included [Sec. 2 (j), (r), (t), (v), (w), (z) & (aa) p. 2-4]

- stranded costs are the amount by which prudent costs of generation assets, and value of generation contracts and other legal obligations included in rates or rate base on 7/1/99, exceeds the amount that will be recovered at competitive market prices

Determination of Amount Allowed (Sec. 7-8, p. 9-11)

- utility applies to KCC for determination of amount that can be recovered
- nuclear decommissioning costs, radioactive waste disposal costs incurred before 7/1/02 & regulatory assets incurred before 7/1/02 can be fully recovered
- other assets and obligations can be recovered in an amount determined by KCC after looking at various factors related to whether the costs were reasonable, what efforts the utility made to mitigate costs, to what extent the utility previously recovered the costs and whether the utility has made efforts to promote competition
- utility has a duty to mitigate stranded costs
- if several utilities are affiliates, the amount to be collected for those affiliates that have stranded costs is offset by those assets of affiliates that are above market value; after that is done, remaining stranded costs are recovered through the charge to customers of the affiliates that have the stranded costs

Mechanism for recovery (Sec. 9, p. 11)

- recovery is through a charge per kilowatt hour of electricity delivered to consumers in the utility's service territory as it existed before implementation of competition ("competitive transition charge")
- consumers that begin generating their own electricity after 1/1/99 must also pay the charge on the basis of kilowatt hours used

Period for recovery and periodic review (Sec. 7, p. 9-10)

- general period for recovery is 12 years; period for nuclear decommissioning costs and radioactive waste disposal is the life of facility; period for recovery of municipal bond indebtedness is the life of bonds
- KCC periodically reviews stranded costs and adjust amount to compensate for over-recovery or under-recovery unless bonds have been issued to recover the costs

Issuance of “transition” bonds to pay stranded costs (“securitization”) (Sec. 11-12, p. 13-18)

- bonds may issued to recover up to 50% of a utility’s stranded costs
- bonds may be issued by a trust, a utility or the state; if issued by the state or a trust, they receive a higher rating and thus can pay a lower interest rate
- bonds issued by the state are not an obligation of the state
- the terms of issuance of the bonds are irrevocable; the competitive transition charges pledged to pay bonds cannot be changed and the amount of the stranded costs to be paid by the bonds cannot be adjusted

Universal Service

Costs include [Sec. 2 (ff), p. 4]

- cost of continued service during winter months (“cold weather rule”)
- cost of providing distribution service to in areas of low population density and high cost

Recovery of costs (Sec. 10, p. 11-13)

- Only available in areas where there is retail competition
- KCC holds hearings to determine amount needed to cover universal service costs
- amount is recovered through fees on licenses of competitive retail providers and a unit charge per kilowatt hour delivered to customers
- distribution utility would qualify to receive money for service in high cost area to the extent that costs of service exceed statewide average by 25% or more
- KCC audits universal service fund and reconciles costs and universal service charge every two years

Consumer Protection (Sec. 13, p. 18-19)

KCC is directed to adopt rules and regulations requiring “unbundling” of retail electric bills into their components

- generation charge
- distribution charge
- transmission charge
- universal service charge
- taxes on sale
-

Municipal utilities are required to show portion of bill attributable to budgeted transfers to city general fund (for subsidy of other city services)

KCC also is directed to adopt rules and regulations

- prohibiting unauthorized switching of customer from one competitive retail provider to another (“slamming”) and establishing complaint procedures
- establishing procedures and standards for disconnecting and reconnecting customer who fails to pay bill
- specifying minimum requirements for representing that power sold is “green” power
- establishing minimum standards that enable comparisons of terms offered by different competitive retail providers
 - duration of contract
 - prices for all components of generation service all other charges

- degree of variability of charges
- price per kilowatt hour for different levels of consumption

KCC also has general duty to ensure that the quality of generation and distribution service does not decrease after competition is instituted

Duties of Distribution Utilities

- must purchase excess power generated by customer who self generates (Sec. 14, p.19-20)
- must serve as emergency supplier if retail supplier fails to supply for reason other than nonpayment (Sec. 17, p. 22-23)

Open Access and Standards of Conduct (Sec. 15, p. 20-22)

KCC required to adopt rules and regulations

- requiring distribution and transmission utilities to provide open access to their facilities and services on the same terms as for the utilities' own use
- establishing standards of conduct for any distribution or transmission utility that is affiliated with a competitive retail provider to insure that the relationship between the utility and the retail provider is at arms' length

Restructuring Plans (Sec. 16, p. 22)

- by 2/1/01 each utility is required to file with the KCC a restructuring plan to implement the act
- KCC holds hearings on plans not later than 6/1/01
- KCC issues orders regarding recovery of stranded costs and other matters to implement competition
- KCC has access to records of utilities' affiliates to determine anticompetitive practices

Aggregation (Sec. 18, p. 23)

- all customers entitled to aggregate loads voluntarily
- if a local subdivision serves as aggregator, it must allow, but cannot require, all customers in its jurisdiction to participate

Regulation of Competitive Providers (Sec. 19, p. 23-25)

All competitive retail providers are required to be licensed

- term of five years
- fees established by KCC rule and regulation
- subject to denial, limitation, suspension or revocation for activities inconsistent with
 - provision of reliable service
 - effective competition
- KCC rules and regulations establish procedures and standards, including requirements for
 - reliability of service
 - financial and operational fitness
 - billing practices and customer service
 - disclosure of pending legal actions
 - disclosure of affiliates
- other requirements
 - must establish an office in the state and receive all payments from Kansas customers at that

office

- must appoint the secretary of state as the provider's agent for service of process
- if previously did business in Kansas, must have opened its certified territory in this state to competition
- if from outside the state, must come from a state where there is competition

Administration and enforcement (Sec. 20, p. 25-26)

KCC given authority to adopt rules and regulations to administer and enforce the act

Administrative fine of \$5,000/day authorized for violations related to consumer protections, open access to distribution or transmission facilities or services, standards of conduct for distribution and transmission utilities or licensure of competitive retail providers

Independent System Operators (ISO's) (Sec. 21, p. 26)

State, KCC and Kansas utilities required to cooperate in establishing mechanisms to operate the transmission system and interstate power pools

Alternative Rates (Sec. 22, p. 26)

KCC authorized to adopt alternative rate making

- could allow greater mitigation of stranded costs

Environmental Impact Statements (Sec. 23, p. 26)

KDHE responsibility

Oversight of Implementation of Act (Sec. 24, p. 26-27)

A joint committee is established

- monitors and review implementation of the act
- makes recommendations to the legislature and the KCC on various matters relating to implementation of competition
- expires 1/1/07

Consumer Education (Sec. 25, p. 27-28)

KCC and CURB are directed to organize an advisory board to address public education efforts

- board makes recommendations to the KCC
- KCC submits recommendations to the 2000 legislature

Taxation of Electric Public Utilities (Sec. 26, p. 28)

A joint committee is established

- studies ramifications of deregulation of electric generation on the state and taxing subdivisions the tax impacts on and among generators
- makes recommendations to the 2000 legislature
- expires 1/11/00

Sections Amended or Repealed (Sec. 28-35, p. 29-40)

- amends open records act and open meetings act adding certain exemptions for municipal utilities that participate in competition

- amends tax statutes to provide for competitive retail providers' property to be taxed as commercial and industrial property (assessed at 25%) rather than public utility property (at 33%)
- repeals generation facility siting act

**TESTIMONY OF JAMES P. ZAKOURA
ON BEHALF OF
THE KANSAS INDUSTRIAL CONSUMERS
BEFORE THE HOUSE UTILITIES COMMITTEE
HB 2025 - ELECTRIC UTILITY RESTRUCTURING ACT
February 15, 1999**

INTRODUCTION:

The Kansas Industrial Consumers ("KIC") are companies located throughout the State of Kansas that purchase large amounts of electric energy for use in manufacturing, service enterprises, and other business endeavors. The Members of KIC endorsing this Testimony are listed on Exhibit A attached hereto. KIC member companies have facilities located on the electric utility systems of Western Resources, Inc. (d/b/a KPL), Kansas Gas and Electric Company ("KGE"), the Kansas City Power & Light Company ("KCPL"), and many additional municipal electric systems and electric cooperative systems. Members of KIC typically have facilities located in many states, and therefore bring a somewhat broader frame of reference to the consideration of electric issues before the Kansas Legislature.

OVERVIEW:

Kansas business and industrial consumers share common goals with residential and small consumers of electric energy. Simply stated, all Kansas consumers desire to have the lowest priced electric energy that is consistent with reliable supplies of electric energy. Throughout much of the State of Kansas, the events of the Summer of 1998 shattered the belief that Kansas consumers -- whether it be business or residential consumers -- have electric energy supply reliability at the high levels that they had presumed. On the electric systems of KPL and KGE, approximately sixty electric consumers that had contracts or tariffs with provisions that their supplier could interrupt them, found themselves interrupted eight times during the Summer of 1998. In addition, the 150 largest customers on the KGE and KPL electric systems

HOUSE UTILITIES

DATE: 2-15-99

ATTACHMENT 2

were asked to reduce electric energy consumption by 10% - 15%, or face the possibility of blackouts. Residential consumers of electric energy on the KGE and KPL systems were requested to move their thermostats up to 82° and to perform basic household tasks such as washing and drying clothes, and cooking, at times other than during peak afternoon and evening usage of electric energy.

On the issue of price, while there may be debate as to the level of electric energy prices on the KGE system as compared to national prices for electric energy, the fact that prices to KGE customers substantially exceed prices to KPL customers is well known, and is the subject of several proposed pieces of legislation. Kansas consumers in many parts of the state, are concerned about their price of electric energy.

Generally, Kansas consumers seem to be saying that the current legislative and regulatory system as it applies to electric public utilities has not produced electric energy at prices with which they are satisfied, and electric system reliability has been called into serious question by recent events. Thus, many Kansas consumers, including the KIC, believe that new initiatives at both the Kansas Legislature and the Kansas Corporation Commission are needed to address the concerns of most Kansans as to the price of electric energy to them and the reliability of their electric service. A modernization of Kansas statutes and regulations is in order, and the Electric Restructuring Act is quite timely before the Kansas Legislature. Indeed, approximately twenty states have enacted electric public utility restructuring in some form, with almost all of the other remaining states reviewing issues related to the price and reliability of electric service.

THE PROPOSED ELECTRIC INDUSTRY RESTRUCTURING IN KANSAS:

The KIC generally supports electric industry restructuring that provides for competition to replace regulation in those areas in which competition will have the effect of lowering prices and increasing the

level of service. Clearly, as contemplated in the proposed legislation, electric generation services is the area where competition can most clearly be seen as a superior alternative to regulation. One need go no farther in analysis than to review the costs and production of nuclear facilities, to know that the bias in favor of competition at the electric generation level is appropriate. It is only through a regulated monopoly, that an electric public utility can charge a price that will allow it to recover its costs of a nuclear plant. For example, completely setting aside any emotion related to the debate surrounding the costs and use of nuclear power, and looking only at the cold, hard math of the equation, KGE has an imbedded cost in its Wolf Creek Nuclear Generation Plant of approximately 1.4 Billion Dollars, for which it receives 547 MW of capacity. The Kansas City Power & Light Company ("KCPL") would have a similar investment and capacity for its investment in Wolf Creek. In comparison, Western Resources owns 1839 MW (KPL's share 1401 MW; KGE's share 438 MW) of capacity at its Jeffrey Energy Center (coal fired), which has a carrying cost of approximately \$969 Million.

Clearly, the proposed electric industry restructuring which removes generation services from a monopoly, cost pass through basis to the concept of "competitive generation providers" is a correct position, which is fully supported by KIC.

Second, KIC fully supports the "netting" of all affiliated generation assets. This concept of "netting" higher cost generation assets against lower cost generation assets among affiliated companies generation asset portfolio, is not only fair to all parties, but reflects economic common sense. It would be completely unreasonable to charge electric consumers any type of "transition costs" to, in effect, bring a non-competitively price generation plant back to a competitive level, without making a concurrent adjustment to a generation plant that has a cost structure that is substantially below market level. In the view of KIC, if a utility proposes to participate as a beneficiary of transition costs, it must share the benefits of the continued use of below market cost generation. The compelling need for netting is clearly evident

when one considers the fact that consumers have paid rates that allowed for the return of capital, and a return on capital, for all of the generation assets of affiliated companies, no matter what their cost.

KIC further notes, in the case of KGE, KPL, and KCPL, that if those companies complete their merger as proposed, all utility assets would be conveyed to and owned by a new company, Westar Energy. In that instance, a single and unitary company will own all of the assets in question for KGE, KPL, and KCPL, and in the view of KIC there will be no issue of netting across affiliate lines, since one company will own all of the generation assets.

Third, KIC strongly opposes the provision of the proposed Electric Restructuring Act, that purports to charge a company transition costs based on its "historic" use of electric energy from a Kansas public utility company. The right to cogeneration -- or as Kansas statutes call it, parallel generation -- is a right granted by federal law. To place on cogenerators what is, in effect, a Kansas tax would be, in the opinion of KIC, an unlawful penalty on a right granted by the federal government. Further, proposing such an unlawful state tax on cogeneration that takes place on or after January 1, 1999, would have the effect of retroactively taxing or penalizing an entity, which is not permitted under either the United States or Kansas Constitutions.

Not only is the proposed provision unlawful in the opinion of KIC, but it is bad economic policy. Cogeneration units are producers of electric energy, and are potential competitive generation providers to the extent that they have available and sell electric energy in an amount that is in excess of the electric energy needs of the particular manufacturing operation for which they serve as a primary power source.

KIC strongly opposes the collection of transition charges on a per kwh basis ("energy charge basis"). KIC Members and business consumers, generally, use electric energy at a much higher rate throughout the year than do residential consumers. Clearly, the generation facilities constructed in Kansas

are sized to serve the peak load of residential consumers, which use the bulk of their electric energy for air conditioning in the Summer months. Thus, when transition charges are collected on an energy use basis, consumers that utilize electricity on a comparatively even basis throughout the year, will pay an inordinate amount of such transition costs, even though their energy use consumption profiles were not the cause for the construction of such large, peak serving electric generation facilities. More appropriately, and consistent with the manner in which rates are set throughout the United States, transition costs recovery should be based on the peak demand of customer classes on the generation system assets.

Next, KIC does not support the provision of the proposed electric industry restructuring legislation that would prohibit electric energy sales by municipalities or electric cooperatives that have elected not to participate in competitive retail markets in their service territories. The prohibition imposed on such municipalities or electric cooperatives, is only a prohibition against selling into areas in retail competition with other service providers. There is no prohibition included in the proposed legislation, that would prohibit such municipalities or electric cooperatives from selling electric energy to competitive generation suppliers. Thus, the end result is to remove a class of competitive supplier from competing directly for the business of KIC Members, while in all likelihood, that same class of supplier will be supplying electric energy to competitive generation suppliers. These competitive generation suppliers will, in turn, sell such electric energy to Members of KIC, after adding their profit margin to the transaction. In this described transaction, KIC Members receive electric energy produced by municipalities or electric cooperatives, but pay an additional, unnecessary profit margin to competitive generation suppliers.

KIC supports, in the strongest possible manner, the proposed legislation's requirement for open access and non-discrimination on the transmission and distribution assets of electric public utilities in the State of Kansas. Any other position would be an unwise retreat and recharacterization of what have historically been "public" utility assets.

KIC, however, cannot support the creation of a type of "universal service fund" that is to have the effect of roughly equalizing distribution costs of electric public utilities throughout the State of Kansas. There is no corollary provision for equalizing electric generation or electric transmission assets throughout the State of Kansas, even though there would appear to be a far wider range of costs in these areas than in the area of local distribution. Indeed, the proposed legislation prohibits equalizing stranded costs of electric generation assets among the various systems throughout the State of Kansas, and requires such transition costs to be paid for by consumers in the service territory previously served by the non-competitive, electric generation assets.

This Testimony, of necessity, must be limited because of considerations of time and the need for all parties to have an opportunity to present their views to the Kansas Legislature. Thus, this testimony is not intended to be an all inclusive statement of the position of KIC with regard to such extensive, proposed legislation. As the discussion of electric industry restructuring goes forward in the State of Kansas, KIC would be pleased to appear and offer testimony for consideration on future occasions on particular points or issues that the Kansas Legislature may choose to hear further discussion.

Thank you for your consideration of this Testimony.

James P. Zakoura
For
SMITHYMAN & ZAKOURA, CHARTERED
Attorneys for the Kansas Industrial Consumers

Exhibit A

The Kansas Industrial Consumers

The Boeing Company

Cargill, Inc.

CertainTeed Corporation

Equilon Enterprises, L.L.C.

General Motors Corporation

Hercules Cement Company dba Heartland Cement Company

LaFarge Corporation

Owens-Corning Fiberglas Corporation

Raytheon Aircraft Company

Statement Before The House Utilities Committee
Proposed Electric Restructuring Act of Kansas
Terry Keller, Manager of Resource Administration and Energy Management
The Boeing Company

Good morning, I am Terry Keller, Manager of Resource Administration and Energy Management for the Wichita Division of The Boeing Company. On behalf of The Boeing Company I would like to express our appreciation for this opportunity to share Boeing's observations on the issue of electric utility restructuring in Kansas. Although I am speaking today on behalf of The Boeing Company, I am confident my remarks will generally reflect the attitude of other large industrial users in Kansas.

Before I share these observations with you, I would like to share some background information with you, which may place my later comments in their proper context and perspective.

Today, The Boeing Company has a presence in twenty-seven states, and our employment exceeds 225,000. The number of employees in Kansas has grown from 14,800 at the end of 1995, to over 20,000 workers today.

We are now delivering more commercial airplanes per month than ever before in our history. With a significant portion of each Boeing airplane built in Kansas, including seventy-five percent of the 737, that's great economic news for our state.

If I asked you to name the primary competitor for Boeing, you would probably say "Airbus" and you would be right. But for Boeing Wichita, our major competitors are the other divisions of Boeing, competing for work in their states. And believe me, with a presence now in twenty-seven states, that competition has increased significantly.

So where does retail wheeling fit into this description of Boeing? Clearly, for Boeing to be competitive in the international market, and for Boeing Wichita

to remain a competitive production facility for The Boeing Company, we must continuously reduce our cost of doing business. Failure to do so can cost us irreplaceable market share during the next twenty years, when our market research indicates our 16,000 airplanes will be required worldwide at an estimated value of one trillion dollars.

One of the most significant issues impacting the future viability of Boeing's Wichita facility today is retail wheeling. Let there be no mistake about what our position is concerning this issue. We favor the full and responsible implementation of retail wheeling and will be working to help assure its timely enactment. It continues to be one of our top legislative issues.

We believe that retail wheeling will benefit residential, commercial, and industrial consumers. No one has to lose, despite what you may hear. There are no losers when consumers have a choice in selecting their particular type of service in a free and open market.

For Boeing Wichita that choice is very important. In addition to our large manufacturing and lighting loads, we have demand tied to temperature, both heating and cooling, which our sister divisions in California and Washington state do not experience. Our consumption of electricity in the last twelve months at our Wichita facility was approximately 550 million - kilowatt hours. Every tenth of a cent change in our per KWH charge translates into \$550,000 of cost on an annual basis. Costs which put us at a further disadvantage over other operating locations and which in the bigger picture make Kansas a less attractive location for all manufacturers to maintain and expand their businesses.

While we support retail wheeling for its benefits to all electric consumers, and for the opportunity to significantly reduce manufacturing costs, we are very, very concerned with the proposed handling of stranded costs – specifically as a per kilowatt hour surcharge to ratepayers.

First of all, it is questionable if there are any net stranded costs in Kansas. This is perhaps the most contentious issue related to retail wheeling and I don't propose to use my brief time to debate this subject. I will say that Boeing agrees with the National Regulatory Research Institute report completed for The Kansas Corporation Commission, which concludes that once stranded costs are combined with stranded benefits under retail competition, Western Resources – and a combined Western Resources and Kansas City Power and Light – have no projected net generation stranded costs in Kansas. But what if stranded costs are deemed to exist and then passed on to consumers? Western Resources has estimated its stranded costs to be in the range of 2.4 to 2.7 billion dollars. A preliminary analysis indicates that stranded costs of this magnitude would amount to 13.39 cents per kilowatt hour for one years consumption. (\$2.55 billion/20,165,742 MWH) while these stranded costs could be collected over a number of years, on a present value basis, the quantity would still amount to

approximately 13.39 cents per kilowatt-hour for all electric consumption for a one year period. For Boeing Wichita, that equates to almost seventy-five million dollars added to our cost of doing business – and that is a cost Boeing and Kansas cannot afford.

As there are no provisions contained in our contract which provide for interruption in our service, we believe we are the largest firm power customer on the Western Resource system. In addition, we believe we are unique in that we take power off the grid at 138 KV; which to our knowledge is higher than any end-user customer. In addition, we have invested millions of dollars of our own capital in two substations, which we operate and maintain, in order to step-down the power we use in our facilities. As evidence of the value we continue to place on firm non-interruptible power, each of the substations, which are located on opposite ends of our complex, is adequately sized to supply our full

requirements, should the lines into the stations or the stations themselves be rendered inoperable.

Despite all of these provisions to assure reliable power to our plant, we like other firm service customers; residential, commercial and industrial were notified this past summer that “voluntary” curtailments would be necessary to avoid brown-outs or rolling black-outs on the Western system. We, like many others who thought of Western Resources as having adequate generating capacity, were surprised to learn that one of the factors which contributed to these events was that Western Resources had committed 7 ½% of their total capacity outside their certified territory.

In our opinion if Kansas electric consumers; residential, commercial and industrial have an absolute obligation to purchase from a certificated utility, the certificated utility has a corresponding absolute obligation to serve those consumers with sufficient and efficient service.

In our opinion the captive Kansas ratepayers who have paid in the past, are paying now, and will pay in the future for Western generating capacity should not by any test of equity be relegated involuntarily to interruptions in service; while ratepayers in areas not certificated to Western are provided priority service. If in fact it is determined that there are stranded costs on the Western Resource system, one can only wonder what share would be absorbed by these highest priority customers?

In our opinion it is no longer a question of if retail wheeling will come to Kansas, but rather when will it come to Kansas?

In our opinion, your deliberations of the Electric Restructuring Act are not only timely but necessary as an important step toward free and open markets for competitively priced, reliable power for all Kansans.

We applaud your efforts and stand ready to be of whatever assistance we can to assist you in your efforts.

THE PROPOSED ELECTRIC UTILITY RESTRUCTURING ACT OF KANSAS
HOUSE BILL NO. 2025
BEFORE THE COMMITTEE ON UTILITIES
TESTIMONY OF BEHALF OF RAYTHEON AIRCRAFT

INTRODUCTION:

Chairperson Holmes, Committee members. I am Dennis Hanson, Group Manager of Facilities and Equipment at Raytheon Aircraft. Our company is a world leader in the manufacture and service of business and special mission aircraft. We operate more than four million square feet of facilities in Wichita and employ some 8,700 people, and have more than 500,000 square feet in Salina, where we employ almost 600. Our total Kansas employment is 9,315, our total payroll in the state is approximately \$500 million and we annually purchase more than \$358 million from Kansas suppliers.

POSITION STATEMENT:

In the interest of time, it is not my intent to discuss in detail the pressing issues involved in this legislation. Raytheon Aircraft agrees with the testimony presented by Jim Zakoura on behalf of Kansas Industrial Consumers ("KIC"), of which we are a supportive member on this issue.

It is important, however, that we discuss the impact to Raytheon Aircraft of delaying this legislation further, as well as the impact to all other consumers.

We believe the electrical shortages experienced during the summer of 1998 can be partially attributed to the lack of firm direction for Retail Wheeling in Kansas.

Failure to move forward on this issue can only continue to hinder the competitiveness of Kansas industry. Companies with national operations are in a transition period, with some facilities having rate competition and others without. Just as

HOUSE UTILITIES

DATE: 2-15-99

ATTACHMENT 4

utility companies have been reluctant to add generation capacity, many companies are facing difficult decisions regarding expansion or consolidations of their operations. The continued lack of firm legislation in Kansas can have a detrimental effect on those decisions.

A possible alternative – which would provide a faster resolution to this issue -- may be to initiate a program that would allow a number of the state's largest users to begin securing peaking capacity contracts through off-system purchases. This would allow a transition into retail competition (pilot program) and could negate KGE and KPL's need to add capacity to their Gordon Evans generation facility. The amount of time to bring these new facilities on-line will not provide relief for the near term and will increase any potential transition recovery costs once competition is enacted.

The final point that I would like to raise regards the recovery of transition costs. It does not appear to be clear how or if transition costs are spread across off-system, wholesale sales. Transition cost recovery is available through application to FERC for wholesale transactions. It is vital that any off-system wholesale transactions are burdened with the same transition cost recovery as those experienced by certified territory customers.

Thank you for this opportunity to address you today.

Before the House Utilities Committee
H.B. 2025

THE CITIZENS' UTILITY RATEPAYER BOARD
by Walker Hendrix, Consumer Counsel

Retail wheeling is most strongly advocated among consumers in the state with high rates, caused by uneconomic investment in generating facilities. Because of a failure of regulation at the federal and state levels and because of restrictions which were placed on fuel use in the 1970s, our utilities embarked on several plant construction projects which by current standards would be uneconomic. Some of the construction projects were designed in part to take advantage of the state regulatory process which rewarded utilities for building bigger and more expensive plants to establish rates with higher revenue streams that could be achieved under rate of return regulation. Although some plant expansion would have been necessitated by growth in electric use, the investor owned utilities built three plants at the Jefferies Energy Center, two plants at LaCygne, Kansas, and the Wolf Creek Nuclear Generating Facility. The rural electric cooperatives also were swept into the construction mania of that time with KEPCO taking a 6% interest in Wolf Creek and Sunflower Electric Cooperative building its Holcomb plant. At the same time, BPU was building its Nearman plant. It would be safe to say that this construction resulted in overcapacity for electric generation in Kansas. It also fostered the plant siting act. Additionally, these plants were built at the time of considerable inflation, and because of the regulatory treatment for construction work in progress and changing environmental and safety standards, these plants became very expensive to construct.

Given breakthroughs in gas turbine technology and more reasonable financing, it is easy to see how the market clearing price for electricity with deregulated generation would be lower in many parts of Kansas than the cost of electricity under regulation. This economic phenomenon is notable in South Central Kansas with Wolf Creek and in most rural areas of Kansas served by

HOUSE UTILITIES
DATE: 2-15-99
ATTACHMENT 5

rural cooperatives. One exception is Northeast Kansas which is served by Western Resources's KPL division. The rates for electricity in Northeast Kansas are below the national average. Consequently, Kansas is a patch work quilt of relatively high rates and low rates.

With more favorable economic conditions, retail wheeling advocates have pointed to the overearnings of some of the electric utilities as a basis for change. In recent cases before the Kansas Corporation Commission, Western Resources and its subsidiary Kansas Gas and Electric Co., as well as Kansas City Power and Light Company were found to be overearning. In settlement agreements, Western Resources agreed to phase in rate reductions equaling \$75 million per year and KCPL agreed to a rate reduction of \$14.2 million per year. These reductions were fostered for the most part by lower financing charges and increased electric sales, reflecting conditions in which these utilities were earning more than they would otherwise have been entitled to after a review of their rates.

Given this history, it is not difficult to understand why the utilities are opposed to some of the provisions in the retail wheeling bill. This becomes especially true where stranded investment would cause some companies to absorb the uneconomic investment which may be established for them in hearings before the Corporation Commission. Although there is some suggestion in the report that there may be a stranded investment component, there is a body of opinion which would suggest that the investor owned utilities have no stranded investment when the utilities are analyzed on a net cash flow basis. Consequently, the utilities could fear retail wheeling and competition because they would result in lower revenue streams and reduced profit margins.

Because there is a genuine concern on the part of all participants on the impact of retail wheeling and whether rates will rise or fall with its implementation, there is a natural tendency to want to delay starting it. As most of us fear, retail wheeling will occur either as a federal mandate or as a consequence of neighboring states implementing it. Oklahoma has its own retail wheeling plan in place. Illinois has just passed retail wheeling legislation.

The concern about retail wheeling may be offset by instituting consumer protections as part of a retail wheeling plan. The proposed bill does have several good features. First, it requires that a utility net all plant to determine the amount of utility investment which is stranded. This process would entail averaging the value of below market plant with above market plant. This approach lowers the overall amount of stranded investment and gives consumers the benefit of plants which are more economic. The bill also requires that utilities look at their stranded investment as one corporate entity and prevents them from avoiding the netting rule by placing uneconomic investment under a subsidiary company.

Second, the bill requires that all stranded investment be mitigated and verifiable. This allows the Corporation Commission to only allow for the recovery of stranded investment which is prudent. The Commission can further reduce stranded investment based on an eight step analysis.

Third, residential and small commercial customers were assisted when the Task Force concluded that any recoverable stranded investment be assessed on a per kilowatt hour basis. This has the effect of causing large consumers to bear more of the stranded investment based on their usage.

Fourth, the Task Force approved a public information plan. This would enable CURB and the Corporation Commission to develop a public information campaign. It would require providers to identify sources of supply which were produced with renewable energy sources. It would also require disclosure standards so that consumers could compare price, price variability, contract terms and conditions, resource mix and the environmental characteristics of their electricity purchases.

Notwithstanding, some of the noble provisions in the proposed bill, CURB has concern about its contents. CURB voiced concern about totally deregulating generation before it was concluded that there was effective competition to control the price of generation. With the

merger proposal between Western Resources and KCPL, there may be too much market power on a vertical and horizontal level, which, in turn, could result in price manipulation. CURB requested that the Corporation Commission be given sufficient authority to establish transitional regulations which would establish and maintain competition in Kansas. Additionally, the Corporation Commission should retain jurisdiction until such time as effective competition is demonstrated in the electric markets in Kansas.

CURB was outspoken in tying any transition to retail wheeling to a rate reduction plan. If rates cannot be reduced as a consequence of competition, there is certainly no political basis for implementing retail wheeling. Massachusetts and Illinois have tied their legislation to rate reductions as high as 15%.

CURB proposed that a sharing of stranded costs be mandated between utility shareholders and investors. Under the bill as drafted, the decision on who should bear the uneconomic investment in utility plant is now left entirely to the discretion of the Corporation Commission.

Finally, CURB opposed the plan to allow utilities the ability to implement a plan of securitization. This would allow utilities to refinance 50% of their stranded investment. Although this could reduce the cost of the utility's existing debt, it would also fix the rate of recovery in a manner which would not allow reductions in the amount of the debt financed, in the event that stranded investment decreased with higher market clearing prices. As a result, there is some risk that consumers could pay off more stranded costs than would otherwise be necessary.

In conclusion, CURB wishes to be supportive of the work done by the Task Force. It also recognizes that there are some measures which can be implemented to reduce rates in certain high cost areas of Kansas. Like many participants, CURB fears that if rate concessions cannot be made to consumers as part of a plan of deregulation, there is very little reason to implement such a plan. However, CURB believes that any effort on the part of utilities in delaying retail

wheeling is motivated by the fact that their current rates are based on the uneconomic plant investment which was made in the 1970s. To that extent, it should be recognized that many consumers are paying rates which do not reflect the lower economic value that the market places on the service they receive.

TESTIMONY ON HB 2025
 Before House Utilities Committee
 February 15, 1999

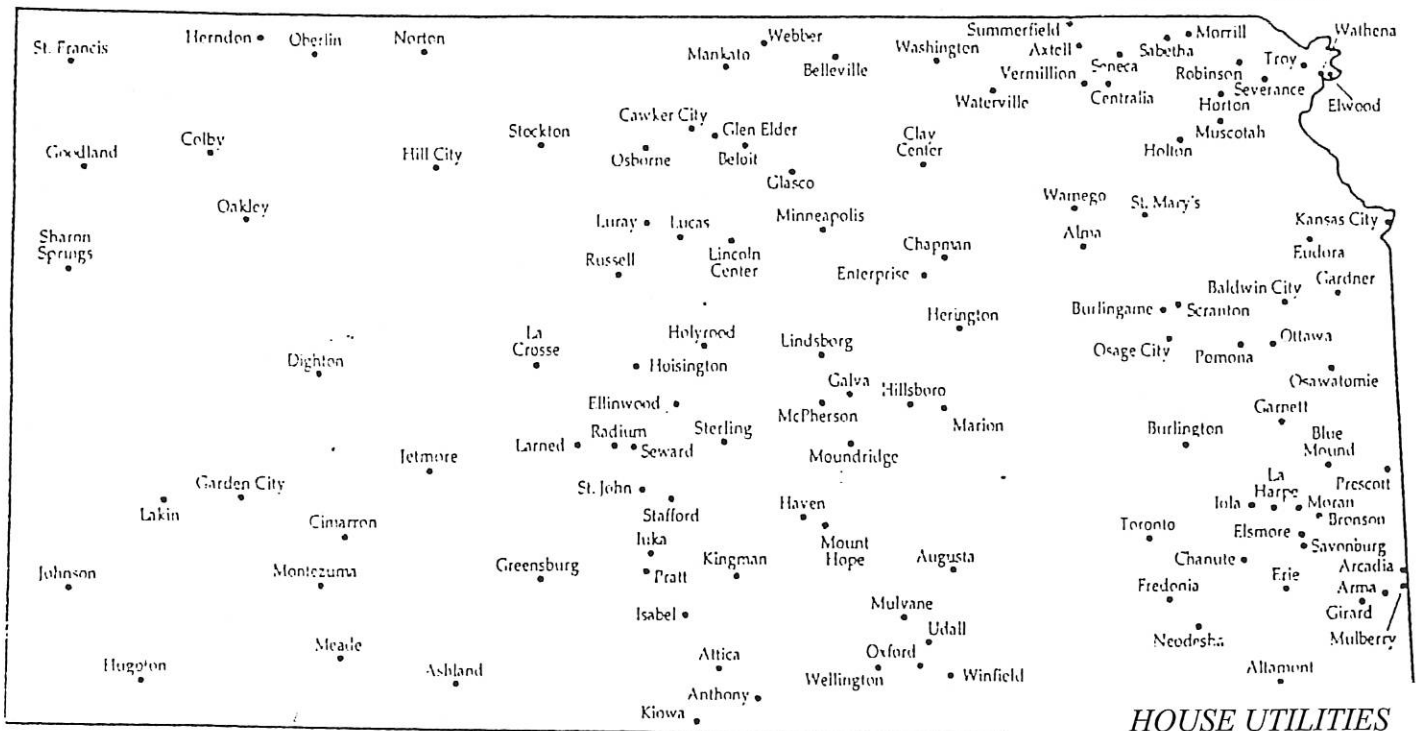
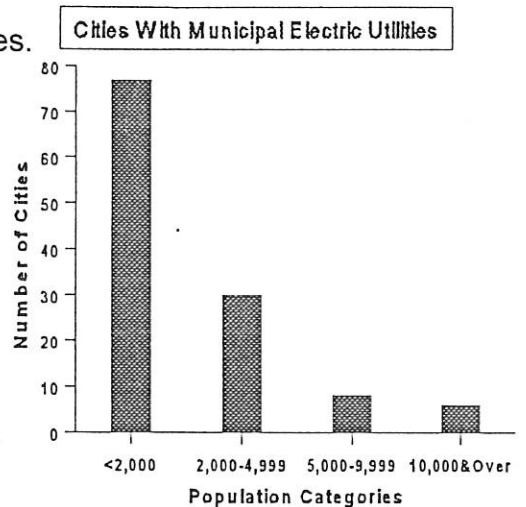
Mr. Chairman, members of the committee, I am Louis Stroup, Jr., executive director of Kansas Municipal Utilities, Inc., a statewide association of municipal electric, gas and water cities which was founded in 1928. Also with me is Jim Widener, general manager of the Kansas Municipal Energy Agency, Overland Park.

Types of municipal utilities

Water -- a majority of the state's 627 cities operate their own water systems.

Gas -- there are 71 municipal gas distribution cities.

Electric -- there are 121 municipal electric cities in Kansas, representing 19% of the cities and 18% of all Kansas citizens. Most serve small cities. 77 serve cities of the third class (i.e., less than 2,000 population). Webber is the smallest of these with 39 residents. 63 of the cities generate part or all of their electric energy supplies and the remaining 58 cities purchase all of their electric energy needs. Municipal power is an American tradition that works well in Kansas, one that began more than 100 years ago. Our consumers are our friends, our neighbors and our families.



HOUSE UTILITIES

DATE: 2-15-99

ATTACHMENT 6

General comments

During the last 2 plus years of debate before the Kansas Legislature and the Kansas Legislative Retail Wheeling Task Force, KMU showed there was a difference between municipal utilities which are owned by the citizens they serve and operated by locally-elected officials and other utilities such as private power companies, power brokers, and marketers who exist to provide profits for shareholders spread across the United States and elsewhere.

HB 2025 recognizes those differences by providing an exemption for municipal electric cities and an "opt in" provision. We appreciate the understanding shown by the task force members and the recommendations contained in the final report which acknowledges the inherent differences we have cited during the debates.

Because of time constraints, it is not possible to discuss all the details we have provided over the last 2 years. However, for background purposes, I have attached 2 documents:

- Statement of Position and Recommendations of Kansas Municipal Electric Cities Concerning Retail Electric Wheeling, and
- An executive summary of "The Impact of Retail Wheeling on Municipal Electric Utilities in Kansas" by the Kansas Public Finance Center, Hugo Wall School of Urban & Public Affairs, Wichita State University (1997).

Retention of key legislative provisions essential

Any retail wheeling legislation must contain the following key points for cities or municipal electric cities would strongly object to the legislation. HB 2025 does contain some of the provisions shown below. Any deletion would be opposed by municipal electric cities:

- Exemption for municipal electric cities from the proposed Act.
- Opt-in provision for municipal electric cities.
- No changes relating to existing distribution service territories, including annexation procedures.
- Satisfactory mitigation of tax and franchise fee revenue impacts on local and state units of government prior to implementation of retail wheeling in the state. (Not in bill).

- Maintain municipal control of rights-of-way. (Not in bill).
- No jurisdiction over municipal electric cities by the Kansas Corporation Commission unless a city chooses to compete outside its own electric retail territory.

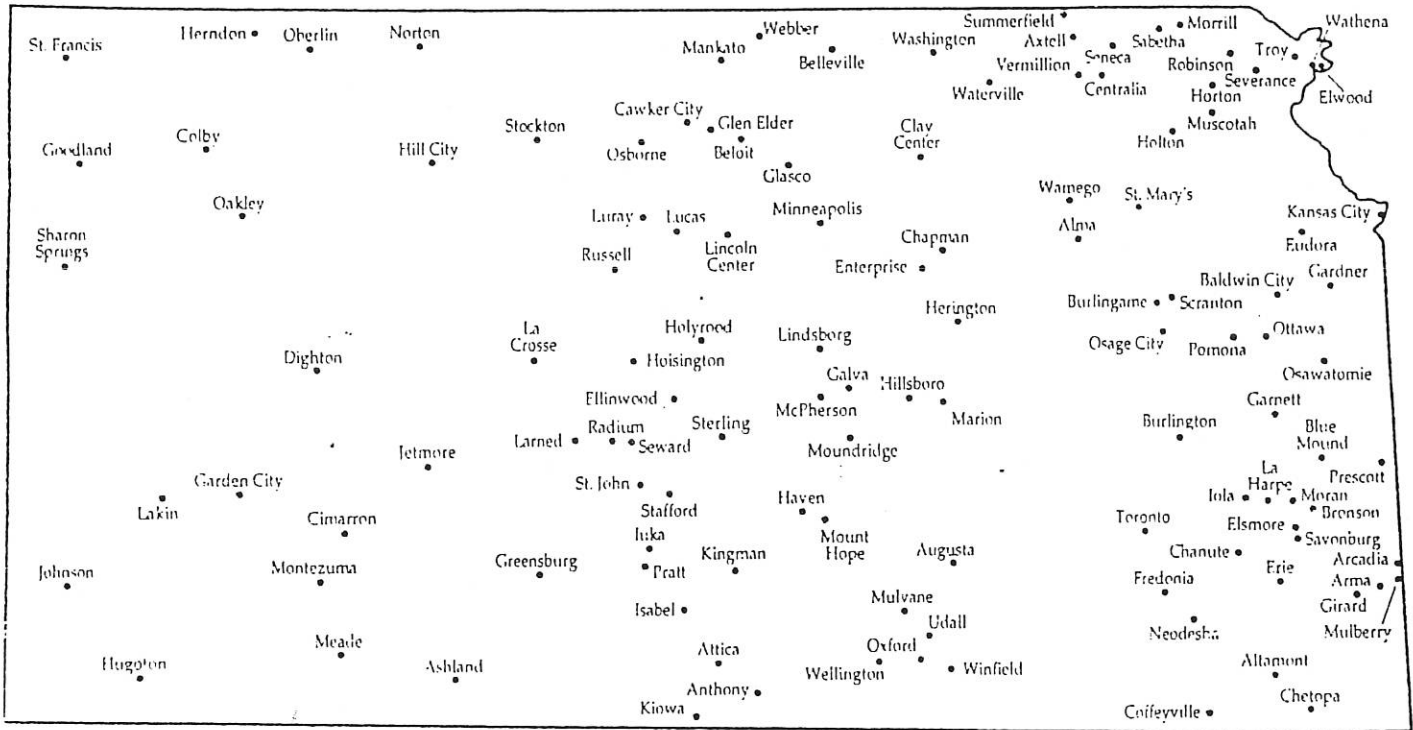
Major concerns relating to any retail wheeling legislation

- As mentioned before, one major issue not yet solved is the mitigation of tax and franchise fee problems related to retail wheeling. KMU feels these questions must be answered satisfactorily before retail wheeling could be implemented.
- The Kansas legislature has the time to get it right -- to move slowly and learn from mistakes that have been or will be made in other states. KMU urges caution concerning at what point in time, or if at all, it is proper to implement retail wheeling in Kansas. We are concerned about the impact on Kansas customers and Kansas utilities if Kansas steps forward before the surrounding states. We must make sure both these groups are not disadvantaged. Kansas is not a high priced state.
- Reliability and safety remain deep concerns to municipal electric cities. We have seen where many private power companies across the country, in preparing for competition, have cut costs and deferred maintenance.
- We are concerned that mergers, market dominance and the ongoing consolidation of existing electric utilities and other energy industry companies are likely to lead to abuse of economic power and manipulation of energy markets to maximize profits at the expense of consumers.

Recommendations

- KMU recommends that Kansas goes slowly in implementing retail wheeling, if at all. The state may find that retail wheeling would have little benefit to Kansas as a whole. In the meantime, the state should position itself to be ready to implement retail wheeling if and when it is determined it would be good for all electric customers in the state, not just large industrial customers.
- Double check the impact on residential and small commercial consumers, who we feel will be harmed by retail wheeling. We are concerned with the early returns from states such as California and New Hampshire where marketers such as Enron and others, who initially promised to take care of the residential market, have pulled out.

**STATEMENT OF POSITION AND RECOMMENDATIONS
OF KANSAS MUNICIPAL ELECTRIC CITIES
CONCERNING RETAIL ELECTRIC WHEELING**



July 1997

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STATEMENT OF POSITION AND RECOMMENDATIONS OF KANSAS MUNICIPAL ELECTRIC CITIES CONCERNING RETAIL ELECTRIC WHEELING

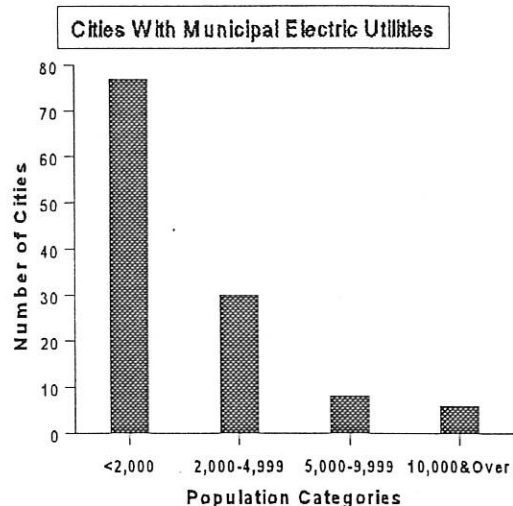
1. INTRODUCTION

It all began in 1888. That was the year in which the first municipal electric system was established in Kansas in Herington. Following on the heels of Herington's innovation came new municipal electric systems in Beloit and Osage City in 1890 and then LaHarpe in 1899. Shortly after the turn of the century, municipal electric systems began to proliferate across Kansas, and by 1930 there were 105 systems in operation.

Cities have actually been in the lighting business in Kansas for 135 years--literally since day one. Within our first years of statehood, state lawmakers assigned cities the job of lighting the developed communities of our state. In 1862 lighting was done with coal oil or gas, of course--the light bulb was not invented for another 20 years.

Today there are 121 municipal electric utilities in Kansas, representing 19% of the cities and 18% of all Kansas citizens. Most serve small cities. For example, 77 municipal electric systems serve cities of the third class (i.e., less than 2,000 population). Webber is the smallest of these with 39 residents. In these cities the electric utility is an integral part of municipal government operations, and it generates a major source of the revenue for both electric utility and general city government purposes. Residents of cities with municipal electric utilities benefit extensively from community ownership of their utility through lower property taxes, enhanced street lighting systems, lower electric utility rates, and discounted electric service at city facilities.

Sixty-three (63) of the 121 municipal electric systems generate part or all of their energy needs, but 58 systems (48%) purchase all their electric energy supplies. In 1995 municipal electric systems served 17.9% of the 1.3 million electric customers statewide. In comparison, private electric utilities served 67.5% of the customer base and rural electric cooperatives served 14.6%.



How cost-effective are municipal electric utilities? Although they generate revenues that support a significant level of property tax relief and enhanced services to their customers and communities, in 1995 Kansas municipal electric utilities ranked **lowest** in average revenues (in cents per kilowatt-hour) from residential customers, industrial customers, and all three classes of customers combined. Only in average revenues from commercial customers does the ranking of municipal electric utilities fall between private utilities and cooperatives. The following table illustrates the competitive ranking of the three categories of utilities by customer class in Kansas and the United States.

Comparison of Electric Revenues in 1995
Average Revenue per Kilowatt-Hour
in Cents per kWh*

	Residential	Commercial	Industrial	All Classes	Adj. Avg.**
<u>U.S.</u>					
Municipal	6.72	6.65	4.73	6.02	6.03
Private	8.87	7.87	4.77	7.15	7.17
Cooperative	7.71	7.34	4.50	6.92	6.52
<u>KANSAS</u>					
Municipal	7.36	6.47	4.28	6.02	6.04
Private	7.68	6.44	4.73	6.37	6.28
Cooperative	9.44	9.62	6.42	8.85	8.49

* Source: "The Impact of Retail Wheeling on Municipal Electric Utilities in Kansas," Hugo Wall School of Urban and Public Affairs, March 1997.

**"Adjusted Average" is the average for residential, commercial and industrial retail customer categories.

2. LOCAL CONTROL AND HOME RULE

Kansas ranks fourth in the nation in the number of cities served by municipal electric utilities--in part because of a state policy of local control of municipal utilities. This fundamental state policy has been reaffirmed at critical junctures in Kansas history because of a deeply-rooted commitment by Kansans to local self-determination. Our state constitution embodies this basic principle in Article 12, Sec. 5, known widely as the "Home Rule Amendment," which empowers cities to control their local affairs and government. In addition to fostering the growth of municipal systems with affordable electric rates, this policy of local control provides a number of advantages to these cities, including:

- **Local Decisions By Local Officials.** The public is able to hold locally elected officials accountable for the operation of their community-owned and operated electric utility. No one has to travel to a far-off corporate headquarters or Topeka to resolve a dispute.
- **Accountable To Electors.** The board of directors of the municipal electric utility, the city governing body or board of public utilities, are elected and "unelected" based in part on their success in managing this important community asset.
- **Taxpayer Dividend: In-Lieu of Tax Payments and Fund Transfers.** Excess revenues received by municipal electric utilities represent a valuable "taxpayer dividend" in the form of *in-lieu of tax* payments and fund transfers which finance a host of municipal and

community programs, including electricity for street lighting, Christmas lights, senior citizen rebates, baseball fields, Boy Scout facilities, city halls, community centers, and other public facilities (e.g., zoo in Garden City). Furthermore, the use of utility employees for general city functions significantly enhances the value of this community asset. The taxpayers in these cities would pay substantially higher property taxes if these revenues were not available to help fund these community functions.

- **Local Decisions Generally Best.** Municipal electric utilities have achieved a high level of service at a competitively low cost while providing ultimate community control and benefits. In these cities, electricity is an essential community service, not just a commodity, similar to fire and police protection, water, natural gas, sewer or refuse collection.

POSITION AND RECOMMENDATIONS:

- ◆ Provide explicit exemption for municipal electric utilities from mandatory retail wheeling.
- ◆ Allow municipal governing bodies discretionary authority to participate in retail wheeling on an optional basis.
- ◆ Preserve home rule by retaining the exemption of municipal electric utilities from regulation by Kansas Corporation Commission.

3. PROPERTY TAX INCREASES

Retail wheeling presents five separate, but interrelated, threats to property taxpayers in Kansas that should be given serious consideration: ❶ potential loss of a substantial portion of private utility property valuation due to assessment at a lower classification rate; ❷ potential loss of the substantial in-lieu of tax support for municipal and community programs by municipal electric systems; ❸ potential loss of electric utility franchise fee revenue in cities served by private utilities; ❹ potential loss of the federal tax-exempt status of municipal utility revenue bonds; and ❺ potential imposition of property taxes on municipal electric utility property. Each of these impacts would require an overhaul of the current property tax lid. Some specifics are as follows:

- **Tax Increases Due to Lost Valuation.** Last legislative session, the Property Valuation Division (PVD) reported that retail wheeling could potentially lead to a dramatic decrease in the assessed valuation of private utility generation, transmission and distribution system property. This could occur if such property is no longer assessed as utility property (@33% of market value) and instead is assessed as commercial and industrial machinery and equipment (@25% of market value/7 year straight line depreciation). This change for private utility generating plant property alone, PVD indicated, could result in a loss statewide in assessed valuation of \$351.6 million. This represents a loss of 2% of the total tax base and a 37% reduction in valuation and revenue from this classification of property. Part of this loss will be felt in state-mandated school finance revenues. For local governments with few tax options, this impact could be devastating.

- **Tax Increases in Municipal Electric Utility Cities.** The authors of a recent Wichita State University study concluded that the average municipal electric city would have to increase property taxes 26.295 mills to offset the loss of over \$37 million in-lieu of tax and fund transfer payments for nonutility city activities (see Section 2). As the following chart illustrates, taxpayers in small cities would be the hardest hit.

Property Tax Implications from Loss of Utility Transfers by Kansas Municipal Electric Utilities for Fiscal Year Ended December 31, 1995*

Population Range of Cities	Average Total Transfers per Capita	Average "Mills" to Pay for Loss of Electric Utility Transfers	Average Percent (%) Increase in Mill Levy
Under 500	\$99.58	49.342 mills	135.03%
500-1,000	\$73.38	32.522 mills	97.61%
1,000-1,500	\$113.71	39.145 mills	114.81%
1,500-2,500	\$120.57	42.450 mills	91.78%
2,500-3,500	\$89.35	26.787 mills	74.52%
3,500-5,000	\$71.24	23.034 mills	50.38%
5,000-10,000	\$85.04	26.549 mills	75.15%
10,000-20,000	\$76.24	22.730 mills	47.59%
Over 20,000	\$79.34	21.926 mills	36.90%
Average	\$87.36	26.295 mills	53.71%

Source: Compiled from 1995 population and 1995 assessed valuations for 1996 taxes as published in the *Kansas Government Journal* (January 1996), and transfer amounts based on a survey conducted in Fall 1996 by the League of Kansas Municipalities.

*From study done by Wichita State University's Hugo Wall School of Urban & Public Affairs "The Impact of Retail Wheeling on Municipal Electric Utilities in Kansas" March 1997

- **Tax Increases in Cities Served By Private Utilities.** Most cities in Kansas enter into franchise agreements with private utilities or rural electric cooperatives allowing the streets and public rights-of-way to be used to distribute electric service in the city. A recent League of Kansas Municipalities study revealed that cities derive a substantial portion of revenue from franchise fees paid by private utilities and cooperatives, an amount equivalent to 11% of the total property taxes levied by these cities. If retail wheeling diminishes the retail sales by the private utility which owns the distribution system and franchise in these cities, property taxes may have to be increased to offset the lost revenue. In these cities it would require an average increase in property taxes of 7.474 mills to replace this revenue, an amount equivalent to an increase of 10.41% in city property taxes for taxpayers in 75% of the cities.

- **Tax Increases Due to Loss of Federal Tax-Exempt Status of Municipal Bonds.** Mandatory or optional retail wheeling presents the very likely prospect of the loss of the federal tax-exempt status of electric utility revenue bonds issued by municipalities to finance generation and other equipment. Under the *private use rule* of the Tax Reform Act of 1986, if more than 10% of the electricity sold is outside a municipality's service area, or more than \$15 million worth of electricity is sold outside their service area, then the debt is no longer tax-exempt. Even if municipal electric utilities do not reach either of these thresholds, the loss of any part of the city's customer base due to competition will increase the pressure for either higher rates (promoting further loss of customers) or higher property taxes to finance payments on the outstanding bonds. Finally, municipal electric utilities can refinance their tax-exempt debt with taxable debt, but the higher interest cost will have to be shared with the consumer.
- **Tax Increases If Municipal Plants Become Subject to Taxation.** Some proponents of retail wheeling suggest the exemption from property taxes enjoyed by municipal electric generation facilities should be eliminated. The effect of such a step would be to shift to municipal electric customers and city property taxpayers additional expense for supporting the operations of other local taxing subdivisions. This simply shifts tax dollars from the pocket of one taxing subdivision to another, with no real benefit for the taxpayer.

POSITION AND RECOMMENDATIONS:

- ◆ Provide explicit exemption for municipal electric utilities from mandatory retail wheeling.
- ◆ Allow municipal governing bodies discretionary authority to participate in retail wheeling on an optional basis without regulation by the Kansas Corporation Commission.
- ◆ Amend the state utility franchise law to impose a duty on all companies wheeling power through a franchised distribution system to pay a fee to the city (through the franchisee) at a rate equivalent to the rate required by the franchise agreement between the city and the company owning the distribution system.

If Retail Wheeling Is Mandated:

- ◆ Provide a property tax circuit-breaker type financing mechanism at the state level if necessary to avoid property tax rate increases due to municipal electric utilities losing the tax-exempt status of their federally tax-exempt bonds.
- ◆ Amend the Kansas property tax law to exempt all property taxes levied to replace revenues derived from municipal electric systems, electric utility franchisees, reclassification of private electric utility property, and taxation of municipal electric utility property.
- ◆ Provide additional local option tax authority to local units affected by loss of property tax revenue due to reclassification of public utility generating facilities.

4. RETAIL ELECTRIC SERVICE TERRITORY

Currently, all electric suppliers serve at the retail level on an exclusive or "certified" basis. This insures there will be no duplication of distribution facilities — a state policy since the mid-1970s. Locally elected officials decide who serves within the boundaries of their city for which they are responsible and may grant a franchise to the current supplier when territory is annexed or, in the case of a municipal electric city, may chose to provide service to the annexed area along with streets, fire and police protection, water, sewer and other services. Current state law provides for adequate compensation should the latter occur.

POSITION AND RECOMMENDATIONS:

- ◆ Existing certified territories should be maintained at the retail distribution level, along with the annexation and compensation provisions.
- ◆ No bypass of the distribution and transmission facilities of service providers should be allowed.

5. STRANDED COSTS

Stranded costs represent commitments reasonably incurred by cities to serve electric customers that may go unrecovered if customers take advantage of retail wheeling and get service from another supplier. In this event, someone will pay. Stranded costs might include multi-year power purchase contracts, long-term debt obligations, and lost revenues used to support community services. The major issues are:

- **Outstanding Municipal Debt.** Kansas municipal utilities have \$302.3 million in electric utility debt outstanding, or an average of \$1,331 per customer. Distribution-only cities have little of this debt, only about \$16 per customer. Most of the debt is held by generator cities.
- **Other Debt Obligations.** A narrow interpretation of stranded costs includes only debt directly related to generating capacity. This is the most significant asset likely to become stranded and includes the production facilities of the smaller generating municipalities in a competitive environment. When some customers select competing suppliers under retail wheeling, those remaining have to pick up any remaining debt and a higher proportion of fixed operating costs. By this definition there is \$204 million of principal due and a total debt service of \$424.8 million that extends through the year 2035. After excluding the debt of the Kansas City Board of Public Utilities, there is \$102.6 million of principal due and a total debt service of \$188 million through the year 2035.
- **Capacity At Risk.** The 63 municipal generating cities have a total nameplate capacity of 1,672,801 kW. Of this amount, 846,301 kW could be placed at risk by retail wheeling. At a cost of \$400 per kW, this capacity at risk has a value of \$338 million to 61 of the cities. Capacity owned by Kansas City Board of Public Utilities (606,000 kW) and

McPherson Board of Public Utilities (220,500 kW) would bring the total value of municipal generation capacity to an estimated \$1.15 billion. Who will replace this at risk municipal electric generating capacity?

- **Burden of Accelerated Payoff.** Accelerating the repayment of outstanding debt to avoid stranded costs by municipal electric cities would impose a large financial burden on customers. If costs are to be recovered, recovery should occur over the remaining life of the bonds.
- **Municipal Taxpayers Are Our Shareholders.** A city, unlike a private power company, cannot accelerate depreciation or "write-off" uneconomical assets. Any attempts to shift the burden for stranded costs to shareholders will not work for a municipal utility since city taxpayers are the owners of a municipal utility.
- **Varying Contractual Obligation Positions.** Contractual obligations may vary among the full requirement municipals. For example, some have contracts to purchase all of their requirements exclusively from existing suppliers while others may have take or pay contracts that vary in length and relative quantities. Variations in contractual positions complicate the development of a uniform state policy on stranded costs.

POSITION AND RECOMMENDATIONS:

- ◆ Provide explicit exemption for municipal electric utilities from mandatory retail wheeling.
- ◆ Allow municipal governing bodies discretionary authority to participate in retail wheeling on an optional basis.
- ◆ Avoid placing any new financial obligations (e.g., taxes) on municipalities that elect to participate in retail wheeling to provide additional flexibility in managing stranded costs.

6. UNBUNDLING OF RATES

Municipal electric cities should unbundle their rates into various service components, i.e. production/transmission/distribution/ancillary services. Accounting practices will have to be enhanced in many municipal electric utilities to support the task of unbundling rates.

POSITION AND RECOMMENDATIONS:

- ◆ Unbundling would help municipal electric utilities quantify the impact of losing customers to open access under retail wheeling.
- ◆ Unbundling of rates should be done to point out services provided to the community by municipal electric systems such as street lighting, traffic signals, reduced energy costs to sewer and water systems and other governmental agencies such as schools and counties.

◆ Unbundling also would help municipal systems evaluate whether they would chose to participate in retail wheeling.

7. OTHER CITY CONCERNS

All cities, regardless of whether or not they operate electric systems, may have a number of concerns relating to retail wheeling such as:

- **Rights-of-Way.** Protection and maintenance of public rights-of-way is of paramount importance to cities. These valuable public assets should be used wisely and subject to municipal control to provide essential municipal services.
- **Local Government Revenues.** Protection of local government revenue sources such as property taxes, franchise fees, utility revenues, free services.
- **Universal Service.** If a deregulated electric utility environment is not carefully planned, some of our citizens may find themselves without electric service. In the most difficult situations, citizens could be injured or die if the loss of service causes an emergency. The impact of these emergency situations will be felt at the local level--where the buck stops in the event of emergencies. Who will be electric supplier of last resort?

POSITION AND RECOMMENDATIONS:

◆ Cities should retain all existing authority to control use, excavation, and repair of municipal rights-of-way.

◆ Amend state utility franchise law to impose a duty on all companies wheeling power through a franchised distribution system to pay a fee to the city (through the franchisee) at a rate equivalent to the rate required by the franchise agreement between the city and the company owning the distribution system.

◆ Adopt universal service requirements, financed by participants in the wheeling system, that prevent degradation of existing quality of service to all customers.

8. IMPACT ON CONSUMERS

Municipal electric cities have numerous concerns about enacting retail wheeling in Kansas, including the following:

- Impact on residential customers in both rural and urban areas.
- Impact on both small and large commercial and industrial customers.
- Future capacity planning activities.

- Marginal cost customers under retail wheeling.
- Impact on viability of municipal electric systems.
- Impact on municipal electric system reliability.
- Impact on safety.
- Impact on services, repairing storm damage, etc.

9. RESPONSE TO "LEVEL PLAYING FIELD" DISCUSSION

There is a tired old adage often cited by some power supplier providers that the reason municipal electric cities have lower rates is because the "playing field" isn't level — that municipal electric cities have tax-exempt financing and do not pay taxes. This is not true.

- Municipal electric systems pay substantial amounts of in-lieu taxes as previously mentioned in Section 2 of this paper.
- Five (5) private power companies serving Kansas have collected, but not paid into the U.S. Treasury, a total of \$203.4 million in deferred income taxes. The private power companies also gained benefits through investment tax credits, and lower interests rates through use of tax free bonds. Had these breaks not been available, Kansas City Power & Light would have had to raise its rates by 10.6%, Kansas Gas & Electric by 17.5%, Western Resources by 6.4%, UtiliCorp (Centel) by 1.6% and Empire by 4.5%. *

*Source: Major Tax Subsidies to Investor-Owned Electric Utilities and the Cost to the U.S. Treasury: A Report to the American Public Power Association Prepared by MSB Energy Associates July 15, 1995

**Tax Breaks for Private Power Companies Serving Kansas
(From MSB Energy Associates Report — July 15, 1995)**

<u>Company</u>	<u>Amount of Deferred Income Tax</u>	<u>Investment Tax Credits</u>	<u>Lower Interest Rates - Tax Free Bonds</u>	<u>Total Cost/ Cost to U.S. Treasury (in \$ millions)</u>
Empire	\$ 6.7 million	\$ 0.6 million	\$0.1 million	\$ 7.5/7.1
KCPL	\$78.0 million	\$ 4.3 million	\$7.7 million	\$ 90.1/85.8
KGE	\$86.9 million	\$19.9 million	\$0.3 million	\$107.0/83.4
UtiliCorp (Centel)	\$ 6.2 million	\$ 0.7 million	\$0.4 million	\$ 7.2/7.0
Western	\$25.6 million	\$ 2.2 million	\$2.8 million	\$ 30.6/29.4

- The use of tax-exempt bonds issued for private power companies and cooperatives in Kansas for pollution control facilities and IRB purposes totals \$1.045 billion dollars, according to Moody's Public Utility Manual (1996) and Moody's Municipal and Government Manual (1996). Nearly all this total was issued on behalf of five private power companies for pollution control facilities — one IRB-financed project alone totaled \$40 million. The cooperative total was \$89.1 million.

**Total Tax-Exempt Bonds Issued On Behalf Of
Private Power Companies Serving Kansas**

KGE	\$396.4 million
KPL	\$122.0 million
KCPL	\$418.4 million
Empire	\$ 13.5 million
UtiliCorp (Centel)	\$ 5.7 million

- Municipal electric utilities must make decisions under open meeting laws, while other power suppliers are not required to undergo this scrutiny.

POSITION AND RECOMMENDATIONS:

- ◆ The argument here is not to say private power companies should not benefit from tax-exempt financing, but rather to point out the "playing field" is not tilted — it is level.
- ◆ Preserve the current tax exempt status of municipal electric utilities and bonds issued by such utilities.

10. CONCLUSIONS

The municipal electric utilities of Kansas have a proud history of serving the residents of the 121 cities with reliable, safe and affordable electric utility service. These utilities also have provided related and tangible benefits to their residents, making a lasting contribution to the welfare of their communities. Based on this outstanding track record of service, we respectfully submit there is a basic question of municipal electric officials which has yet to be answered: "What is broken with the current Kansas electric industry?" In fact, there are substantial reasons, many of them enumerated above, to draw the following conclusions:

- Implementation of retail wheeling is unnecessary at this time, and in fact, may be unwise and imprudent in Kansas, a low-cost power state. In short, there may be much more to lose from retail wheeling than to gain. The property tax implications alone counsel moving slowly and carefully.
- Retail wheeling is likely to place at risk the reliable, safe and affordable electric utility services that have become the hallmark of Kansas' municipal electric utilities.
- Kansas should monitor retail wheeling development in the other states before enacting legislation at this time. More answers to these very complicated problems must be forthcoming before this complex, and irreversible, step is taken. We should not allow high-cost states to set Kansas' agenda.

THE IMPACT OF RETAIL WHEELING ON MUNICIPAL ELECTRIC UTILITIES IN KANSAS

- EXECUTIVE SUMMARY -

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Several developments create a movement for deregulation of the electric industry in the United States. These trends include technological advances in generating cheaper power and delivering it to customers over an interconnected power grid, a political environment favoring a reduction in government intervention in markets, and deregulation in industries such as telecommunications, transportation, and natural gas. Furthermore, federal regulation of electric power promotes "wholesale wheeling," or the ability of various energy suppliers to reach wholesale customers over another utility's electric-transmission lines. Currently, federal law prohibits the Federal Energy Regulatory Commission (FERC) from ordering "retail wheeling," but Congress may change the law and allow retail customers to select from among competing electricity suppliers.

The State of Kansas faces pressure to examine existing policies regarding the provision of electricity to consumers. Strict regulation of privately owned utilities contrasts with very limited state involvement in the affairs of municipal electric utilities. In Kansas, however, a few investor-owned utilities dominate the electric power industry. Still, significant numbers of customers receive electricity from many small, rural electric cooperatives and municipal electric utilities. Of the 121 municipal electric utilities in Kansas, 63 are vertically integrated utility systems that can generate, transmit, and distribute electric power locally. These 63 "generator" cities compare with 58 "distributor" cities that only distribute purchased power.

The full report examines the development of municipal electric utilities in Kansas, specifies state policy choices for handling retail competition, and analyzes possible implications of competition for Kansas municipal electric utilities and their customers. This executive summary is organized around the questions covered by the comprehensive report.

Executive Summary - I

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What Are the Policy Implications and the Alternatives Available to the State for Dealing with Municipal Electric Utilities in a Retail Wheeling Environment?

State Policy of Local Control

- For more than one hundred years Kansas lawmakers have embraced a state policy of municipal control of municipally owned electric utilities. This state policy has been challenged and reaffirmed at critical stages in state history. Furthermore, municipal electric utilities have, with few exceptions, been exempted from all state regulation, and state lawmakers have espoused municipal exemption from state regulation repeatedly for 85 years.
- State lawmakers have authorized, and municipal electric utilities in Kansas have formed a municipal joint-action agency in order to respond to changes in the economics of electricity and advances in the technology of electricity. As a result, municipal electric utilities in Kansas have achieved, through interlocal cooperation, economies in the purchase of electricity and enhanced reliability of service through municipal interconnection.
- A state policy of local control requires that locally elected officials be held accountable for the operation of municipal electric utilities. As a consequence, local customers of electricity, taxpayers, and voters are provided with extensive opportunities to seek remedy for any grievances with the electric utility, including the right to vote local officials out of office.
- For state or national lawmakers to take actions that undermine local control of municipal institutions without compelling justification would be contrary to basic principles of U.S. federalism. Moreover, reversing a long-standing feature of local self-government, such as local control of municipal electric utilities, would call for compensation of the full range of losses incurred. Overwhelmingly broader interests are at stake.

National and Regional Context

- States with rates for electricity significantly above national averages are moving quickly to provide customers with access to competitive suppliers. In comparison, Kansas municipal utilities and investor-owned utilities, on average, have rates at or below national averages.
- Electric rates in Kansas are slightly higher on average than those in Colorado and Missouri and significantly higher than those in Nebraska and Oklahoma. State policymakers in these surrounding states are considering the issue of retail wheeling but have not initiated retail competition in electric service as of the date of this report.
- State associations of municipal electrical utilities in states surrounding Kansas generally

Executive Summary - II

oppose immediate action on retail wheeling and support more careful study of the impact of retail competition on consumers and state economies in general.

State Policy Choices

- With respect to municipal electric utilities, three state policy choices--the municipal-island option, the municipal-emasculatation option, and the municipal-choice option--emerge from actions taken to date by state lawmakers in the four states that have enacted legislation implementing retail competition and from legislative proposals in Kansas.
- The municipal-island option prohibits the intrusion of other electric suppliers into a municipality but does not make the municipal utility completely immune from the influence of retail competition in electric service.
- The municipal-emasculatation option eliminates local control of municipally owned electric utilities and establishes state control of the implementation of retail wheeling and of all electric transmission, distribution, and sales in the state.
- The municipal-choice option allows municipal electric utilities to open their service territories to access from outside suppliers but preserves the state policy of municipal exemption from regulation and allows municipal utilities to choose whether to participate in retail competition and to determine terms of that participation.

What Are the Fiscal Impacts of Retail Wheeling on a Municipality and Its Electric Utility?

Municipal Values

- A city that owns and operates an electric utility forgoes the taxes it could have collected from an investor-owned utility and therefore may compensate city services for this loss by 1) charging an in-lieu-of-tax amount similar to the amount a private firm would owe; 2) imposing a charge similar to a franchise tax; 3) reimbursing the general fund for overhead costs; 4) providing electric service to community facilities without billing; 5) paying utility employees to work on nonutility public services; and/or 6) transferring a percentage of utility income each year to the city's general fund.
- Kansas municipal electric utilities provide, on average, transfers of \$48 per capita to achieve municipal purposes other than electrical service. By adding the value of free electric service and the use of utility employees for nonutility activities, the amount of transfer increases to an average of \$87 per capita. The average city would have to levy an additional 26.295 mills in property taxes to offset the value lost by these utility transfers. The total value of reported

Executive Summary - III

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utility support for nonutility city activities is \$37.3 million.

- Municipal values take shape in the mix of taxes and customer charges supporting public services. Citizens, who ultimately own the municipal electric utility, should be able to receive any dividends forthcoming from the operation of the utility, including the use of utility transfers to reduce local reliance on property taxes. Using the local utility to reduce property taxes helps fulfill a long-standing commitment by state lawmakers to reduce governmental reliance on the property tax.
- The values underpinning municipal ownership and operation of an electric utility require public understanding and support. A municipality may, in the view of local policymakers, receive a reasonable return on the municipal investment in an electric utility; however, the type and amount of this return on investment should be well-defined and fiscally sound to ensure the continued financial viability of the municipal electric utility. Furthermore, municipal values associated with the municipal electric utility should be easily identifiable, open to public scrutiny, and periodically subject to public discussion.
- Municipal values will be at risk if state action on retail wheeling forces a change in the locally preferred mixture of taxes and utility charges, forces the loss of utility transfers for nonutility services, and/or forces the reduction of local control over electrical service.

Municipal Vulnerability

- Competitive market pricing will lead customers of electricity to seek the lowest-price provider, thereby challenging higher-cost municipal utilities to reduce their costs, to use taxes or other revenues to cover electric service costs, or to abandon the business.
- Many municipal generating facilities are smaller, older units that may not be as cost-effective in a competitive market as cheaper power using newer technology.
- Sampled Kansas cities with generating capacity have an average unit cost of 2.54 cents per kilowatt-hour for purchased energy, compared with a cost of 7.19 cents for generated electricity.
- Sampled Kansas cities without generation capacity have an average cost of 5.09 cents per kilowatt-hour for purchased electricity, compared with 2.54 cents for the average generator city.
- In 1995, electric rates of municipal utilities in Kansas exceeded those charged by the lowest-cost investor-owned utility in Kansas by nearly one-sixth. Specifically, the adjusted average revenues of 6.04 cents per kilowatt-hour for municipal electric utilities exceeded by 15.9 percent the comparable 5.21 cents per kilowatt-hour by the lowest-cost private utility in

Executive Summary - IV

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6-18

Kansas.

- If the existing cost patterns persist, Kansas municipal electric utilities will face enormous pressure in a competitive market for electricity. Based on a sample, Kansas municipal electric utilities may be covering their total costs today, but their profit margins are so small that they will likely be unable to maintain existing cost structures in a competitive environment.

What Is the Extent of Stranded Costs for Kansas Municipal Electric Utilities?

Stranded Commitments

- Stranded costs represent commitments reasonably incurred to serve power customers. These costs may go unrecovered if those customers can take advantage of open access and get service from another supplier. These stranded costs will not disappear. Someone will pay.
- Stranded commitments include potentially uneconomical multi-year power purchase contracts, long-term debt obligations, lost utility revenues used to support community services, and diminished municipal values.

Stranded Debt

- Kansas municipal utilities have \$302.3 million in public debt outstanding, or an average of \$1,331 per customer. Distributors have little of this debt, only about \$16 per customer; therefore, most of the debt is held by generator utilities.
- A narrow interpretation of stranded costs includes only debt directly related to generating capacity since this is the most significant asset likely to become economically unproductive under a competitive environment. By this definition there are \$204 million of principal due and a total debt service of \$424.8 million that extends through the year 2035. After excluding the debt of the Kansas City municipal utility, there are \$102.6 million of principal due and a total debt service of \$188.0 million through the year 2035.
- If the goal is to repay all generating capacity debt (principal only) in one year with a surcharge based on the kilowatt-hour used, then based upon 1995 figures all customers of the 29 municipal utilities with generating debt would pay an average surcharge of 5.82 cents per kilowatt-hour. By delaying the burden of a surcharge until the year 2005, customers in only 11 cities would face an average one-year surcharge of 4.10 cents per kilowatt-hour.
- Accelerating the payoff of outstanding debt incurred by municipal electric utilities imposes a large financial liability on current ratepayers (citizens), thus suggesting the need for a longer transition period such as ten years to coincide with the typical call option embedded

Executive Summary - V

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6-19

in utility bonds.

- A city, unlike an investor-owned utility, cannot take a tax-law write-off of uneconomical assets. Any attempt to shift the burden to shareholders for stranded costs will not work for a municipal utility, since city taxpayers are the owners of a municipal utility.

Stranded Revenues

- Lost revenues are the difference in revenues induced by a price change, assuming the same volume of service as before the change.
- A loss of revenue due to mandated deregulation is the amount that would not be available for the utility to use for locally defined purposes. Revenue losses require a reduction of cost. These reductions jeopardize not only secondary costs (such as fund transfers, unbilled power for public services, and shared expenses) but also operational costs. Further, these reductions could translate into job reductions in the city, either in the utility or in other public services.
- At a competitive market rate defined as that rate of the lowest-cost Kansas private producer, municipal generators and distributors alike would face revenue losses. Generator cities face large losses, with only one city having a resale rate below the assumed market price. Also, only one distributor city does not lose revenue under this scenario. Therefore, under a price-competitive environment, nearly every municipal utility would have to institute budget cuts or substitute revenues from other sources. To compensate for lost revenues, the mean generator city would face a 25.780 mill increase and the mean distributor city would face a 63.655 mill increase.
- If cities with municipal electric utilities have to offset revenue losses with increased property taxes, then the negative effect of this shift to higher property taxes will not only affect that community's economic prospects but will also extend to Kansas taxpayers, through lower local contributions to the state's school finance formula.

What Are the Economic Impacts of Retail Wheeling on the Customers of Municipal Electric Utilities?

Electric Customers

- As customers shop for the best price in a competitive market, some electric utilities--public and private alike--will be net gainers while others will be net losers. Low-cost producers may experience a net gain of customers; high-cost producers face a net loss of customers and a reduction in the diversity of customer types, possibly to the point of having to cease operations.

Executive Summary - VI

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6-20

- A model of price sensitivity for a sample of Kansas municipal electric utilities reveals that a 1-percent decrease in the price of electricity will increase overall residential megawatt-hour demand by 0.679 percent, a 1-percent decrease in the price will increase commercial demand by 3.855 percent, and a 1-percent decrease in price will increase industrial demand by 1.910 percent.
- Although most municipal electric utility customers as taxpayers of the municipality may face higher property taxes to offset a decline in utility revenues now used to support local general services, a counterbalancing element is the lower utility prices available to consumers in a competitive market. However, this process is likely to evolve over time.

Price Competition

- The distributional-impact model assesses the impact of changes in prices on various customer characteristics, but does not include any offsetting assessments to cover stranded utility debt, the replacement of utility revenue now transferred to other local services, or transition and interconnect expenses.
- The market price used in modeling a price-competitive electric market in Kansas is that of the lowest-cost Kansas private producer in 1995 compared with the adjusted average for all Kansas municipal electric utilities. This aggregate analysis, therefore, does not reflect the actual effects on customers of a particular municipal electric utility.

Residential Impact

- Although residential electric consumption tends to be directly related to household income, the proportion of expenditures going toward electricity is inversely related to income. Therefore, higher-income households will experience a larger absolute dollar savings from lower electricity prices, but lower-income households will experience a larger relative saving as a proportion of income.
- On a per-household basis, the residential customers who would experience the largest decreases in electric bills under the modeled price-competitive environment are residents of rural cities, homeowners, households earning \$75,000 or more, householders between the ages of 45 and 54, and households with six or more members.
- On a group basis, the residential customer groups that would experience the largest decreases in electric bills under the modeled price-competitive environment are residents of urban cities, homeowners, households earning between \$35,000 and \$50,000, householders between the ages of 35 and 44, and two-member households.

Executive Summary - VII

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Business Impact

- The commercial customer groups that would experience the largest decreases in electric bills under the modeled price-competitive environment are offices, mercantile and service establishments, warehouse and storage facilities, and educational facilities. On a per-customer basis, health care facilities, lodging establishments, offices, food sales establishments, and education facilities would experience the largest decreases in electric expenditures.
- The industrial customer groups that would experience the largest declines in electric expenditures under the modeled price-competitive environment are producers of chemicals and allied products, primary metal industries, and producers of food and kindred products, transportation equipment, and paper and allied products. On a per-customer basis, primary metal industries, petroleum and coal producers, producers of chemicals and allied products, and producers of paper and allied products face the largest decreases in electric expenditures.
- Commercial and industrial customers may manifest their price sensitivity by locating to a lower-cost jurisdiction if prevailing rates in the area are judged to be too high. The perception of high rates is also likely to have negative consequences for a community attempting to attract new residents and businesses.

Price and Non-Price Impacts

- Based on current consumption of electricity at the modeled Kansas market rates, the average reduction in primary electricity expenditures per customer would be 11.7 percent for residential, 22.8 percent for commercial, and 4.2 percent for industrial customers. These figures, however, are averages across all municipal electric customers in each customer grouping and do not take into account the non-price effects of higher taxes to offset the loss of utility transfers, reductions in public services to avoid tax increases, transition charges to cover utility stranded costs, and the loss of local control over electric service; therefore, the net change for any particular consumer after accounting for these various costs and benefits will vary by location and will depend on rates presently charged by the municipal electric utility. Any benefits of lower primary production costs may be offset in whole or in part by these other charges or taxes.
- Industrial customers are likely to be the major beneficiaries of a price-competitive marketplace because of the electricity-intensive nature of their operations, followed by commercial customers and residential customers who are likely to benefit to a lesser degree. Major industrial customers are likely to be the first targets of competitive electric utilities because they represent low-cost, high-volume customers. Commercial customers are also likely to be the targets of competing utilities because of their high price-sensitivity and the ability to change the location of some of their business to obtain lower rates. On the other

Executive Summary - VIII

hand, residential customers will probably be the last group of customers targeted, because they are typically high-cost, low-volume customers.

What Are the Issues that Municipal Electric Utilities Should Consider in Influencing State Policy on Retail Wheeling?

What role should local policymakers with responsibility for municipal electric utilities play in the retail wheeling debate in Kansas?

- Should local officials provide information to state policymakers about retail wheeling and its implications? If so, how? Through the Kansas Municipal Energy Agency? Through Kansas Municipal Utilities, Inc.? Through the League of Kansas Municipalities? Through local state legislators?

What position should municipal policymakers take on the various issues involved in retail wheeling?

- Should municipal officials be prepared to adopt policy positions on retail-wheeling issues such as recovery of stranded costs, transition charges, transition timing, state-versus-local control, imposition of charges for energy efficiency or low-income assistance, independent system operator, rate freeze, and aggregation of customer demand, among others now under consideration by state policymakers? Will cities that are not within a territory serviced by a municipal electric utility consider these positions consistent with their particular needs?

Should local policymakers with responsibility for a municipal electric utility seek an exemption from possible mandated retail wheeling?

- Should local officials advocate the municipal-island option for municipal electric utilities--in other words, a state policy that prohibits the intrusion of other electrical suppliers into the city? Is the municipal-island option realistic given the changing technology and economics of electricity? Is this option realistic in the local political environment?

Should local policymakers with responsibility for a municipal electric utility acquiesce to possible retail wheeling?

- Should local officials advocate the municipal-choice option for municipal electric utilities--in other words, a state policy that encourages city utilities to open their cities to competition from outside suppliers but preserves the state policy of municipal exemption and allows cities to choose whether to participate in retail competition and determine the terms of that participation? If a municipal-choice option is adopted by state policymakers, what new regulatory burdens will the state impose on municipalities? Is the municipal electric utility prepared to compete with outside electric suppliers? Does the municipal electric utility have

Executive Summary - IX

the capacity to compete technologically? Economically?

What position should municipal policymakers take concerning the possible impact on low-volume consumers?

- Should municipal policymakers advocate to state policymakers on behalf of the smaller consumers of electricity--for example, residential and smaller commercial customers--who lack bargaining power to extract many of the advantages of competition enjoyed by larger volume customers?

What Are the Issues in Developing a Strategic Business Plan for Each Municipal Electric Utility?

Should municipal officials with responsibility for a municipal electric utility develop a strategic business plan in preparation for a more competitive environment in electrical service?

- What is the purpose of a strategic business plan? The business strategy adopted by a municipal electric utility will be a critical step in charting the future course of the utility in a competitive electricity environment. Even if a municipal electric utility and its customers are satisfied with the present arrangement, revisions may be necessary to adapt to the changing environment.

What issues should be addressed in a strategic business plan for a municipal electric utility?

- Should a particular electric utility system abandon generation and transmission and concentrate on electricity distribution? The generation function is the most vulnerable in a competitive environment.
- Should the system compete as a wholesale power supplier? This aggressive use of generation capacity depends on the ability to offer competitive prices.
- Should the utility consider an upgrade or expansion of its generating facilities? Most privately owned utilities are hesitant to invest in facilities during this uncertain time; so it should give pause to any local construction initiative.
- Should the utility expand its transmission system and increase interconnections with other utilities? Utilities with the most effective interconnections will have better opportunities to handle bulk power.
- Should the utility develop a marketing campaign to attract new customers and/or retain existing customers? Under retail wheeling, any utility can seek to expand its service territory

Executive Summary - X

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6-24

if it is prepared to compete with other utilities.

- Should the utility expand the scope of services offered to its customers to include things such as cable television, telephone, or home security systems? Just because a city operates the electric utility, this does not prevent the municipality from adopting an aggressive expansion plan if such a plan is consistent with approved public policy.
- Should the municipal electric utility seek a cooperative relationship with other municipal utilities or with a private energy firm? Retail competition for electric service opens the door to innovative joint actions or public-private alliances, such as a private energy firm with aggressive pricing advantages serving as the contract manager of the local utility system or a group of municipal electric utilities.
- How offended are citizens and customers of a particular municipality going to be if they do not have the same choices as citizens in neighboring communities? Elected officials must give very careful consideration to the implications of restricting individual choice and responsibility.

What should municipal policymakers with responsibility for a municipal electric utility know about the operation of a municipal electric utility?

- Is the municipal electric utility principally a generator of electric energy or primarily a purchaser? A utility with generating capacity may have significant stranded costs invested in generating facilities.
- To what extent does the utility's price for purchased power depend on an investor-owned utility's recognizing that the municipal utility has some generating capacity? Any price discount enjoyed in the past for preserving this generating capacity will probably vanish as the private utility gains access to lower-cost, volume suppliers.
- What is the status of the municipal electric utility's distribution infrastructure? Municipal utilities with older distribution lines or in growing areas requiring new connections may also face future capital investments in distribution infrastructure.
- What is the cost structure of the municipal electric utility? Older, higher-cost municipal electric systems are likely to become technologically and economically obsolete, making them vulnerable to competitive pressures.
- To what extent can costs be reduced? Utilities that control their costs will be more capable of competing on price terms than utilities that are unwilling to reevaluate every cost item.
- Where is the municipal electric utility located compared with the location of potential

Executive Summary - XI

competitors? Municipalities located near potential, large, low-cost private utilities are more at risk. Municipalities located near state borders may have to deal with potential changes not only in Kansas but in other states as well.

- What is the extent of the municipal electric utility's stranded costs? A narrow definition of the most potentially strandable costs would focus on obsolete or uneconomic generation capacity for which there is debt outstanding. A broader definition would include the loss of transfers to nonutility activities, the loss of customer revenues, or the loss of municipal values.
- How large is the municipal electric utility's customer base? Larger utilities are likely to be more economically viable in a competitive environment.
- How is the municipal electric utility's customer base (residential, commercial, and industrial) distributed? Each type of customer has unique characteristics that lead it to respond differently to changes.
- What are the economics and demographics of the municipal electric utility's residential customers? The impact of price competition on a municipal electric utility's residential customers will vary across economic and demographic groups.
- In what types of activities are the municipal electric utility's commercial customers principally engaged? The more energy-intensive the activity, the more likely the customer is to be price-sensitive. In addition, some commercial customers may choose to "vote with their feet" if more attractive prices may be found elsewhere.
- In what types of activities are the municipal electric utility's industrial customers principally engaged? Although some industrial customers may be receiving specially negotiated rates, others may not. Because of the energy-intensive needs of most industrial customers, industrial customers have much incentive to shop for better rates and/or an alternative location.
- What is the level of satisfaction with the price charged and the level and quality of service provided by the municipal electric utility? The higher the level of dissatisfaction, the more likely customers will be to seek an alternative provider.
- How would municipal electric utility customers rank the importance of low utility rates relative to a high mill levy and/or the loss of subsidized electricity for governmental, nonprofit, and/or charitable activities, etc.? Elected officials in a community with rate payers unaware of the transfer feature of their electric charges are open to charges that public officials are engaged in a "fiscal illusion" to keep everyone from seeing the true costs of public services and electric services, whereas a community openly debating and adopting

Executive Summary - XII

fiscal policies may better reflect municipal values.

- What are the fiscal policies regarding the use of utility transfers to the general fund, shared use of utility employees, and free or reduced power? Every dollar of transfer out of the utility account, for whatever reason, should be consistent with a clearly articulated, broadly debated, formally adopted, and frequently reviewed fiscal policy statement.

PROJECT DESIGN

The Kansas Municipal Energy Agency and Kansas Municipal Utilities, Inc., contracted with the Kansas Public Finance Center in November 1996 to conduct an analysis of the impact of retail wheeling on Kansas municipal electric utilities as of December 31, 1996. Therefore, this project examines the development of municipal electric utilities in Kansas, specifies state policy choices for handling retail competition, and analyzes possible implications of this competition for municipal electric utilities and their customers. First, a profile of the Kansas electric industry highlights the significant activities of municipal electric utilities. The study then shows that local control of municipal electricity service has been the policy position of this state for over one hundred years. In response, municipal electric utilities have tailored their particular services to meet needs, as revealed by their functions and costs.

To advance competition requires changes in state law. Thus, it helps to know what other states are doing about electric deregulation, in general, and the role of municipal electric utilities, in particular. Based on developments in other states, the State of Kansas faces three fundamental state policy choices: create exemptions for municipal utilities; lose independent status as a municipal utility and assume the same future as privately owned utilities have; or give these municipalities a choice, so each may tailor its own path in a competitive environment.

Retail wheeling will have implications for municipal electric utilities, and this study projects these effects. There are operational issues that deserve attention, including the physical capacity of the transmission grid to hold the many new buyer/seller transactions and the incentives for suppliers to use the most cost-efficient electric-energy-generation equipment. Moreover, competition raises questions about the existing state of equipment in use by Kansas municipal electric utilities.

If a customer is allowed to change suppliers without moving from a utility's territory, that customer may effectively bypass any costs incurred by the utility to meet electrical-energy demands. As a result, municipal utilities may face a loss of customers and revenues, and potentially incur stranded costs. Several measures of such stranded costs are calculated for Kansas municipal electric utilities, and implications are drawn.

To assess the overall impact of competition on the municipal electric utility market in Kansas requires models of the consumption of electricity by ultimate customers and the rates charged by the municipal electric utilities. This work quantifies the responsiveness of consumption and rates to key factors of the utility market.

The impact of retail wheeling will not be uniform across all customers of municipal electric utilities in Kansas. An examination using proxy Kansas market prices permits an assessment of the

Executive Summary - XIII

distributional impact of prices on various customer characteristics. Because municipal electric utilities are so intertwined with the provision of many local public services, any price changes for electric service will have non-price effects revealed through higher taxes, reductions in general city services, and the loss of local control over electric service.

Municipal electric utilities, and the elected officials accountable for their operations, face a range of issues in a competitive retail electricity market. The report concludes with a call for each municipal electric utility to assess its competitive position as it seeks to inform public debate on the topic of retail wheeling.

Executive Summary - XIV

Kansas Public Finance Center
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6-28

**House Bill 2025
House Committee on Utilities
February 15, 1999**

**Testimony of
Barbara A. Hueter
Director, Government Affairs
Enron Corp.**

Enron Corp. appreciates the opportunity to submit this testimony on the Task Force on Retail Wheeling's legislation: HB 2025. Enron participated in the task force's meetings in 1997. Last year, I testified before this committee on Enron's general positions on electric industry competition and as a proponent for legislation to unbundle current electric service components. Enron continues to advocate for the timely and appropriate transition to competitive retail electricity markets across the United States.

The task force submitted its report and draft legislation to the Kansas legislature in December, 1997. Since then electricity markets have continued to develop and we have all learned from experience. Many of the suggested changes contained in this testimony come from lessons learned since the task force's deliberations of over one year ago. In the interest of the committee's time, I do not mention every change that should be made to the legislation. Instead, I highlight major provisions that require immediate and considerable attention. Any lack of attention to other areas of the bill does not imply Enron's support but should be considered as areas for further discussion.

Overall, HB 2025 is a sound place for this committee to start deliberations on opening Kansas's retail electricity market to competition. It is clear that the task force thought through key issues very thoroughly. The legislation shows a commitment to giving all customers meaningful choices. It also shows an understanding of the need to establish a market structure that enables new suppliers to compete in the marketplace.

HOUSE UTILITIES
DATE: 2-15-99
ATTACHMENT 7

The following comments are arranged in order of the bills' sections.

Section 1

The legislation defines "competitive electricity provider" as a "marketer, broker, aggregator or other entity selling generation service to consumers at retail." The definition further states that it "does not include any exempt utility".

This definition appears to recognize that utilities already provide electric generation service. However, it fails to recognize that once deregulation occurs, utilities should only be in the business of providing regulated services (transmission and distribution). Competition is fatally flawed if utilities are able to use their incumbent, monopoly status to their advantage. No utility should be allowed to sell competitive electricity. If the utility wishes to do so then it must be required to form an affiliate. That affiliated company should be included in the definition of a competitive electricity provider. This would place all competitive suppliers on a level playing field for state laws and rules. The standards of conduct established in Section 19 would govern the relationship between the utility and its affiliate.

Section 3

Section 3 allows all Kansas electricity consumers the right to purchase electric power directly from the supplier of the customers' choice on or after July 1, 2002. It deregulates the sale of generation service. For customers that do not make a choice of supplier, it maintains the utility as the default supplier.

Experience in other states has shown that the state can successfully implement transition plans for utilities in about one year. Therefore, there is no need for the legislation to postpone choice for another two and one half years. The start date should be moved up to January 1, 2001 or July 1, 2001 at the latest. Furthermore, the legislation should contain a date certain for

customer choice and not an “on or after” date. Certainty requires suppliers, utilities, commissioners and staff to stick to a deadline and will prevent parties from unnecessarily delaying the onset of competition. In addition, new suppliers may not enter the market at the onset of competition if there is a prevailing opinion that utilities or other “implementers” are not committed to a set starting date.

While generation is the largest component of electricity service (on average it is about two-thirds of the total bill) it is not the only portion of electric service that belongs in the competitive market. Ancillary services, metering and other customer care services must also be included as deregulated service components for all customers on competition’s start date. While not all customers will want or need to purchase other services from suppliers, a very large number of them will want to take advantage of competition and technological innovations to maximize their opportunity to decrease their electric bill.

For commercial and industrial customers, Enron owns proprietary software and metering systems to manage customers’ use of electricity. For instance, we have the ability to meter the usage of appliances, lighting fixtures and equipment on a customers’ premise. This information is necessary for knowing how much power these items consume and when they consume it. It is only with this information that we can begin to help the customer manage load so that they can control their demand charges by using power more consistently and eliminating peaks which raise their costs. Enron does not look at retail electricity competition as merely an opportunity to sell cheap electrons. We look at it as the prime opportunity to help customers’ manage their energy usage and decrease their energy expenditures over time through lower commodity prices and decreased energy consumption.

There is no technological reason to allow utilities to maintain their monopoly over metering and customer care services. A large market exists for these services. More and more states are opening this market. Not opening it to competition at the same time as generation is akin to keeping one arm tied behind competition and innovation's back.

Finally, Section 3 maintains the utility as the default supplier for all customers who do not exercise choice. The bill does not say whether the utility will provide electric service at competitive rates or if they are required to charge regulated rates. The likely effect of this provision will be that only those customers who switch will receive lower electricity rates. It will also permit the utility to hold on to the vast majority of the market and leave new suppliers to continually attempt to erode the utilities' market dominance. Again, this is akin to tying one arm behind competition's back and fully expecting it to succeed.

If the goal of competition is to bring savings to all customers and to create a robust market then the legislation should establish a mechanism to competitively bid service to default customers. One way to accomplish this is to require existing utilities to subdivide their service territories into customer pools. Once competition begins the State would bid the service of all non-choosing customers in each pool to qualified suppliers. The winning bidder would become the default supplier. Customers receiving default service should still be allowed to choose a supplier at any time.

Competitively bid default service pools create a level playing field for competitors by putting the entire state up for bid and remove the incumbent advantage of the utilities. Customers benefit from the lower costs and an increased number of suppliers in the market.

Missouri is currently considering this type of default supplier mechanism. I strongly urge you to consider the issue of continued utility market dominance and establish policies and the

means to create a level playing field for all suppliers and increased opportunities for all customers to save money on their electric bills.

Section 7

Section 7 permits utilities to apply to the Kansas Corporation Commission (KCC) to recover competitive transition costs (CTC). The KCC would hold hearings and determine the amount of CTC each utility could recover. The legislation includes a list of considerations for the KCC to use in determining CTCs and grants the KCC discretion to determine the correct amount. The legislation also allows for CTC recovery to last up until the end of 2014.

This section sets up a process to quantify transition costs and mitigate them. It establishes that costs must be just, reasonable, verifiable, nonmitigable and be the net of all assets. It recognizes that utility stockholders already may have been compensated for the risk of not recovering all costs in the form of high rates of return. It gives the KCC discretion to award CTC to “the extent to which the utility’s restructuring efforts promote and provide for competition in sales of generation service” (Section 3, b(8)). Finally, it recognizes that the utility “had the discretion to determine whether to incur the costs and if the utility or any successor had the discretion to determine whether to mitigate the costs (Section 3, b(5)). This represents a thorough attempt to reduce CTC to the lowest possible number without resulting in bankruptcy for any company. It also recognizes that the utilities have a central role to play in promoting and establishing competition and holds them accountable in this regard. This language does a very good job of defining transition costs.

The legislation does not calculate transition costs but then establishes up to a twelve year recovery period. Twelve years is probably the longest period that any state is considering and it

appears unnecessarily long. The legislation should be amended to shorten the period to within six years.

The legislation also permits utilities to issue bonds to “securitize” the revenue flow to pay the transition costs. Since we do not know how much CTC there will be in Kansas it is extremely premature to award the utilities their revenues up front. Securitization should be considered separately after CTC determinations are made. The risk to customers and the State is very high. If Kansas awards too much in CTC and the utilities are permitted to securitize the assets up front, there is no ability for Kansas to recover from the utility excess CTC charges. However, if the state rejects securitization and maintains the ability to reduce CTC on an ongoing basis, customers will be protected from CTC over-recovery.

Section 10

This section enables the KCC to establish a program to fund universal service in low population density and high cost areas of the state. Supplier licensure fees and kilowatt hour surcharges on customers who select suppliers will fund the program. This program appears to be in addition to existing programs at each utility.

Enron supports universal service charges, however, for the sake of uniformity and fairness to all customers and suppliers, one program should be implemented for the entire state. Furthermore, customers, whether they choose or not, should have to pay the same charge per kilowatt hour. There should be no discrimination between customers who choose and those who do not. Furthermore, provider licensure fees are an inappropriate source of funding. First, it is best to maintain one source. A nonbypassable service charge on each kilowatt hour consumed is a simple, fair and common way to assess the fee. Second, an up front licensure fee to fund the program is a barrier to market entry. Whether the fee is based on a lump sum payment or a

projection of how many customers the supplier will obtain, it deters suppliers because it unnecessarily increases the cost of doing business in Kansas. It would be particularly burdensome for a small supplier. Finally, if suppliers are assessed the fee based on how many customers they obtain or how many kilowatt hours they sell, the procedure for calculating the charge will be administratively burdensome. Moreover, since competitive suppliers will not be regulated, it would be against the point of competition to authorize the KCC to regulate suppliers in this regard.

Section 11

This section permits securitization of CTC revenues. See Section 7.

Section 12

This section establishes that the KCC's final order permitting the issuance of transition bonds (i.e. securitization) and the CTC charge "shall be irrevocable". If the KCC inaccurately calculates stranded costs, and customers are paying too much, then the utility will not be required refund money to customers. See comments on Section 7.

Section 13

This section establishes the unbundled components of electric service that shall be listed on customer bills. The list includes, but it not limited to: generation, distribution, transmission, CTC, universal service and transaction taxes. In Section 3, I argue for inclusion of metering and customer service as a competitive component of electric service, therefore, it should be separately listed as a service component on customer bills.

Even if the legislature does not immediately deregulate metering and customer service, it should require these components to be listed on customer bills because it is a discrete, calculable service component that should not be hidden elsewhere in customer bills.

This section also authorizes the KCC to adopt rules and regulations to establish procedures to prevent the unwilling switching of customer's service providers. This is also known as slamming. The section also establishes the KCC as the complaint authority.

Enron supports anti-slamming procedures and penalties. Switching customers' electric service is very different from switching customers' telecommunications providers. Telephone numbers are public. Electricity as well as natural gas account numbers are known only by the customer and the utility. Slamming has not become an issue in competitive retail natural gas and electricity markets. For instance, Columbia Gas of Ohio's Choice program has switched over 300,000 retail customers in the past year and half and there is not one verified slamming complaint. This is not to say that slamming will not occur. It merely shows that slamming exists in large part because telephone numbers are public.

Slamming of customers in a competitive retail electricity market should not be handled by a regulatory agency. Slamming complaints for electric service should be handled like all other consumer complaints - through the Consumer Sales Practices Act section at the state Attorney General's office (or its equivalent). Enron advocates penalties for corrupt business practices but insists that consumer protection lie with the agency that handles all other consumer complaints and not with a regulatory agency.

Finally, this section authorizes the KCC to adopt rules for disclosure and labeling of claims that power is from renewable resources. Enron supports this type of measure.

Section 14

Section 14 requires distribution utilities to contract with a customer to buy the customers' "excess electricity which is generated by such customers' energy producing system into the

utility's system". This language appears to be acceptable, however, the language should be amended to acknowledge the customers' right to own metering equipment.

Section 15

This section requires the KCC to adopt standards of conduct to govern the relationship between the utility and other suppliers. Such standards and enforcement mechanisms are needed to ensure fair and nondiscriminatory access to transmission and distribution facilities. Attached is a copy of Enron's proposed code of conduct.

Section 19

Section 19 requires competitive electricity providers to be licensed by the KCC. It requires the KCC to adopt appropriate rules and regulations to implement this section.

HB 2025 permits utilities to sell electricity on the competitive market. Utilities are not required to divest of assets, form an affiliate or otherwise truly separate the competitive and non-competitive functions within the company. This entrenches the incumbent utility as the dominant supplier. New suppliers must qualify with the state and be licensed before they can sell. This is an unfair advantage for the utility. All suppliers, be they affiliates or independent companies, should have to meet the same standards in order to do business in Kansas. Furthermore, out-of-state companies should not be required to physically locate in the state. Enron is a unitary tax filer in Kansas and nexus exists. It is unnecessary to require us to locate an office in the state. This does not mean that we will not locate an office in Kansas because we generally have offices in the retail markets we serve. However, there appears to be no legal reason to require it of us.

The legislation requires reciprocity for competitive electricity providers that are affiliated with utilities in other states. Therefore, any affiliated supplier of a utility in another state cannot sell retail power in Kansas unless the affiliates' home state has opened their market to

competition. This is an attempt to keep affiliates out of Kansas when in fact, the affiliates do not control of the activities of the legislatures in their home states. Reciprocity is widely considered to be unconstitutional as a violation of the Interstate Commerce Clause.

Section 21

This section requires the state, KCC and utilities to “work with the federal government, other states in the region and interstate power pools to establish independent system operators ... to operate the transmission system ...”.

Enron Corp. supports the creation of regional transmission entities to operate the transmission system. The entities, if properly governed and managed, will ensure nondiscriminatory pricing and access. The competitive market will fail if suppliers cannot move their power on transmission lines. Therefore, this language should be strengthened to require the utilities to join a federally approved regional transmission grid management entity as a precondition for obtaining competitive transition costs. This link between cooperating to form a regional transmission entity and obtaining CTC recovery will serve to ensure compliance.

Independent System Operators are not the only type of entity that can perform this function. Regional transmission entities are evolving and with each day we are learning more about how to best structure the entities to maximize reliability, safety, efficiency and non-discriminatory treatment of system users. The language should be amended to replace “independent system operator” with “regional transmission entity”.

This concludes my initial testimony on HB 2025. Thank you once again for this opportunity.

BEFORE THE HOUSE UTILITIES COMMITTEE
PRESENTATION OF THE
KANSAS CORPORATION COMMISSION ON
HOUSE BILL NO. 2025

Thank you Mr. Chairman and members of the Committee, I'm Larry Holloway, Chief of Energy Operations for the Kansas Corporation Commission and I'm appearing today on behalf of the KCC. The KCC does not take a position on this bill. My purpose here today is to provide information to assist you in considering this important policy decision.

While the Commission does not take a position on this bill, I do think a note of caution is appropriate. House Bill 2025 is essentially the same legislation proposed by the retail wheeling task force in its report the 1998 Legislature. The Commission itself did not participate in the retail wheeling task force, but I had the privilege of providing input as a member of Commission Staff. The task force was directed to provide an analysis of various issues surrounding retail competition and to attempt to develop the best implementing legislation for consideration by the legislature. This bill is the result of that attempt. HB 2025 is highly detailed contains many specific requirements and provisions. Another retail competition bill, HB 2026 leaves most of the detail to the KCC. If you decide to implement retail competition you must first decide whether you prefer a very detailed and prescriptive approach, or whether you prefer to let the Commission handle the details. If you decide HB 2025 is the approach to take, you should be aware that many of the details in this bill were worked out after long, difficult discussions. Therefore, I would encourage you, if you decide to approve this bill, to do so with little modification.

Retail competition in the electric industry is a difficult policy issue. Certainly in the short

HOUSE UTILITIES
DATE: 2-15-99
ATTACHMENT 8

term, there will be winners and losers. Unlike natural gas, much of the retail electric customers' ratebase includes production facilities, or in electric terms, generation plants. While there is a growing competitive electric wholesale market, the production and transmission functions of the electric industry are still highly integrated and have not been unbundled as in the gas industry. For this reason, estimates of the price of electricity in a completely deregulated market vary across a wide range. However, one thing is for certain, if your electric rates are below the competitive market price you will be paying more for electricity following deregulation. If your electric rates are above the competitive market price, depending on treatment of transition costs, you may be paying less.

Some believe that the national average price for electricity is a good approximation of the true market price of electricity with full generation competition. Today I have presented you with some information regarding Kansas electric utilities. This information is based on 1997 data collected by the Energy Information Agency of the Department of Energy. Included in this information is 1997 data for the average revenue per kilowatt-hour for every state, as well as that for every Kansas utility, by customer class and for all customers. This information will allow you to consider which Kansans may or may not benefit, in the short term, from a fully competitive generation market.

I have discussed the short-term winners and losers under retail competition of electricity. However, it is also important to discuss the long-term implications. Over time, differences between short-term winners and losers could disappear. Even with no changes in the regulation of the electric industry, low cost utilities could be forced to add expensive generation in the future while high cost utilities may avoid such additions and achieve lower costs. Furthermore, growing competition in the wholesale electric markets is creating an increasing amount of

nonutility generation. Increasing wholesale activity and trading has also created challenges to the operation of transmission systems throughout the nation. Regardless of whether retail competition is implemented, these changes in the wholesale market will affect retail customers. Retail competition is only one way to introduce a fully competitive generation market. Many believe the same result can be achieved on the wholesale side.

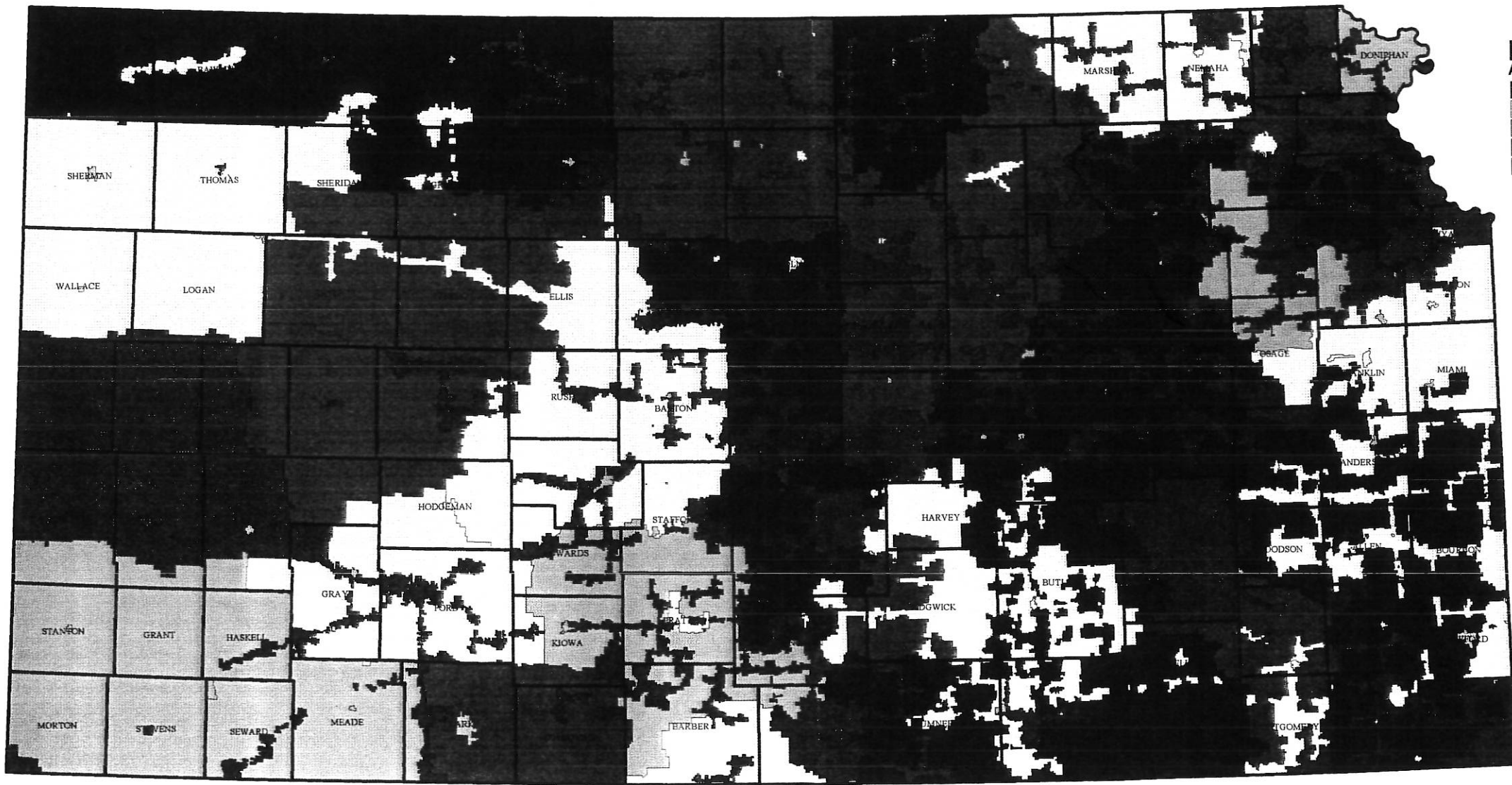
The question remains, is retail competition beneficial in the long run? While several states have implemented retail competition, it is probably too early to evaluate even the short-term costs and benefits. To decide if retail competition is beneficial in the long run, you should be able to answer yes to both of the following questions:

- Do you believe that a fully competitive generation market will achieve lower prices than the existing regulated generation market with acceptable reliability?
- Do you believe wholesale competition will not achieve the same benefits to retail customers as retail competition?

In summary, you should recognize the possibility of short-term winners and losers, decide whether or not you believe in the long-term benefits of a fully competitive generation market and then if you believe these benefits can only be fully achieved through retail competition. If you decide to implement retail competition you should decide whether or not you prefer detailed and prescriptive legislation or if you prefer to leave the details to the KCC. Finally, if you decide to pass HB 2025, you should recognize the efforts of the retail wheeling task force and adopt it with little, if any, modification.

Kansas Average Electric Rates Cost per KWh

House Utilities
2-15-99
Attachment 9



County Line
Average Rate / KWh

- 3.44 - 6.34
- 6.34 - 7.52
- 7.52 - 8.7
- 8.7 - 10
- 10 - 13.77



Data from Department of Energy,
Energy Information Agency
Electric Sales and Revenue, 1997

Map by KCC
Electric Division

HOUSE UTILITIES
DATE: 2-15-99
ATTACHMENT 9

Kanss Electric Utility Information

Distributed by Larry Holloway
Kansas Corporation Commission

Held in file in office of

Utilities Chairman

Carl Holmes

Room 115-S



League of Kansas Municipalities

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To: House Utilities Committee
From: Chris McKenzie, Executive Director ✓
Date: February 15, 1999
Re: House Bill 2025

Thank you for allowing me the opportunity to offer comments concerning House Bill 2025 on behalf of the League of Kansas Municipalities and our 529 member cities. The possibility of retail electric competition in Kansas gives rise to a variety of questions and you are to be commended for starting the process of tackling the complex issues involved.

Because we believe that the question of whether Kansas should or should not implement retail electric competition is a major policy question which can only be answered by the Legislature, we are neither proponents or opponents of House Bill 2025. Rather, I would like to offer some comments concerning those aspects of the bill which would have a direct impact on Kansas cities.

There is no doubt that the implementation of competition in the electric industry would have a dramatic impact on state and local revenues. It is imperative that we understand and resolve these issues before competition begins. We support the concept of New Section 26 which establishes a joint committee to study and make recommendations concerning the tax-related issues of retail electric competition. However, it is also important to note that there is nothing in the bill which would prohibit the implementation of competition in the event that the tax issues are not solved.

Property Taxes

- Utilities are currently taxed at a 33% assessment rate.
- This rate applies to all aspects of the industry (generation, transmission, and distribution).
- If these components are unbundled, it is not clear which property will continue to be taxed at the 33% rate and which property will be considered commercial or industrial and taxed at a 25% rate.
- Generation property is concentrated in 14 counties, therefore, those counties will bear the greatest burden if the assessment rate on generation facilities is reduced.

Sales and Use Taxes

- In FY 1997, electric utilities remitted approximately \$23 million in state sales tax and \$18 million in city and county sales taxes.
- Today cities levy as much or more in sales taxes than they do in property taxes.
- It is unclear whether the licensing requirements in House Bill 2025 would be viewed as a permissible burden on interstate commerce which also estab

HOUSE UTILITIES

DATE: 2-15-99

ATTACHMENT 11

- order to impose this tax on out-of-state providers. The issue may turn on whether courts would consider the sale of electricity as a "good" or a "service."
- If it turns out to be a "service" then it is more likely that the nexus requirements would be met (assuming the licencing requirements are constitutional).
 - If it turns out to be a "good" then the compensating use tax would apply. Because state law provides that the local use tax only applies to vehicles and boats, no local use tax would be collected. Further, because the burden of collection of the use tax is on the consumer, compliance is difficult to enforce.
 - It is also unclear whether all of the unbundled components would be subject to state and local sales tax. Because the state sales tax is calculated based upon gross receipts, how each of the components is classified will greatly impact the sales tax revenues.
 - If retail competition results in a reduction in the price of electricity to consumers, as proponents argue, then sales tax revenues will also decrease.

Franchise Fees

- K.S.A. 12-2001 *et seq.* requires that all utilities using the public rights of way obtain a franchise agreement from the city.
- The Act further requires that sufficient consideration be paid to the city for the use of the rights of way.
- While some recently negotiated franchises contain some franchise renegotiation provisions in the event of wheeling, most franchise agreements calculate this compensation based upon gross receipts of services provided by the local utility provider. There is no provision in current agreements for applying the franchise fee to power which is transported in the right of way by a provider other than the local distribution utility.
- Imposing retail electric competition prior to changing the method of computation of the franchise fee would result in a significant decrease in revenues causing the public not to be appropriately compensated for the use of the rights of way.
- Attached for your information is a recent *Research Information Bulletin* by the League which provides information on franchise fees and options available to cities under current law.

Municipal Utilities

- 121 cities operate municipal electric utilities (MEUs). 63 generate and distribute; 58 distribute only.
- Surplus from these utilities is an important part of the revenue mix in those cities.
- Because most of these cities are small and have little sales tax base, a loss in this revenue source would likely result in a dramatic increase in property taxes in those communities. This likely impact was documented in the attached League Research Information Bulletin.
- In order to preserve local control over MEUs, we support the opt-in procedures set out in Section 5 of House Bill 2025.
- We also support Sections 28 and 33 which establish specific exemptions in the Kansas Open Records Act and the Kansas Open Meetings Act for those cities that choose to

participate in retail electric competition.

This is just a brief overview of the issues that we believe must be addressed prior to the implementation of retail electric competition. While many are studying the issues and solutions to some of these challenges may be formulated, it is premature at this time to determine whether the net benefits of retail electric competition will outweigh the irreversible costs which will have to be borne. The League and others will continue to study the issue in an attempt to answer this question.

Once again, thank you for giving me the opportunity to offer the perspective of cities on this very important issue.

RESEARCH / INFORMATION BULLETIN

League of Kansas Municipalities / 300 S.W. Eighth Street / Topeka, Kansas 66603 / 785-354-9565

Vol. XVII No. 648
October 9, 1998

PRESERVING FRANCHISE REVENUES IN AN ERA OF RETAIL WHEELING AND COMPETITION¹

1. History and Legal Basis of Franchise Agreements. Since 1905 cities have had the clear statutory authority to control the use of public streets, alleys and rights of way by companies providing a range of public services, including the provision of electricity and gas. Three major enactments govern this activity: (1) K.S.A. 12-848, enacted in 1905, applying only to cities of the 2nd and 3rd class; (2) K.S.A. 12-824, enacted in 1915, applying to all cities; and (3) K.S.A. 12-2001, enacted in 1945, applying to all cities. These statutes all authorize the exercise of such control through the approval of ordinances granting companies the privilege or "franchise" to use city-owned right-of-way to provide electricity, natural gas, railway and bus service, telephone or telegraph service, steam heat, water, etc .

In the last few decades, K.S.A. 12-2001 has been used most commonly as the legal basis for the granting of franchises by cities. This extraordinary statute authorizes cities to grant a franchise for up to 20 years after three public readings of the ordinance granting the franchise. The franchise granted also is subject to a public referendum if a sufficient petition is filed. In many respects, the granting of franchises was one of our earliest forms of "privatization" of public services in the cities that chose not to create municipal utilities (currently operated by 121 cities). In such cases, the franchise ordinance contains the terms under which private companies can supply these public services in any city.

2. What Rights Are Granted And Duties Created Under A Franchise? Those not familiar with utility franchise ordinances might incorrectly assume that they only concern fees. This assumption would be very inaccurate. It is clear from a recent Kansas Supreme Court decision that cities, acting in accordance with state statutes, actually do grant a "franchise" to persons, firms or corporations that request to use the public right-of-way and provide public services within city limits.

Although a franchise is granted by a municipality by an extraordinary ordinance (i.e., one subject to referendum and which must be read three times in public), it also comprises a legal contract between the city and the company, conferring valuable rights. In fact, many franchise ordinances read like contracts, specifying the respective privileges and duties of the parties, and providing remedies for nonperformance. Both federal and state courts have recognized that franchise ordinances/agreements are contracts which confer specific property rights. See, e.g., *Kansas Gas & Electric v. City of Independence*, 79 F.2d 32, 35 (1935); and *City of Liberal v. Teleprompter Cable Service, Inc.*, 218 Kan. 289 (1975).

3. Franchise Compensation or Fees. K.S.A. 12-2001 requires companies which receive a franchise from a city to provide "adequate compensation or consideration therefor" and to pay a fixed charge for the right regardless of whether or not other or additional compensation is provided. The statute goes on to say:

Such fixed charge may consist of a percentage of the gross receipts derived from the service permitted by the grant, right, privilege or franchise from consumers or recipients of such service located within the corporate boundaries of such city. [Emphasis added].

¹Presented at 88th Annual Conference of the League of Kansas Municipalities, October 4-6, 1998, in Wichita, Kansas.

The franchise fee may be based on any agreed-upon terms, but it is most commonly based on a percentage of the gross receipts derived by the company from its services in the city. While the League has not done a recent survey of city franchise fee rates, our franchise files contain ordinances with fee provisions ranging from 2% - 5% of gross receipts derived from electric service in the city. Consider this provision from a 1994 franchise ordinance of Yates Center:

As further consideration for the granting of this franchise, and in lieu of any city occupation, license, or revenue taxes, the Company shall pay to the City during the term of this franchise two percent (2%) of its gross revenue from the sale of electric energy within the corporate limits of said City, such payment to be made monthly for the preceding monthly period.

The first underlined passage demonstrates a common feature in such provisions; i.e., the franchise fee is the exclusive payment made by the Company and the Company is exempt from other payments. The second passage also is common in these agreements. Franchise payments are typically computed based on sales within the city only. While it may be computed based on a percentage of gross receipts, the franchise fee is not a tax. It is a fee paid for the privilege of using the public rights-of-way to deliver electricity to the residents of a city. By order of the KCC it now appears on ratepayers bills in a way that it appears to be a tax, but it most closely resembles a payment for the use or rental of the rights-of-way in delivering a public service. This is extremely valuable property which, in many instances, the city purchased from private landowners. Recent studies in other states have demonstrated that franchise fees in those states were usually substantially less than the franchisee would pay in fair market rent or for the purchase of comparable property.

4. The Relative Importance of Franchise Fees As A Revenue Source. Franchise fees can comprise a significant component of a city's revenues—easily three times what it derives from its 1% sales tax from the sale of electricity if the franchise fee rate is 3%. A recent League survey revealed that statewide cities receiving electric franchise fees receive an amount which on the average equals 11% of their property tax revenues from all sources, and it would require an average mill levy of 3.8 mills to replace all electric franchise revenues. In cities with populations between 299 - 499, the average mill levy increase to replace the franchise fees would be 10.7 mills.

The 1997 tax and fee payments reported to a 1998 interim legislative committee by Western Resources to cities within its utilities service territories provide a compelling illustration of the relative significance of electric franchise fees to city budgets and as a way of avoiding reliance on the property tax. Western Resources reported it paid the following amounts to cities in 1997:

Payment Type	Amount	Percent Total
City Franchise Fees	\$27,881,643	(81.8%)
City Property Tax	2,890,304	(8.5%)
City Sales Tax	<u>3,278,883</u>	(9.6%)
	\$34,050,830	

Statewide we estimate cities collected \$312 million in sales tax revenue in 1997—with approximately \$14 million (4.6% of the total using the Dept. of Revenue's estimates) being derived from the sale of electricity. In comparison, cities levied \$319 million in property taxes in 1997.

5. How Wheeling May Affect Electric Franchise Revenues. Municipal electric franchise revenues can be expected to be affected by retail wheeling in many of the same ways as sales tax revenues will be affected. In fact, the recent growth in retail competition in supplying "transported" natural gas to some industries has caused some cities to lose natural gas franchise fees that are based on a percentage of gross receipts on natural gas sold locally by the franchisee (i.e., the local distribution company, or LDC). Local franchisees in such cases actually collect lower gross receipts on natural gas which they sell locally, but they offset this revenue loss with distribution fees they collect for the natural gas they "wheel" through their distribution system. In these cases, cities experience revenue losses since older franchise agreements do not cover gas which is transported or "wheeled." In some recent renewals or amendments of gas franchise agreements cities have built in compensation provisions to cover this "transported" gas. When this is not possible, it effectively increases pressure to raise property taxes or increase other revenues.

Retail wheeling of electricity is expected to affect electric revenues in an identical way. Long term franchise agreements have provisions for franchise fees that are typically based on the gross receipts of the franchisee from the sale of electricity within the city limits and not from its distribution on behalf of other suppliers. Secondly, since the duty to make franchise fee payments falls on the franchisee and not other suppliers, cities and their franchisees will have to develop new mechanisms for the collection of franchise fees (or their equivalent) from competitive suppliers. If this potential loss of revenue is not addressed, it will competitively disadvantage franchisees which will sell electricity to a portion of the local market (which will pay the fee) and cities which must turn to other sources of revenue, including the property tax, to replace the lost revenue..

Like the sales tax, municipal franchise revenues also can be expected to be affected by the dropping electricity prices (unless consumption increases) as well as the unbundling of the components of what today is known as the sale of electricity, including amortization of generating plant costs (which in the future may be "stranded investment") and other built-in costs such as universal service.

6. Policy Options. There are both local and state, as well as short-term and long-term, policy options for addressing the franchise revenue concerns raised by retail wheeling. Cities can clearly include provisions in their franchise agreements as they are renewed that anticipate this sea-change and which provide for renegotiation of the fee provisions in the event of electric retail competition. This has advantages, but given the long-term nature of most existing franchises it may take many years to address all cities' needs. In the meantime, substantial revenue losses could occur. An alternative is simply to impose a duty on the franchisee to remit a fee based its distribution of electricity (or gas) on a billed unit of energy basis--whether the franchisee generated or simply distributed the electricity for another supplier. There are drawback to this approach--not the least of which is that if the franchisee/LDC is not responsible for billing the customers of companies for which it simply distributes power, the fee cannot be easily recovered from the customer. It would be necessary for any retail wheeling legislation to address this concern, either requiring use of the LDC for billing or requiring energy suppliers to pay the fee.

OPTIONAL FRANCHISE PROVISIONS

Cities have begun to incorporate provisions into their new franchise agreements that contemplate both the "wheeling" of electricity and the "transportation" of natural gas. There is clearly no one way to do this. These samples are provided for illustration purposes only.

ELECTRICITY

City of Lawrence, Ordinance No. 7034

In the event customers of the Company within the area covered by this Agreement are granted the right to purchase electricity from a provider other than the Company, either party may, upon thirty (30) days' notice to the other party, request that the provisions of this Agreement, including the franchise fee rate provided herein, be adjusted to reflect the modifications of governing law allowing the customers of the Company to purchase electricity from providers other than the Company. The parties agree that, upon the giving and receipt of such notice, they will meet in good faith to negotiate any necessary changes to this Agreement to conform it to the intent of the modifications of governing law. The failure to negotiate in good faith shall be considered a material breach of this Agreement.

City of El Dorado, Ordinance No. S-1047

In the event the Company's customers served within the area covered by this Agreement are granted the right to purchase electricity from a provider other than this Company, either party may, upon thirty (30) days' written notice to the other party, request that the franchise fee rate provided for herein be adjusted to reflect the modifications and resolution of franchise fee issues adopted in the legislation which created the right of customers to obtain electricity from providers other than the Company. The parties agree that, upon the giving and receipt of such notice, they will meet in good faith to negotiate any necessary changes to this Agreement. However, if the parties are unable to reach an agreement within

11-6

ninety (90) days after the receipt of notice by the receiving party, the City, at its option, has the right to terminate the franchise granted to the grantee by action of the governing body repealing this Ordinance.

Western Resources' Recommendation

In the event Western Resources' customers served within the area covered by this Agreement are granted the right to purchase electricity from a provider other than Western Resources, either party may, upon thirty (30) days' notice to the other party, request that the franchise fee rate provided for herein be adjusted to reflect the modifications and resolutions of franchise fee issues adopted in the legislation which created the right of customers to obtain electricity from providers other than Western resources. The parties agree that, upon the giving and receipt of such notice, they will meet in good faith to negotiate any necessary changes to this Agreement to conform it to the intent of such legislation.

City of Quinter, Ordinance No. 427

If and when retail wheeling becomes an option, this ordinance may be opened so that a franchise tax may be collected on such electric energy that is being wheeled through Midwest Energy's local distribution system in the City limits of Quinter, Kansas. The option to reopen this provision of section 6 will not effect the other terms of this ordinance.

NATURAL GAS

City of Dodge City Ordinance No. 3233

In consideration of the granting of this franchise, the Grantee shall pay to the Grantor an annual Franchise Fee (Fee) of \$.5255 per foot for each foot of the Grantee's gas distribution main within the corporate boundaries of the Grantor, which at the time of the signing of this Franchise is 618,466 feet. The fee shall be computed annually on or before December 31 of each year using the actual footage of mains within the corporate boundaries as of November 30 of that year. At the end of the initial five year term, the Grantor may, by ordinance, change the per-foot amount of the Fee up to ten percent (10%) compared to the existing per-foot amount. Thereafter and no more frequently than once every five years, the Grantor may, by ordinance, change the per-foot amount up to ten percent (10%) compared to the existing per-foot amount. The Grantee shall pay to the Grantor on or before the 15th day of each and every month that portion of the Fee actually collected from Consumers during the previous month, based on the following:

1. The Grantee shall collect the Fee from all Customers within a Customer Class located in the corporate boundaries of Grantor.

2. The Fee shall be collected from the customer classes in the same proportion as the previous year's actual franchise fee receipts from the customer classes. The franchise fee shall be collected from each customer within the class, regardless of the type of natural gas service obtained (i.e., sales or transportation) from Grantee and shall be computed on a volumetric basis. The volumetric rate for each Customer shall be computed annually by dividing the total Fee for the customer class by the previous year's volumes from that customer class (i.e., $\text{Volumetric Rate} = \frac{\text{Customer Class Fee} + \text{Previous Year's Customer Class Volume}}{\text{Customer Class Volume}}$). An example of the computation of the Franchise Fee will be on file with the City Clerk and on file at People's operation headquarters in Dodge City.

The Grantee shall list the Fee to be collected from each Customer as a separate item on bills issued to Customers as a "City Franchise Fee."

The amount so paid by Grantee to Grantor shall be adjusted down for that portion of the Franchise Fee that is uncollectible. The amount paid to Grantor shall be adjusted up for receipt of Franchise Fees paid by Customers towards previously uncollected Franchise Fees.

City of Logan Ordinance No. 532

In consideration of the rights and privileges herein granted, the Grantee shall assess effective the first billing cycle after this franchise customers within the City a franchise tax or fee of two percent (2%) of the gross receipts (exclusive of the franchise fee or tax) derived by Grantee from sales by Grantee to such customers and of \$0.0095 (.95 cents) per therm for gas transported to residential and commercial customers within the City on Grantee's distribution system when Grantee solely provides distribution transportation and not sales service. Grantee shall pay to the City Treasurer a semi-annual payment for each year of the franchise's duration an amount equal to the franchise fee or tax funds collected by Grantee hereunder.

ELECTRICITY OR NATURAL GAS

League of Kansas Municipalities Sample

Section ____. **Franchise Fee.** (a) In consideration of the granting of the franchise, the grantee shall monthly (or quarterly) pay to the city a franchisee fee equal to the following:

(1) **Based on Grantee's Sales.** ___% of the gross receipts derived by grantee from the sale or furnishing of gas (or electricity) by grantee to customers within the present or future boundaries of the city; and

(2) **Based on Sales By Other Suppliers.** ___% of the gross receipts derived by any other supplier from the sale or furnishing of gas (or electricity) through grantee's distribution lines, pipes, and system (hereinafter referred to as the "system") to customers within the present or future boundaries of the city. If, after diligent efforts, grantee is unable to secure gross receipts information from other suppliers using the system to supply gas (or electricity), the governing body may authorize the grantee by ordinance to remit an amount to the city based on the billed unit of energy (mcf or kWh, as appropriate) furnished to customers by other suppliers of gas (or electricity) through the system during the reporting period, multiplied by a factor which is the rate which grantee would have charged for the same commodity and service to such customers during the same time period. Such authorization may be revoked at any time by the governing body. Grantee shall be responsible for payment of all fees required herein based on the sale or furnishing of gas (or electricity) by other suppliers through grantee's system, and grantee may collect from other suppliers any amounts which it pays under the provisions of this paragraph for gas (or electricity) so furnished.

11-8

From: "Matthew Brown" <matthew.brown@ncsl.org>
To: "Energy-l" <energy-l@ncsl.org>
Date: Wed, Feb 10, 1999 11:34 AM
Subject: new jersey restruturing bill article

Legislature OKs energy deregulation
01/29/99
By TRACEY L. REGAN
Staff Writer

TRENTON – State lawmakers in both houses approved a bill yesterday opening up the state's energy markets to retail competition and requiring an across-the-board discount to utility customers for the next four years.

The Republican-sponsored legislation allows electricity customers to shop for a new supplier on Aug. 1 and calls for a 5 percent discount on utility electric rates to go into effect as soon as the markets open.

Gov. Christie Whitman, who left for Europe yesterday, plans to sign the bill when she returns next week, a spokeswoman said. When she does, New Jersey will join its neighbors in the Northeast in restructuring its electricity markets.

The bill is expected to primarily benefit large businesses that buy energy in bulk, which initiated the call for reforms several years ago. Lawmakers included the discount to protect smaller buyers, while also establishing mechanisms for them to band together in municipal buying blocks to exert purchasing power.

During the first year, the average residential ratepayer should save between \$36 and \$50 on the price of energy, consumer groups said. The discount would increase to 10 percent within three years. After the fourth year, utilities will be allowed to charge market rates. The distribution portion of the industry will remain regulated.

Businesses have been able to pick a natural gas supplier since 1994. The legislation allows residential consumers to choose at the end of this year.

THE LEGISLATION passed by wide margins in both houses, although a vocal group of Assembly Democrats assailed the bill for failing to protect consumers and the environment.

"This is based on a premise that does not exist in the real world – that the consumer will be protected when there is competition," said Assemblywoman Nia Gill, D-Montclair, one of more than a dozen Assembly Democrats who did not support the bill. Gill argued that rather than ending a monopoly, as its supporters contend, the bill would give rise to "an unregulated monopoly."

Critics also cautioned that the bill gives too much discretion to the state Board of Public Utilities to shape important provisions, such as the amount of debt that utilities will be able to recover through rates in the newly

HOUSE UTILITIES

DATE: 2-15-99
ATTACHMENT 12

competitive marketplace and the level of shopping credit -- the reimbursement utility customers would receive if they decide to choose a new energy provider -- now-regulated companies would be required to provide.

The issue of shopping credits is a hotly contested one. Both business and consumer groups insist that the shopping credit be larger than the utility's avoided expenses -- including the cost of energy -- to encourage competition in the marketplace. Public Service Electric & Gas Co., the state's largest energy utility, was equally adamant that it not give what they said would be a discount larger than the one already mandated by the bill.

"I don't see how we could provide service at these higher (discount) levels. If this becomes unfairly taking of our property, then we would pursue a legal remedy," PSE&G President Lawrence Codey said earlier this month.

THE BILL leaves it to the BPU to establish a universal service fund, which would provide money for social programs and consumer education.

"Considering that the surrounding states have already started to restructure, I'm pleased to see New Jersey on this road, but this bill is skeletal in nature," said Blossom Peretz, the New Jersey ratepayer advocate, referring to the many items left to the BPU to decide.

The legislation won mostly praise, however, from the business lobby, which has long complained that energy costs in New Jersey are far higher than in other regions of the country and demanded that the state lower them -- or risk defections to other states.

Independent energy producers, including large businesses that generate their own electricity, or hope to, said they were pleased with the final version of the bill. It allows them to leave the grid without having to pay "exit fees," a portion of utility debt now being paid by all ratepayers. Only when their collective departure reached 7.5 percent of a utility's 1999 revenues would new ventures be assessed such a fee, said Steve Gabel, an energy consultant.

The bill prevents the utilities from breaking their long-term -- and in some cases above-market-rate -- contracts with independent energy producers to buy power, said Adam Kaufman, director of the Independent Energy Producers of New Jersey.

CODEY ALSO praised the bill, saying it "allows our workers a chance to compete."

"It doesn't bankrupt us, and it views our stranded costs as legitimate," Codey said, referring to the billions of dollars in investments in nuclear power plants and long-term energy contracts that the utilities do not feel they could recoup in a competitive market. The legislation leaves it to the BPU to determine how much of this debt they can continue to recover through rates, but sets no ceiling.

The bill establishes protections for utility workers who lose their jobs due to restructuring, which include benefits such as ratepayer-subsidized severance pay, medical benefits and worker training.

"The utilities had a lot of say in (the bill's) formation and they're comfortable with it," said David Schanzer, an analyst with Janney Montgomery Scott Inc. "There is no question that stock prices have been edging up in anticipation of a fair and balanced deregulation bill."

Schanzer said the legislation, which allows the utilities to refinance the majority of their debt, frees them up to "change their focus." He said he expected to see more consolidation in the industry and "major alliances in pursuit of nonregulated business."

But environmentalists said the bill was woefully lacking in funding for conservation measures, among others, and pollution protections.

It provides for a minimum of \$140 million in ratepayer-subsidized spending on energy conservation measures and funding for renewable energy initiatives, and stipulates that 4 percent of the kilowatt hours sold in the state must come from renewable power sources by 2012.

GROUPS SUCH AS the Environmental Federation, the New Jersey Public Interest Research Group and the Sierra Club were also disappointed that the bill does not establish air emission portfolio standards for energy providers that emphasize nonpolluting sources of power. Instead, it ties New Jersey's adoption of such a policy with that of neighboring states in the Pennsylvania Jersey Maryland (PJM) power pool. Critics have said it is unlikely that New Jersey's largest neighbor, coal-producing Pennsylvania, would adopt such a standard.

"The bill provides chump change for consumers and a windfall for polluters," lamented David Pringle, of the New Jersey Environmental Federation. Before the bill had even passed, he and others had begun working on amendments.

Sen. John Bennett, R-Little Silver, has said he and Sen. Diane Allen, R-Edgewater Park, will introduce legislation to increase spending on energy conservation programs and drop garbage incinerators from inclusion as a renewable energy source.

Bennett said he is also considering introducing a bill that would tie New Jersey's action on emissions standards to states such as Massachusetts and Connecticut, which have taken more aggressive positions on environmental safeguards.

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