

MINUTES OF THE SENATE UTILITIES COMMITTEE.

The meeting was called to order by Chairperson Sen. Pat Ranson at 1:30 p.m. on February 3, 2000 in Room 531-N of the Capitol.

All members were present except:  
Sen. Hensley was excused

Committee staff present:  
Lynne Holt, Legislative Research Department  
Mary Torrence, Revisors of Statute Office  
Jeanne Eudaley, Committee Secretary

Conferees appearing before the committee:  
J. C. Long, Director of Government Services, UtiliCorp United  
Max Sherman, Vice President, Project Development, Aquila Energy (subsidiary of UtiliCorp United)  
Sheldon Hamilton, Property Tax Division, UtiliCorp United

Others attending:  
See attached list

Sen. Ranson introduced her pages and thanked them for assisting the committee. Sen. Ranson then announced deadlines for introductions and consideration of bills. She also announced distribution of the 2000 Report to the Kansas Legislature by the Kansas Corporation Commission (available from the Kansas Corporation Commission). Sen. Ranson referred to a memo sent to members yesterday, along with Minutes of the Meeting for January 19, 20 and 25 and asked if there were questions regarding the Minutes. There was none. Sen. Clark made a motion the Minutes be approved, and it was seconded by Sen. Lee; the Minutes were approved.

Sen. Ranson announced the committee will have a briefing on merchant power plants and the property tax differential. She then introduced J. C. Long, who introduced Sheldon Hamilton. Mr. Hamilton presented information to the committee relating to property taxes (Attachment 1), and began by telling the history of UtiliCorp's creation and growth and stated that UtiliCorp ranks as the fourth largest utility company in the U.S. based on sales. He then compared the estimated property taxes for Kansas and Missouri; he also discussed electric generation in the three states - Kansas, Colorado and Missouri. Sen. Steffes asked how the property tax rate on electric assets is measured, and how the net book value is calculated. Mr. Hamilton answered to measure the rate of tax, they take the property tax expense and divide by the net book value (or the original cost of the property less depreciation), and that is how the rate of tax was calculated for 1998. Sen. Steffes questioned how the estimated useful life of the plant is measured, and Mr. Hamilton replied that they are required to determine the useful life of the plant, and it is estimated the merchant plant in Kansas City's useful life is 25 years. He added that the property depreciates each year it is in operation. He also discussed proposed legislation in Missouri which will shift existing taxes on generation assets to an excise tax on energy delivered and eliminate property taxes on generation by 2002. The intent is to preserve local revenue streams before deregulation and to provide an attractive environment for an investment in generation, which could overcome local opposition to building a power plant in the community. The Missouri bill is SB 803, and Sen. Ranson requested that Ms. Torrence get a copy of the bill for the committee.

Sen. Ranson introduced Max Sherman, who first gave a brief biography and continued to the history of Aquila Energy, which is a "nonregulated" subsidiary of UtiliCorp United (Attachment 2). He outlined the purpose of his testimony and gave a national overview, which points out the need for more power plants, and the difficulty for regulated utilities to build plants because of regulations. He continued by discussing the "competitive" market, and independent power producers or "merchant" developers (including non-regulated utility affiliates) and how the ownership risks are being undertaken by them because they are competing with each other. The outcome of this change has resulted in the transfer of the risk factor from the regulated utility and its customers to the developer. The results of this are that competition works and drives the price down and the customers win. He emphasized the fact that a state can meet its power

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needs from plants which are built far outside the state as regional transmission organizations develop and they provide a "one price" transmission rate across long distances. Also, the formation of RTOs and regional transmission tariffs, which is being encouraged by FERC, allow for "one price" transmission charge to wheel energy across long distances with large decreases in transmission rates.

Mr. Hamilton continued by discussing why the plant was built in Missouri and cited three reasons: one was to supply certain Missouri Public Service power requirements and the fact that property taxes are higher in Kansas than Missouri as well as economic development incentives to obtain a competitive package. Location was another consideration and access to existing transmission lines and adjacent electrical substations and natural gas pipelines. The environmental considerations were also important, because the site could be located in a rural area. One of the negatives was the water supply, but Kansas City extended the waterlines to the site to accommodate the plant. Another reason for building the plant in Missouri is that it has a favorable regulatory environment. Mr. Hamilton emphasized the fact that Missouri has favorable regulations with no siting requirements, while Kansas' siting regulations require considerable time to accomplish, which disqualified Kansas in the competition. The project required a "fast track" development because it must be operational by June 1, 2001, and it will supply one-fourth of the 2001 summer peak capacity.

Sen. Brownlee asked if the Kansas Siting Act had been repealed last session, it would have made a difference in their decision, and Mr. Hamilton replied they would have taken a harder look. He also stated that Missouri had interconnections in place for their plant; that some utilities drag their feet, which is a real disincentive. Sen. Steffes discussed building on top of the source of energy and inquired about coal plants, and if that was a consideration. Mr. Hamilton replied that coal plants are not environmentally friendly; that all merchant power plants will have to be gas powered; that declining costs can be credited to the costs of electrical power generation.

Mr. Hamilton continued by giving a Kansas Overview, beginning with the high property taxes relative to other states and that Kansas is competing for power plants in a large geographic market. He recited the hot markets are the States of Oklahoma, Missouri, Arkansas and Illinois, with the capitol of hot markets being the State of Mississippi. An advantage to the state is that power can be wheeled to Kansas and power from Kansas can be wheeled elsewhere. Along with the advantages is a locational disadvantage, with major power markets located east or southeast of the state. He referred to a map, which is attached to his testimony, and pointed out the various regions and to the fact that Texas has its own grid. He also stated that building a grid to Western Kansas, which would be very costly and the Holcomb experience of fifteen years ago, would scare off developers. Major power markets are either east or southeast of the state, and Kansas can't sell into the Western Interconnection or most of Texas. Mr. Hamilton pointed out to the committee the fact that the ideal situation exists in the State of Mississippi, which requires only a Certificate of Public Convenience and Necessity, for all plants, and that from the filing date, only 75 days are required for approval. He stated that repeal of the Generation Siting Act does not repeal environmental or zoning requirements, which leaves that responsibility to local authorities, and requires developers to negotiate with local entities, as it should be. He closed by recommending that power plant development be treated like manufacturing plants, with lower property taxes and competitive economic development incentives. He also urged repeal of the Generation Siting Act and quick action, as there is a stampede to build plants now, and it may be sometime before additional ones are built.

Sen. Ranson asked questions regarding property tax abatements and job credits, and Mr. Hamilton answered that they were given different tax incentives in Missouri, and that the job credits are not significant for the project; that Kansas did have the 10-year tax abatement. Sen. Steffes asked which unit of government gave them abatements in Missouri, and Sen. Barone asked if they even checked with Kansas to see what was available; if Kansas offered a package to Aquila and if they even contacted the State of Kansas to see what was available. Mr. Hamilton replied that they did check to see what was available and that an initial look indicated that financially Kansas appeared to have an advantage. However, when the Missouri economic development package was put together, the advantage swung to Missouri, which technically was the better site. Sen. Barone asked Mr. Hamilton to not make assumptions regarding what Kansas might offer, but to give us a chance to compete, and to inquire as to

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what is available. Sen. Barone also asked questions regarding taxes and the formula used, and Mr. Hamilton cited the methodologies used and explained the net book value is the company's investment. He also told of disadvantages in Oklahoma; however, it is closer to the trading hub, there is significant demand, and tax incentives can be credited for the stampede there.

Sen. Steffes discussed differences in cost per kilowatt hour for the nuclear, coal and the gas powered merchant plants, and Sen. Ranson asked Mr. Sherman if the new transmission interconnection in Western Kansas extending on to Lamar, Colorado will be of benefit to Kansas. Mr. Sherman answered it would add reliability; however, the cost of the transmission line and the additional cost into Colorado would have to be considered. Sen. Ranson stated the problem with transmission needs solving and plays a part when considering Retail Wheeling. The federal government will play a part in solving the problem. Mr. Sherman cited the problem of joining regional transmission organizations, whether it could be done in a voluntary or mandatory process, and the question of forcing the transfer of assets to another entity, as problems confronting FERC. Sen. Ranson thanked Mr. Sherman and Mr. Hamilton for their presentations.

Sen. Ranson announced the agenda for next week.

Committee adjourned at 2:30.

Next meeting will be February 8.





**Kansas Senate Utilities Committee**  
**February 3<sup>rd</sup>, 2000**

Madam chairperson, and members of the Committee. UtiliCorp United, Inc. (UCU) is pleased to appear and present comments today regarding the status of its most recent power plant, located in Cass County, Missouri.

My name is Sheldon Hamilton, I am the property tax manager for UtiliCorp. I have been with the company for 12 years in the tax department.

I would like to present some background information about UtiliCorp as well as comparative tax information about the plant.

UtiliCorp was formed in 1985 from its predecessor company, Missouri Public Service. The company has transformed itself from a Missouri based company with 200,000 customers and \$243 million in annual sales, to a global energy services company with more than 4.5 million customers and 12 month sales of \$14.9 billion, in 5 countries.

Utilicorp is very active in energy marketing and trading - the fastest-growing segment in the industry. Its rapidly growing Aquila Energy unit is currently ranked second largest in the US.

UtiliCorp ranks 132<sup>nd</sup> on the Fortune 500 list, based on 1998 sales. The company is also included in Fortune's list of America's Most Admired Companies and Forbes Magazine's Platinum 400 listing, based on growth and profitability.

UtiliCorp pays approximately \$10,600,000 a year in property taxes in Kansas through its regulated divisions, WestPlains Energy, Peoples Natural Gas and Missouri Public Service. These taxes cover approximately 80 counties.

I have been asked to provide the difference between Kansas and Missouri property taxes on a merchant power plant being built in Missouri. Identical assumptions about market valuation and mill levy increases have been used

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to estimate the taxes. In Kansas, I used the average for the two most likely sites.

The estimated Kansas property taxes exceed the estimated Missouri property taxes by approximately \$66,000,000 over the estimated 25-year-life of the plant. This equates to \$2,640,000 per year.

UtiliCorp currently has electric generation in three states. The state-wide property tax rate on electric assets for those states is as follows. Kansas is 2.75%, Colorado 1.47% and Missouri is 1.77%. These percentages were derived by dividing property tax expense by net book value for 1998, the latest year that actual property tax expense is known.

My final comments pertain to property taxes on generation in Iowa and Missouri. In Iowa, property taxes on generation assets have been shifted to a combination of other taxes. An excise tax on energy delivered, a tax on transmission pole miles and a minimal tax on generation.

In Missouri, there is proposed legislation to shift existing taxes on generation assets to an excise tax on energy delivered and eliminate property taxes on generation altogether by the year 2002.

The intent of this type of legislation is two-fold. The first, is to preserve local revenue streams in advance of deregulation, and the second is to provide an attractive environment for new investment in generation. However, this may have the opposite effect. There can be significant local opposition to locating a power plant within a county. Property tax revenues are an incentive to local residents to accept this type of asset.

This concludes my presentation, I will answer questions at this time.

**Testimony of Max Sherman**  
**Kansas House and Senate Utilities Committees**  
**February 3, 2000**

**Name, title, employer, and work location:**

I am Max Sherman, Vice President, Project Development, for Aquila Energy's Merchant Energy Partners (MEP) subsidiary in Kansas City, Missouri. I am one of those responsible for development of MEP generating projects in the U.S.

**Relevant work experience:**

I've been in the electricity business since 1971 and employed by Aquila Energy since 1996. My most recent assignment was Project Director for development of the Aries Power Plant, near Pleasant Hill, Missouri, which is now under construction. Previously I had power marketing roles within Aquila Energy with responsibility for originating and structuring long term transactions in the Southwest Power Pool. Previous assignments included 12 years of wholesale power marketing for Entergy subsidiaries in New Orleans and Little Rock, including 3 years as a power plant asset manager; and 7 years of nuclear power plant equipment fabrication and construction roles for Commonwealth Edison and Entergy.

**Aquila Energy**

Aquila Energy, a "nonregulated" subsidiary of UtiliCorp, is an international energy merchant that provides energy-related risk management solutions to its customers in the U.S., Canada, and Europe. It is the 2<sup>nd</sup> largest gas marketer and 3<sup>rd</sup> largest power market in the U.S. Aquila has relocated its corporate headquarters and ~400 jobs from out-of-state to downtown Kansas City, and is working to make Kansas City a national energy center.

**Purpose of testimony**

I am here to explain (1) why MEP chose to build the Aries Power Plant in Missouri, (2) national changes that affect Kansas' competitive position for new plants, and (3) what Kansas

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can do to improve its competitive position. The message is simple: Kansas is competing for new power plants in a large geographic market.

I'll start with a national overview of the business environment that results in power plants being built by new market entrants, so that the state issues can be presented in a broader context.

### National overview

1. **The U.S. needs more power plants** as a result of the economic growth we've enjoyed since the last batch of plants were completed in the mid-1980s. This is particularly true in the mid-west, central states, and southeast.
2. **The regulatory paradigm makes it difficult for regulated utilities to build plants.** Utilities have major risk if they build new power plants because, with restructuring coming, they don't know if they'll have the customer base to pay for the new plants for their useful (e.g., 30+ years) lives. They also don't know what the restructuring rules will be. That, along with rate disallowances from construction of nuclear plants in the 1980s, has limited construction of new plants by utilities around the country.
3. **Most new plants are being built in the "competitive" market.** When demand for power exceeded supply in June 1998, it broke the log-jam on new plant orders. Most new projects are being undertaken by independent power producers or "merchant" developers (including non-regulated utility affiliates) willing to take the ownership risks for these plants without having them in rates. Power has become a commodity, and supply is becoming like that in other industries (steel, autos, chemicals) in that suppliers will build production capacity and compete with each other for sales in their markets.
4. **Utilities can reduce their risk by buying power in the market.** They can obtain bids to supply power from new plants built by others, for terms much shorter than the useful lives of the plants. This transfers risk from the regulated utility and its customers to the developer. For example, MPS had an open bidding process resulting in a 4 year contract with MEP Pleasant Hill for power from the plant we're building in Missouri. MPS is out



of the deal when our contract expires, and can shop the market for the best deal out there. Competition works, and customers win. We win only if we're the low cost provider.

5. **Power plants don't have to be built locally to meet local load.** A state's power needs can be served from plants built far outside the state as regional transmission organizations (RTO's) provide "one-price" transmission rates across long distances. FERC is strongly encouraging formation of RTOs. In the central U.S., RTOs or regional transmission tariffs are in place (SPP and MAPP) or forming (Midwest ISO), and they're all in merger discussions. We expect to see one RTO from Ohio to Kansas, and from Canada to the Texas border. That will allow for "one-price" transmission wheels across long distances, with large drops in transmission rates. For example, three years ago energy could be moved from North Dakota to Kansas City, Missouri for 1 cent per kWh. Today, under the MAPP tariff, it is ~0.1 cent per kWh. SPP has also reduced its rates, and adjusts them frequently to maximize transactions and revenues to transmission providers.

### **Aries Power Plant – why was it built in Missouri?**

#### **1. Economics**

- One reason for building the plant was to supply certain Missouri Public Service power requirements, which MEP won the right to meet in an open competitive bidding process. It made sense to locate Aries on MPS' transmission system to avoid the cost of "wheeling" power in from a remote location.
- Taxes – Property taxes are higher in Kansas than Missouri. Mr. Sheldon Hamilton has testified on how Kansas property taxes compare to those in other states in which UtiliCorp has generating assets.
- Economic Development incentives – We were able to obtain a competitive package.

#### **2. Favorable site characteristics**

- Location -- In the load center of the initial customer (helps reliability).
- Existing infrastructure -- The Aries site has 161 kV and 345 kV transmission lines crossing it, an adjacent electric substation and interstate natural gas pipelines nearby.

Water supply was a negative, but we overcame it with a bidding process which resulted in Kansas City (Mo.) agreeing to extend a water line to our site.

- Environmental – the site is in a rural area, which helps with zoning. It's in an EPA "attainment" air quality region, which made it easier to obtain the construction and operating permit from the state. Water supply was a drawback, but Kansas City, Mo. is extending their water system to our site.

### 3. **Ability to quickly complete the project**

- The Aries Power Plant must be operational June 1, 2001 to meet the MPS contract obligation. This required a "fast track" development effort to get the project into construction, which is typical of new projects selling into wholesale power markets.
- Missouri has a favorable regulatory environment, with no state siting process for new generation or transmission upgrades, which could have delayed construction.
- Electric interconnection -- The utility worked with us to get interconnection arrangements in place. The time it takes for this elsewhere in the country is a real concern, because the time required can easily delay or kill a project.

## Kansas overview

1. **Kansas property taxes are high relative to other states.** Kansas should treat new power plants for what they are – clean, efficient manufacturing plants that can locate almost anywhere to supply their geographic market. Without that treatment, taxes and jobs from these plants will go elsewhere. Power plants are major capital investments that create jobs and revenues for local government. Kansas should do what is needed to get its share of these projects, including making economic development incentives available that are competitive with other states.
2. **Kansas is competing for power plants in a large geographic market.** Power from much of the central U.S. can be wheeled to Kansas, and power from Kansas can be wheeled elsewhere. Kansas competes with much of the country for new plants.
3. **Kansas has a locational disadvantage in its geographic market.** Major power markets are east or southeast of the state. Because of weak electric interconnections, Kansas can't readily sell into the Western Interconnection or most of Texas.

4. **Kansas also needs additional power supplies** to meet increased electric demands due to economic growth, just like many other states.
5. **Kansas' Generating Siting Act discourages investments by new entrants.**
  - The act seems intended to protect Kansas ratepayers from inappropriate investments by regulated utilities which could otherwise be included in rates. That makes sense when ratepayers bear the risk of those investments. It doesn't make sense for new market entrants that bear the financial risks of those investments themselves.
  - State review of project siting, beyond the environmental reviews, risks delay and higher project costs. We understand that Sunflower Electric Cooperative's Holcomb power plant took 1-2 years to get through the process. That kind of delay can and will kill projects. While recent proceedings have moved fairly quickly, the risk of intervention in the process by competitors to delay or kill an application still exists.
  - MEP believes that siting oversight should be the responsibility of local zoning authorities, as is the case for other industrial projects.

#### What can be done to make Kansas more competitive?

1. **Encourage power plant development**, such as treating them like other manufacturing plants considering locating in Kansas. That includes lower property taxes and making competitive economic development incentives available.
2. **Repeal the generation siting act** – it's no longer needed.
3. **Act quickly** – there's a boom underway in the building of new power plants, and when it's over it may be some time before many additional ones are built.

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