

MINUTES OF THE SENATE UTILITIES COMMITTEE.

The joint meeting of the House and Senate Utilities Committees was called to order by Chairperson Carl Holmes at 9:30 a.m. on January 16, 2002 in Room 526-N of the Capitol.

All members were present except:

Committee staff present: Raney Gilliland, Legislative Research
Ann McMorris, Secretary

Conferees appearing before the committee: none

Others attending: see attached list on House Utilities Committee
minutes of same date

Chairman Holmes called on Larry Holloway of Kansas Corporation Commission who presented update on regional transmission organizations (RTO) with slides and a comprehensive explanation of each. Slides covered (1) profile of electric power system; (2) map of Kansas electric transmission lines; (3) southwest power pool map; (4) FERC regions and control areas; (5) transmission, generation and demand trends; (6) system congestion; (7) FERC Order 888 - requirements of all transmission owners; (8) FERC order 888 RTO policies; (9) FERC order 2000; (10) Order 2000 required filings; (11) Order 2000 minimum RTO characteristics; (12) Order 2000 required RTO Functions; (13) Map of RTOs; (14) Midwest RTOs; (15) FERC July 2001 Orders, October & November 2001; (16) FERC 12/20/01 orders; (17) Map of MISO and ARTO; (18) FERC MISO conditions; (19) Future FERC Actions; (20) KCC RTO Activity.
(Attachment 1)

Tom Day of KCC introduced Paula Lentz, KCC assistant general counsel who presented a report on Kansas ad valorem tax refund matters. (Attachment 2)

The next meeting of the joint committees will be on Wednesday, January 23, 2002.

Adjournment.

Respectfully submitted,
Ann McMorris, Secretary

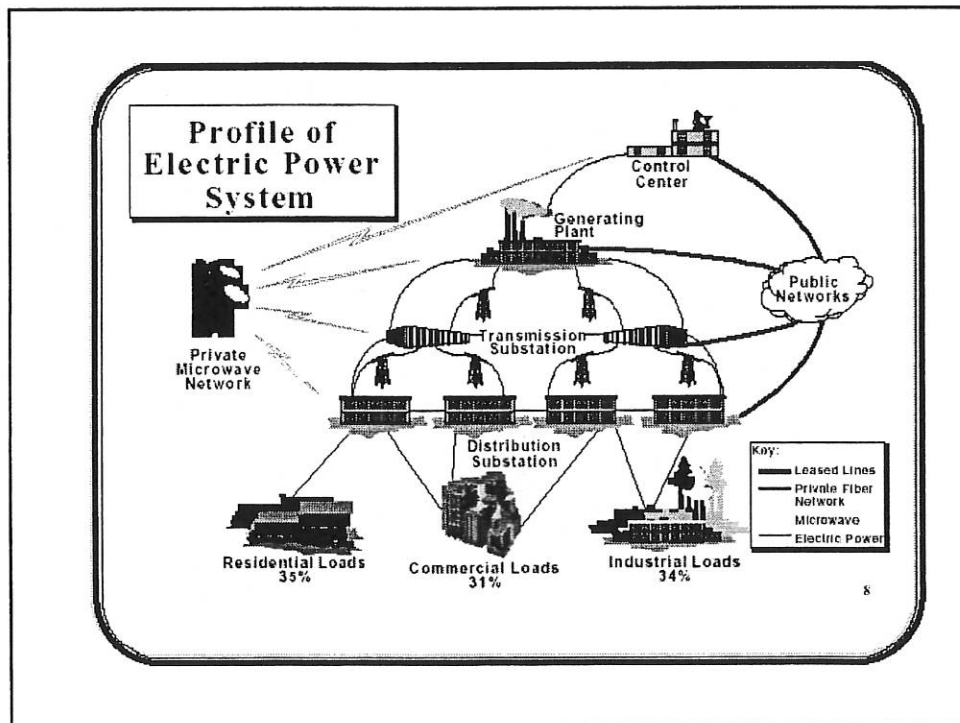
Attachments - 2

Update on RTO Activities

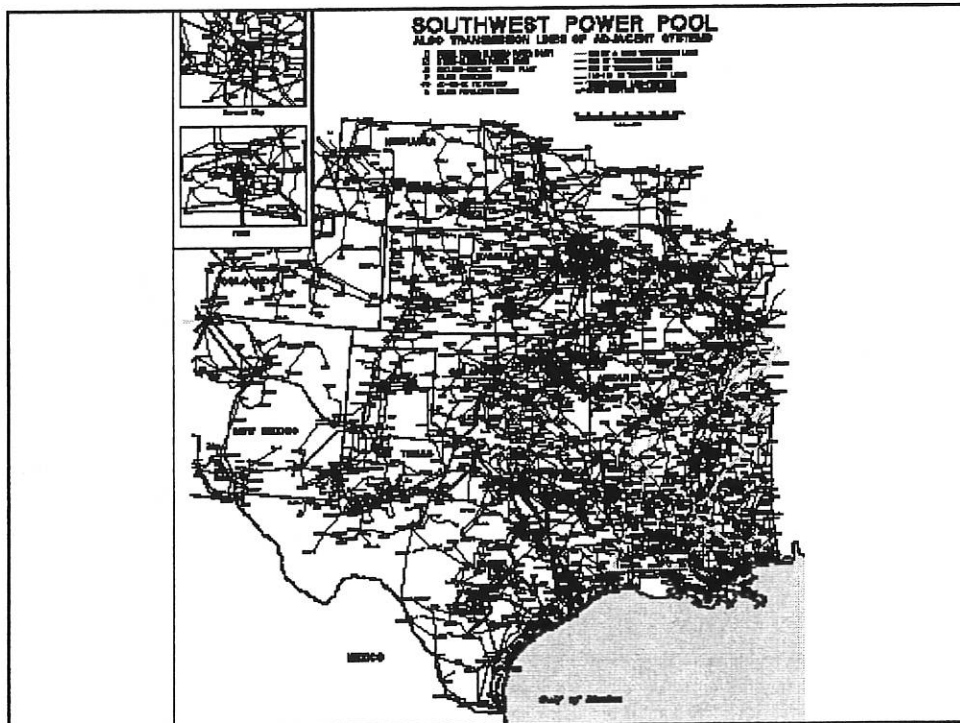
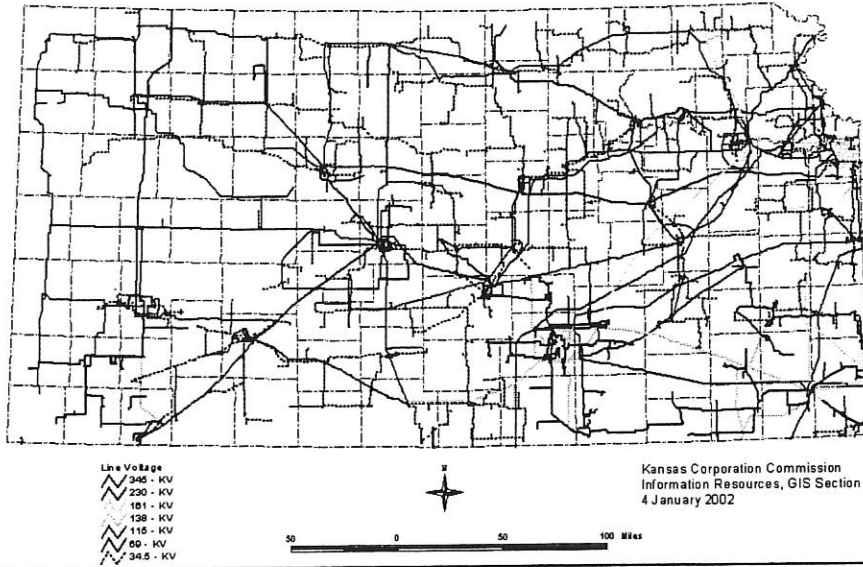
Larry Holloway

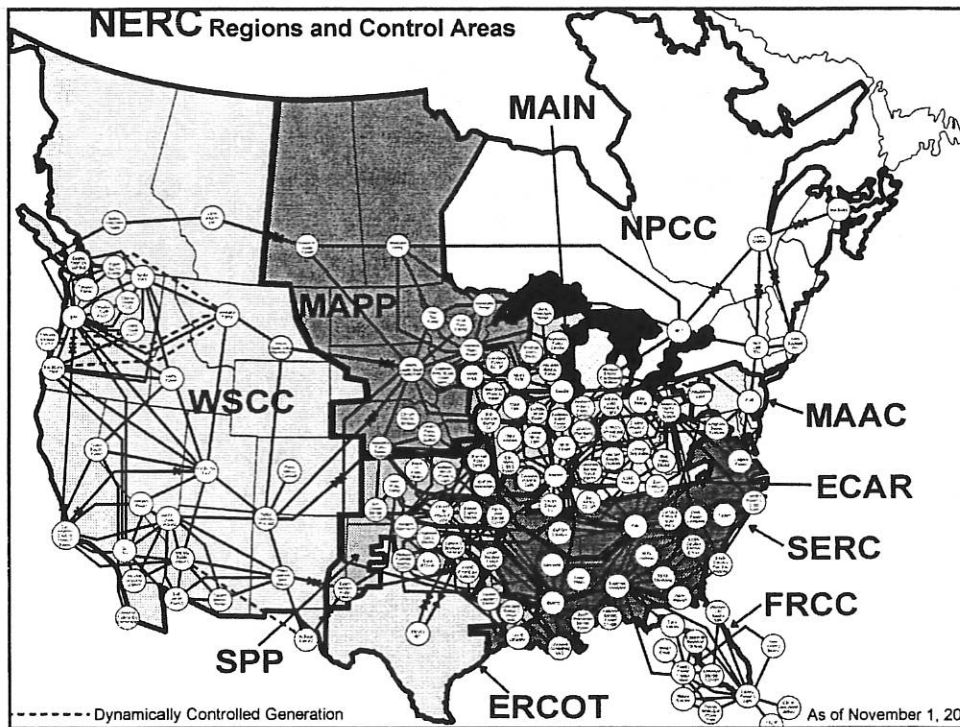
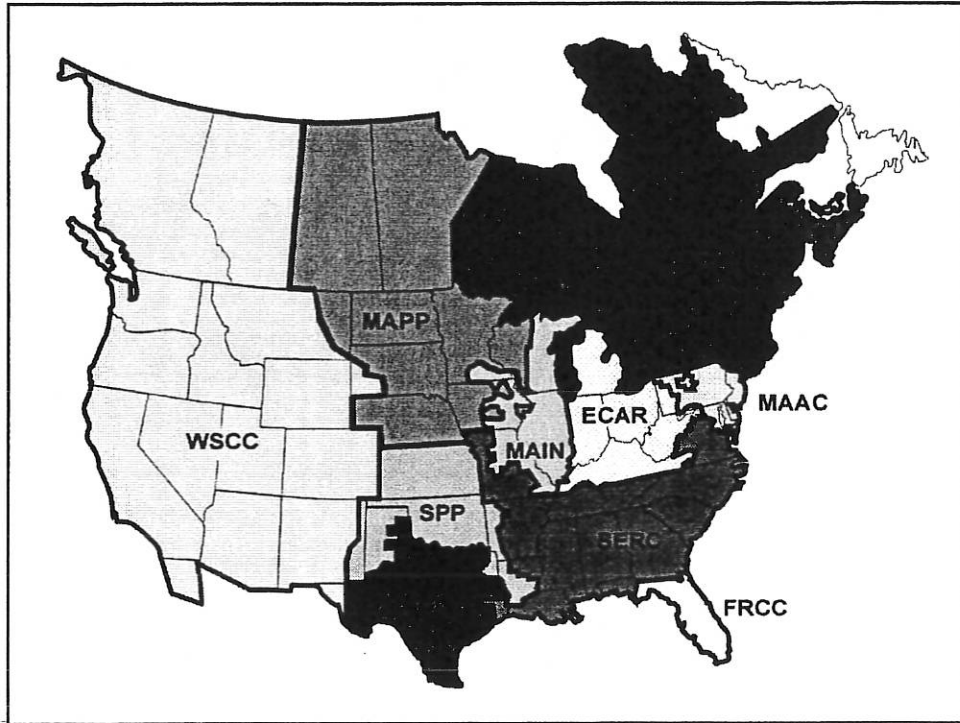
Chief of Energy Operation

Kansas Corporation Commission Staff



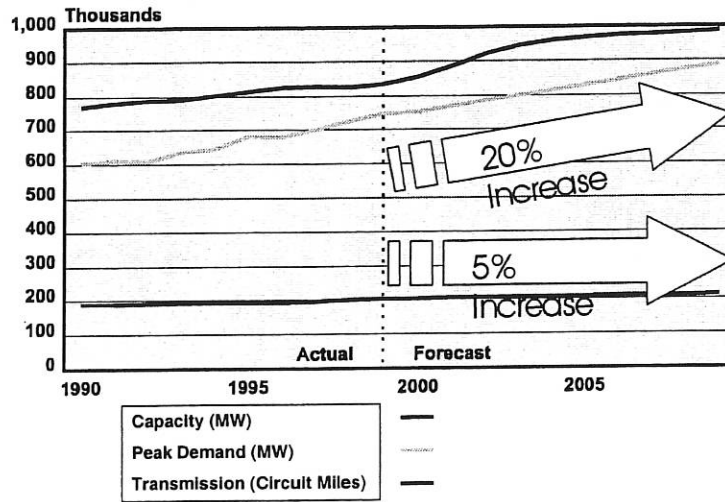
Kansas Electric Transmission Lines



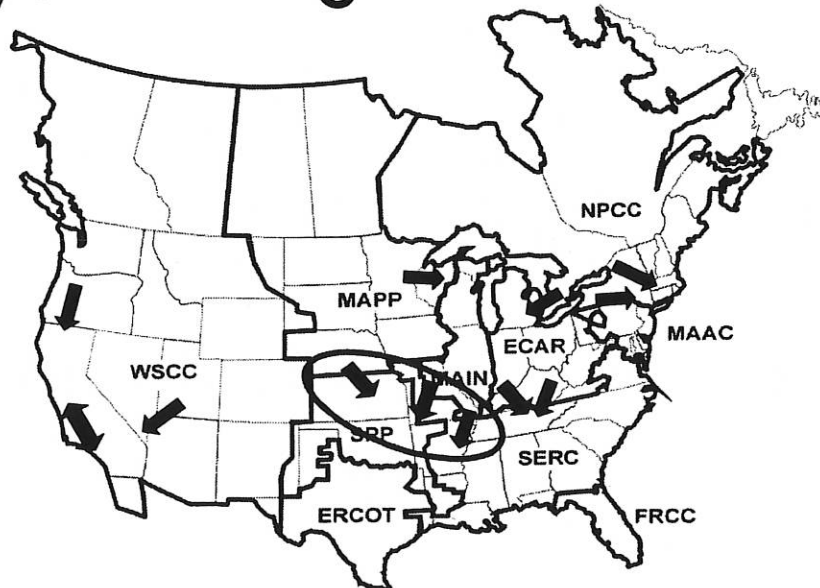


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Transmission, Generation and Demand Trends



System Congestion



1-4

FERC Order 888
April 1996
Requirements of all Transmission Owners

- Open Access Tariffs
- Ancillary Services
- Same-Time Information System
- Transmission Separation
–from generation and marketing

FERC Order 888
RTO Policies

- Nondiscriminatory Access
- Uniform Tariffs

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FERC Order 2000

December 1999

- Asked All Transmission Owners to Join RTOs
 - Including non-jurisdictional
- Minimum RTO Characteristics
- Required RTO Functions

Order 2000 Required Filings

- For Transmission Owners Planning to Join an RTO
 - A Proposal to join by Dec 15, 2000
- For Transmission Owners Not Planning to Join an RTO
 - Description of efforts, reasons and plans by Oct 15, 2000
- For Transmission Owners Already in an RTO
 - Explain how RTO satisfies order 2000
 - Plans to join or modify RTO to satisfy order 2000

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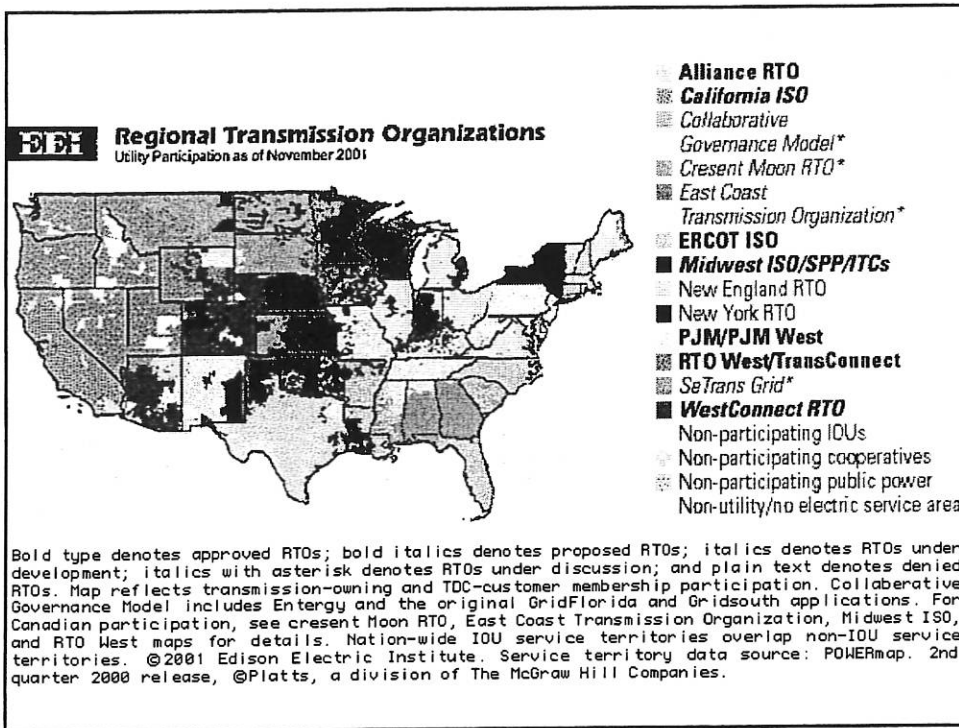
Order 2000 Minimum RTO Characteristics

- Independence
 - From market participants
- Scope and Regional Configuration
 - Sufficiently large and interconnected
- Operational Authority
 - Must be security coordinator
- Maintain Short-Term Reliability
 - Exclusive authority

Order 2000 Required RTO Functions

- Tariff Administration
- Congestion Management
- Address Parallel Flows
- Ancillary Services – Provider of Last Resort
- OASIS, TTC and ATC
- Market Monitoring
- Planning and Expansion
- Interregional Coordination

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Midwest RTOs Developing by June 2001

- Midwest ISO
- Southwest Power Pool
- Alliance Regional Transco

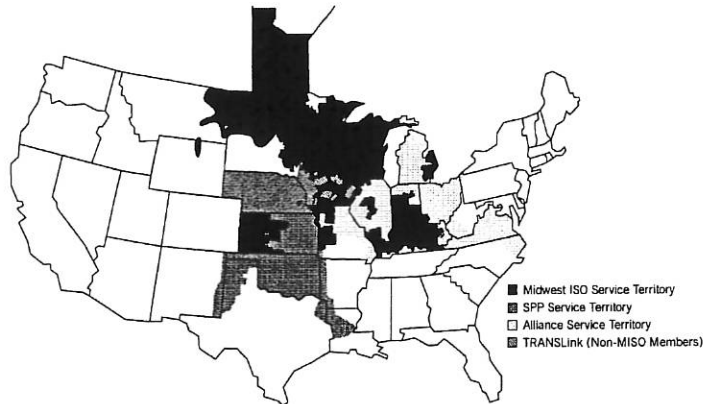
FERC July 2001 Orders

- SPP RTO Insufficient Scope
 - Entergy may be better fit with south
 - MISO appears to be logical Midwest RTO
 - SPP without Entergy too small
- One RTO for the Midwest
 - Prefer MISO
- SPP, MISO and Alliance Mediation
 - SPP also to participate with Southern mediation

October and November 2001

- SPP and MISO Announce Merger Intentions
 - October 19, 2001
 - Details to be reviewed February, 2001
- FERC Announces State and Regional Panels
 - Conferences held November 2001
 - Comments from Midwest state commissioners December 2001

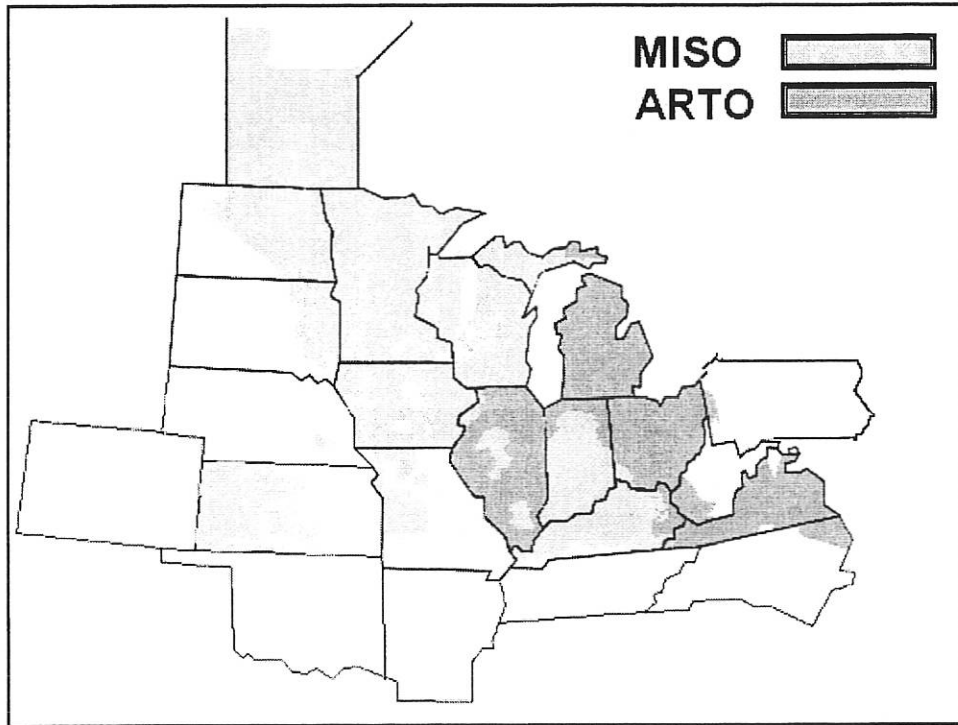
MISO TRANSLink SPP Alliance



FERC 12/20/01 Orders

- Alliance Directed to Join MISO
 - Reversal of July finding
 - Responsive to state commission comments
- Approval of MISO RTO Status
 - First RTO approved
 - Conditional Approval

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FERC MISO Conditions

- Remove TO Veto Power
- 30 Days to Address ARTO Seams Problem
- Future Revisions of Market Monitoring Provisions
 - Based upon upcoming FERC rulemaking

Future FERC Actions

- Market Design Technical Conference
 - January 22 & 23, 2002
- FERC Meeting with State Commissioners
 - NARUC Winter conference February 11 & 12, 2002
- Market Design Rulemaking

KCC RTO Activity

- Approval of WPE and MISO
- Monitoring of MISO and SPP
- Review of MISO and SPP Merger Agreement
 - Expected in February, 2002

REPORT ON KANSAS *AD VALOREM* TAX REFUND MATTERS

This summary outlines the federal and state proceedings involving the Kansas *ad valorem* tax refunds ordered by the Federal Energy Regulatory Commission (“FERC”). Included in this summary are brief descriptions of the court cases resulting from appeals taken from decisions issued by FERC and the Kansas Corporation Commission (“KCC” or “Commission”).

Executive Summary

On May 3, 2001, the Commission issued an order announcing that it was following the general policy considerations recommended by the Kansas House in House Resolution No. 6006 and by the Kansas Senate in Senate Resolution No. 1808. Accordingly, the Commission established a low income energy assistance program to be funded with *ad valorem* tax refunds currently held in escrow and subsequently recovered by the Kansas local distribution companies that were participating in the Commission proceedings discussed below. The participation by Kansas customers who qualify under the Commission’s guidelines has been great and may require that all of the *ad valorem* tax refunds be utilized to fund the program.

As a result of the Commission’s May 3, 2001 Order, numerous appeals were taken to the courts of several jurisdictions. Appeals were filed in United States Court of Appeals for the District of Columbia, United States District Court for the District of Kansas, the Court of Appeals of the State of Kansas and the District Court of Johnson County, Kansas. These appeals have challenged the Commission’s authority to direct distribution of gas supplier refunds.

As a result of the numerous appeals, the receipt of the additional *ad valorem* tax refunds from interstate pipelines by Kansas local distribution companies has been slowed. The *ad valorem* tax refund monies currently held in escrow are not sufficient to fully fund the low income energy assistance program that was established by the Commission. The additional monies (now stalled by the appeal filed at the United States Court of Appeals for the District of Columbia of a FERC settlement) are necessary to fully fund the program.

Background

In 1988, the United States Court of Appeals for the District of Columbia required the FERC to explain its existing policy allowing the Kansas *ad valorem* tax assessed against producers and royalty owners to be recovered from customers of interstate natural gas pipelines. In 1993, FERC reversed this long standing policy that had been in effect for approximately 19 years and ordered the refund of *ad valorem* taxes paid in excess of the maximum lawful price (“MLP”) that could have been charged by producers during the period from 1988 to 1993. In 1996, on appeal again, the United States Court of Appeals for the District of Columbia upheld FERC’s order finding that reimbursement of Kansas *ad valorem* taxes, as part of the price paid in a regulated “first sale” of

natural gas, did not qualify as a permissible allowance under Section 110 of the Natural Gas Policy Act of 1978 (“NGPA”), 15 U.S.C. § 3320 (1998), and extended the refund period to include sales made during the period from October 1983 to 1988. *Public Service Company of Colorado v. FERC*, 91 F.3d 1478 (D.C. Cir. 1996), *cert. denied*, 117 S. Ct. 1723 (May 12, 1997)(hereinafter referred to as “*Public Service*”).

The consequence of the holding in *Public Service* was that any amounts received after October 3, 1983, in a regulated first sale of natural gas as reimbursement of Kansas *ad valorem* taxes, regardless of tax year, were subject to the ceiling prices prescribed by the NGPA and could not be retained by the regulated first seller to the extent the total compensation received exceeded an applicable MLP. The court’s decision did not rule that receipt of reimbursement of Kansas *ad valorem* taxes by regulated first sellers was *per se* unlawful. As an additional consequence, the extension of the refund period had the effect of tripling the liability due to FERC’s interest rate on refunds and its compounding rules.

Federal Proceedings

To implement the 1996 court decision, FERC initiated a series of pipeline-specific and producer-specific cases. In the initial order on remand, FERC ordered first sellers, both those who were party to the proceedings in *Public Service* and those who were not parties, to comply with generic refund procedures. *Public Serv. Co. of Colorado*, “Order Denying Petitions for Adjustment and Establishing Procedures for Payment of Refunds for Kansas *Ad Valorem* Taxes,” 80 FERC ¶ 61,264 (1997), *reh’g denied*, “Order Denying Rehearing,” 82 FERC (CCH) ¶ 61,058 (1998). As part of these procedures, the interstate pipelines sent bills to each producer from whom they purchased natural gas.

Based upon refund reports filed at FERC by interstate pipelines, the total liability for producers and royalty owners was estimated at one time to be as high as approximately \$400 million. These refund reports generally made no attempt to reconcile whether tax reimbursement to a producer did, in fact, result in a price that exceeded the MLP or determine whether any amounts were uncollectible. Eventually, the total liability will be reduced by settlement and resolution of the discrete-type issues mentioned above. It should be noted that due to the lapse of time, approximately seventy-five (75) percent of the total liability will represent accrued interest.

The KCC and State of Kansas jointly intervened in the various FERC proceedings and supported generic relief where all small producers would be granted equitable relief through the abatement of the interest. FERC, however, ruled that it will not consider generic relief but will consider relief on an individual case-by-case basis. FERC also ruled that it would not look at the legal effect the Kansas statute of limitations may have on any claims on a generic basis. FERC specifically attacked the applicability of Kansas House Bill 2419, now codified at K.S.A. 2000 Supp. 55-1624. The KCC and State of Kansas jointly appealed FERC’s ruling on Kansas House Bill 2419. The United States Court of Appeals for the District of Columbia is holding the appeal in abeyance until FERC rules on an application for relief filed by the Strohl family. The Strohls are royalty

owners who have asserted that the Kansas statute of limitations, including Kansas House Bill 2419, bar recovery of any claim. The Strohls have requested a hearing; however, FERC has not taken any action to set the matter for hearing.

In March 2000, the KCC initiated multilateral settlement discussions in Topeka, Kansas, involving a number of interstate pipelines, numerous affected working interest owners, pipeline customers, state commissions, and those parties who were not subject to FERC jurisdiction. The settlement discussions were sponsored by the KCC, in conjunction with Kansas Senator Morris and the Attorney General of the State of Kansas, in an attempt to reach comprehensive, just and reasonable resolution of the Kansas *ad valorem* tax refund problem that has plagued the State of Kansas as well as the Commission, interstate pipelines, producers, and other parties for more than a decade. These proceedings held in Topeka were highly publicized and widely attended.

The KCC efforts, although continuing, culminated in settlement agreements being filed at FERC and refunds to be distributed to local distribution companies (“LDCs”) by Northern Natural Gas Company (“Northern”), Panhandle Eastern Pipeline Company (“Panhandle”), Colorado Interstate Gas Company (“CIG”) and Williams Gas Pipelines Central, Inc. (“Williams”). These settlements have brought significant relief to small producers and royalty owners.

With respect to Williams, the primary settlement agreement which provides substantial payments to Kansas local distribution companies was approved by FERC on April 12, 2001 and affirmed by FERC in its Order Denying Rehearing issued on June 11, 2001.¹ The Midwest Gas Users’ Association (“MGUA”) appealed these FERC Orders to the United States Court of Appeals for the District of Columbia, Case No. 01-1342. MGUA is an association of unidentified members. The appeal itself is a collateral attack on KCC orders that established an energy assistance program for low income residential customers with the *ad valorem* tax refunds recovered by Kansas Gas Service Company, a division of ONEOK, Inc. (“KGS”); United Cities Gas Company (“United Cities”) and Greeley Gas Company (“Greeley”), divisions of Atmos Energy, Inc.; and UtiliCorp United, Inc. (“UtiliCorp”). The KCC intervened in the appeal and joined with the other parties in filing a Motion to Dismiss or in the alternative, Summary Affirmance. On December 7, 2001, the United States Court of Appeals granted the Motion for Summary Affirmance. MGUA has 45 days in which to seek rehearing of the decision and 90 days to file a Petition for Writ of Certiorari in the United States Supreme Court.

If MGUA seeks neither rehearing of the United States Court of Appeals’ order nor certiorari from the United States Supreme Court, the effective date of the Williams settlement will be March 8, 2002. This effective date would trigger the following dates/events pursuant to the settlement:

January 7, 2002 – Interest Cut-Off Date (60 days prior to the effective date).
Interest will be calculated through November 23, 2001.

¹/This third settlement agreement covered all claims except those attributable to the State of Missouri. The Missouri Public Service Commission opted out of the settlement in order to litigate its refund claims against producers.

March 18, 2002 – Williams pays assessment of \$15,000 to KCC for costs assessed in Docket No. 99-GIMG-068-GIG (10 days after effective date).

March 20, 2002 – Working Interest Owner payments due to Williams (12 days after effective date).

March 28, 2002 – Williams makes refunds to working interest owners who have overpaid their refund obligation (20 days after effective date).

April 3, 2002 – Williams makes refunds to jurisdictional customers (except those who opted out) and the 10 KCC customers listed in the original and second KCC Settlements (14 days after payments are received from working interest owners).

Counsel for MGUA also filed a class action law suit against KGS, United Cities and Greeley and UtiliCorp in the United States District Court for the District of Kansas, Case No. 01-2315-CM. The named plaintiffs are Justin Hill, Gary A. Martin, Mary Ann Martin, Jim A. Mowder, Allan Flentie, Robert A. Crown, David Stutenroth, William D. Hamilton, Mary Alice Sandidge, Maria Sanchez, Midwest Grain, Inc., Lawrence Paper Company, Inc., and W.S. Dickey Clay Products Manufacturing Corporation. KGS, United Cities, Greeley, and UtiliCorp responded by filing a motion to dismiss. The KCC filed an amicus brief in support of the motion to dismiss. On December 21, 2001, MGUA filed a Motion to Amend the complaint to name the KCC as a party defendant. The amendment alleges that the KCC and the Kansas Legislature unlawfully conspired to use the *ad valorem* tax refunds recovered by these Kansas local distribution companies for a low income energy assistance program. The complaint and now amended complaint are collateral attacks on KCC orders that established the low income energy assistance programs. The KCC filed an amicus response opposing the amendment. A decision from the Federal District Court is expected soon.

ANR Pipeline Company and El Paso Natural Gas Company have reached settlements with producers that sold gas to them during the applicable time period. None of the monies collected will be returned to any LDC customer. FERC ruled that these two pipelines were entitled to keep any monies recovered from producers because of prior rate case settlements.

Settlement negotiations have commenced with Kinder Morgan Interstate Gas Transmission Company, formerly K N Interstate Gas Transmission Company. It is anticipated that a settlement agreement will be filed at FERC the week of January 14, 2002. The Kansas local distribution company that is most impacted by the settlement agreement is Midwest Energy, Inc. Midwest Energy, Inc., is an electric and gas cooperative, headquartered in Hays, Kansas. If a settlement agreement is reached and approved by FERC, only the claims concerning *ad valorem* tax refunds that will remain at FERC are the claims by the Missouri Public Service Commission with respect to Williams.

State Proceedings

In 1999, several producers filed lawsuits against several royalty owners in the District Court of Stevens County, Kansas, seeking to recover tax reimbursements paid to them but ordered by FERC to be returned. The royalty owners argued that the action was barred by the statute of limitations, including the recently passed House Bill 2419, now codified at K.S.A. 2000 Supp. 55-1624. The Attorney General intervened in the proceeding on behalf of the State of Kansas to defend the constitutionality of K.S.A. 2000 Supp. 55-1624. The District Court ruled that the action was barred by K.S.A. 60-512 and that, in the alternative, the equitable defense of a "change in circumstances" precluded recovery on any claim of unjust enrichment. The District Court also ruled that K.S.A. 2000 Supp. 55-1624 was unconstitutional. The District Court's decision was appealed to the Kansas Supreme Court. The issues are currently being briefed. It is anticipated that the Kansas Supreme Court will hear oral arguments in early 2002. The parties recently filed a motion to continue the oral argument in light of FERC's approval of settlement agreements discussed above which precludes settling producers from assert any claims against royalty owners.

In early 2000, the KCC became concerned that increases in the price of natural gas could create problems for consumers as the winter heating season approached. The KCC gathered a group of knowledgeable individuals to discuss the problems higher gas prices would create, and to develop potential solutions. The KCC Task Force on Natural Gas first convened in June 2000 and was comprised of members from local distribution companies, natural gas producers, social service agencies, KCC staff and others concerned with the impact that unusually high gas bills would have on Kansas consumers. At the time, gas was projected to reach a price of approximately \$4.25 per MMBtu by winter. Throughout its deliberations, the KCC Task Force became most concerned about the potential impact of high winter bills on consumers just above the poverty level, because they make too much money to qualify for the low income assistance programs already in place, yet would suffer hardships if the trend of increasing gas prices continued.

On January 2, 2001, the Commission issued an order in Docket No. 99-KGSG-477-GIG authorizing KGS to partially release *ad valorem* tax refund monies held in escrow to current residential sales customers and to a gas assistance program ("GAP") for low income customers. The GAP program was authorized by the KCC in Docket No. 01-KGSG-494-TAR.

In mid-January, 2001, both the Kansas Senate and House passed resolutions requesting the KCC use all *ad valorem* tax monies to provide residential ratepayer relief to those in need. House Resolution No. 6006 and Senate Resolution No. 1808. At that time, it was estimated that KGS; United Cities, Greeley and UtiliCorp will recover the following amounts, including any monies currently held in escrow:

| | |
|----------------------------|----------------|
| Kansas Gas Service: | \$23.1 million |
| UtiliCorp United: | \$ 3.4 million |
| Greeley Gas Company: | \$ 0.7 million |
| United Cities Gas Company: | \$ 4.6 million |
| Total | \$31.8 million |

Each of these companies is an investor-owned public utility that utilized substantial transportation service from Williams during the period from 1983 to 1988. Williams is the source of the vast majority of the refunds for each of these companies.

On March 6-7, 2001, April 4, 2001, and April 10, 2001, the KCC conducted hearings to determine the refund procedures to be implemented for additional monies to be recovered by KGS, United Cities, Greeley and UtiliCorp by virtue of the settlement agreement with Williams which was ultimately approved by FERC on April 12, 2001. As a result of the hearings, the KCC directed that all recovered *ad valorem* tax refund monies be used to fund low income energy assistance programs with any residual to be refunded to current sales customers, as provided in the current tariff for each respective LDC. Presently, the Commission's orders establishing the low income energy program are on appeal.

Farmland Industries, Inc. ("Farmland") and Vulcan Materials Company ("Vulcan") filed an appeal with the Kansas Court of Appeals, Case No. 01-87485-A, to challenge the KCC orders that established a low income energy gas assistance program. Kansas Industrial Customers also filed an appeal with the Kansas Court of Appeals, Case No. 01-87500-A. This case was consolidated with the Farmland and Vulcan appeal. The Kansas Industrial Customers consist of the University of Kansas Medical Center, Cargill, Inc., General Motors Corporation, Owens-Corning Fiberglas and Proctor & Gamble Manufacturing, Inc. On November 21, 2001, the Kansas Court of Appeals issued a decision in these appeals affirming the KCC orders. Farmland and Vulcan have petitioned the Kansas Supreme Court for review. The Kansas Industrial Customers did not and consequently, the Court of Appeals' decision is final with respect to their rights and interests.

MGUA filed two appeals in the Johnson County District Court, Case Nos. 01 CV 3957 and 01 CV 4836, to challenge the same KCC orders establishing a low income energy fund. These two appeals were transferred to the Kansas Court of Appeals. MGUA identified the following entities as participating members in this particular appeal at one time or another: U.S.D. 500, Kansas City, Kansas, Public Schools; Kansas Municipal Gas Agency; City of Lincoln, Kansas and the Lawrence Paper Company. On January 11, 2002, the Kansas Court of Appeals again affirmed the KCC orders that established the low income energy assistance programs. MGUA has 30 days in which to petition the Kansas Supreme Court for review.

Also, the Kansas Energy Group filed an appeal with the Kansas Court of Appeals, Case No. 01-87760-A, to challenge the same KCC orders. The Kansas Energy Group consists of Via Christy Medical Center, Boeing Company, Beech Aircraft Company and Cessna Aircraft Company. On January 11, 2002, the Kansas Court of Appeals affirmed the KCC orders once again. The Kansas Energy Group has 30 days in which to petition the Kansas Supreme Court for review.

KGS, United Cities, Greeley and UtiliCorp implemented the assistance programs and are in the process of determining eligible customers who qualify for assistance. These programs were widely advertised. Customer participation and interest are high. It is anticipated that as much as 100 percent of the *ad valorem* tax refunds recovered by these local distribution companies will be used to fund the program.