

MINUTES OF THE SENATE UTILITIES COMMITTEE.

The meeting was called to order by Chairperson Senator Stan Clark at 10:45 a.m. on May 1, 2002 in Room 235-N of the Capitol.

All members were present except: Senator Wagle (excused)
Senator Tyson (excused)

Committee staff present: Bruce Kinzie, Revisor of Statutes
Raney Gilliland, Legislative Research
Ann McMorris, Secretary

Conferees appearing before the committee:
Doug Lawrence, Western Resources
J. C. Long, Aquila
Larry Holloway, Kansas Corporation Commission

Others attending: See attached list

Chairman Clark opened the hearing on:

Substitute for HB 3017 - Off-system and wholesale sales by utilities of electricity generated from renewable resources and technologies.

Proponents

Doug Lawrence, Western Resources, urged the passage **Sub. For HB 3017**. By allowing utilities to retain a portion of the net revenue from renewable energy sales the state would be taking a proactive market-based approach that enables and encourages investment in new renewable generation facilities. (Attachment 1)

J. C. Long, Aquila, supports passage of **Sub HB 3017**, which would allow utilities that own or have purchased power contracts for renewable energy to retain a portion of income from wholesale sale of that energy. (Attachment 2)

Bruce Graham of KPECo, provided a written statement. (Attachment 3)

The committee asked many questions regarding profits, rate management, definition of renewable attributes, the effect on the consumer, how other states have addressed this matter and the incentives for building.

Opponents

Larry Holloway, Kansas Corporation Commission, does not support **Sub HB 3017** as it attempts to provide an incentive for renewable energy by allowing an electric utility that purchases renewable energy to resell it when market conditions are favorable and keep a large portion of the profits from that transaction. The Commission opposes this legislation for the following reasons: (1) this bill is unnecessary; (2) this bill is harmful; and (3) there are less costly ways to subsidize renewable energy. The attached testimony details the reasons for the Commission opposing this legislation. (Attachment 4)

Considerable discussion on the points presented in opposition.

Chair closed hearing on **Sub for HB 3017**.

No action taken. The meeting was adjourned.

Respectfully submitted,

Ann McMorris, Secretary

Attachments - 4



**Testimony before the
Senate Utilities Committee**

By

Doug Lawrence, Vice President, Public Affairs

Westar Energy

May 1, 2002

Chairman Clark and members of the committee, I am Doug Lawrence, vice president, public affairs for Westar Energy.

House Bill 3017 encourages development an important resource — renewable energy. Kansas is said to be the third-best state in the nation for the production of wind power. Therefore, it is fitting that our state would develop this resource.

As the state's largest electric utility, Westar Energy is well positioned to play a big role in renewable energy projects. As this committee considers legislation to encourage development of renewable energy projects, we encourage you to closely look at a market-based approach.

Utilities in our region are interested in purchasing energy generated from renewable sources, including wind. Wholesale opportunities to sell this power exist north, south and east of Kansas. Uncertainty about the status of federal incentives tied to so-called "green" energy and the status of transmission systems to deliver that power into those markets makes determining the economics of long-term commitments difficult at best. Wind energy in this aspect is like other products of the state. Kansans do not consume all of the wheat produced here. Instead we participate in markets to deliver that native product to consumers around the world. Wind-generated electricity can be exported to other utilities that have specific needs and opportunities beyond those in our state.

Senate Utilities Committee
May 1, 2002
Attachment 1-1

Westar Energy increasingly is interested in renewable energy opportunities in Kansas. Our company was the first to introduce commercial wind applications in Kansas, with two wind turbines installed on the grounds of Jeffrey Energy Center in 1999. Last year, our company made a bid to purchase power from the Montezuma wind farm but was outbid by another utility in the state. Our company is considering other opportunities to purchase power from similar projects in Kansas.

In addition to the environmental attractions of wind energy, wind farms bring jobs and economic development to rural areas. The economics of the projects and market opportunities associated with them control the viability of such endeavors.

Westar Energy supports HB 3017. This legislation uses a market-based approach to encourage development of renewable energy in our state. It recognizes the opportunities that exist for development of wind technology and the ability to leverage a natural resource in Kansas. Currently, however, the Kansas Corporation Commission requires that any revenues from off-system sales of electricity generated by our system resources be credited back to our customers. Without the ability to realize some benefit of marketing energy generated by a Kansas-based resource, there is no incentive for making the commitments necessary for development of that technology.

By allowing utilities to retain a portion of the net revenue from renewable energy sales, the state would be taking a proactive market-based approach that enables and encourages investment in new renewable generation facilities. This approach is good for Kansas, business and the environment.

1-2

Testimony in Support of Sub. HB 3017
by
J. C. Long
Aquila, Inc.
Senate Utilities Committee
May 1, 2002

Senator Clark and Members of the Committee:

My name is J. C. Long and I am Director of Government Affairs for Aquila, Inc (formerly UtiliCorp United).

Aquila supports passage of Sub. HB 3017, which would allow utilities that own or have purchased power contracts for renewable energy to retain a portion of income from wholesale sale of that energy.

Further, HB 3017 would allow utilities to unbundle so-called green credits from renewable energy sources and keep 50% of the proceeds from the renewable sources for the shareholders, with the other 50% going to the ratepayers of the utility.

With green credits, also known as an emissions reduction trade, one company earns "credits" for Green House Gas emissions that are either not released or are removed from the atmosphere. These credits can then be sold to companies that use them to meet voluntary or mandated emission reductions or Renewable Portfolio Standards. Trading of green credits allows the benefit from green energy to be exported to another locality or state or even country without physically moving the electricity over constrained transmission corridors. You just sell them a renewable credit and they "own" part of the wind farm's Green Attributes for a specific period of time, usually five years.

Aquila, Inc. (formerly UtiliCorp United Inc.) serves over 174,000 customers electricity and natural gas service in Kansas.

Senate Utilities Committee
May 1, 2002
Attachment 2-1

Recently, TransAlta of Canada, a large coal generator, purchased green credits from Hamburgische Electricitats-Werke AG (HEW), a large producer of wind energy near Hamburg, Germany. These credits offset carbon dioxide emissions in a global sense.

Kansas, which is now ranked first in the potential production of energy from wind according to the U.S. Public Interest Research Group, can now reap two “crops” from the wind – energy and renewable credits.

2-2

Aquila, Inc. (formerly UtiliCorp United Inc.) serves over 174,000 customers electricity and natural gas service in Kansas.

Long, J. C.

From: Bob_Bergstrom@fpl.com
Sent: Thursday, April 11, 2002 1:29 PM
To: Long, J. C.
Subject: Market incentive for Energy development

To J.C. Long ,

FPL Energy supports the proposed legislation . As you know we do not favor mandates. We prefer the principal of market rewards.

As we understand it, in part, this proposed legislation will offer an market incentive for Kansas utilities to buy renewable energy and its green attributes. This is accomplished by allowing the utility to sell the energy and green attributes to other off system parties and then share the proceeds equitably with the ratepayers and shareholders of the utility. We think this is the right principal as it shows the leadership government should provide by enhancing a market.

It is a safe bet that the economic rewards allowed by this proposed legislation will do more to promote the rapid development of renewables in the State of Kansas than a mandate could achieve. The rewards to the State from a bill such as this are more than just to the utilities ratepayers and shareholders.

The sustainable rural economic development that will flow to small Kansas towns and counties from this bill are huge. Local jobs, both construction and operational jobs will be created . These are good paying career positions. Local material and contractors will be used. The lease payments to local land owners are substantial. The tax benefit to the counties is real. As you are aware, FPL Energy has made commitments of large yearly donations to Gray County and we intend to continue this practice of making sizable donations to the host counties as we build out more in Kansas.

It is great for the environment . Wind development is clean and consumes no water and generates no pollution.

A you may recall, Kansas is blessed with a very robust wind resource. More energy can be produced in Kansas by wind than the State can use. If this proposal becomes law we envision utilities in Kansas contracting with companies like FPL Energy to have even more renewables built in the State. In turn those utilities will then profitably sell this clean energy out of state . Therefore, this bill allows the State to maximize the development of this excellent wind resource for the financial benefit of the people of Kansas.

For example, the State of Missouri is a huge electric market, but because of that States very poor wind resource it can not generate wind energy even half as cheaply as Kansas can . This is a case where supply and demand are locally adjacent . When Missouri is subjected to either a state imposed renewable portfolio standard or a federal one, then Kansas will stand ready to supply abundant low cost green energy to that huge power market.

This proposal is forward looking and clearly a market reward for doing the right thing.

Bob Bergstrom
Project Director
FPL Energy

Sen. Stan Clark

From: Bruce Graham [bgraham@Kepco.org]
Sent: Sunday, April 28, 2002 5:24 PM
To: AnnM@senate.state.ks.us; Sclark
Subject: HB 3017



Bruce Graham
(E-mail).vcf (834...

Senator Clark:

Thanks for the notice on HB 3017. The RECs have a schedule conflict with a Board meeting on May 1 and 2, so I won't be able to attend the hearing. However, as written, the bill has no direct impact on KEPCo and could be positive for all utilities and consumers if it encourages continued diversity of generation resources. Of course, we could be concerned with significant amendments to this bill that may change its purpose.

Thanks again. Hope you had a chance to catch up with constituents and get lots of other projects accomplished during the break.

Bruce Graham,
Vice President, Member Services and External Affairs
Kansas Electric Power Cooperative, Inc. (KEPCo)

<<Bruce Graham (E-mail).vcf>>

Senate Utilities Committee
May 1, 2002
Attachment 3-1

**BEFORE THE SENATE UTILITIES COMMITTEE
PRESENTATION OF THE
KANSAS CORPORATION COMMISSION
May 1, 2002
Substitute for House Bill No. 3017**

Thank you Chairman and members of the Committee. I am Larry Holloway, Chief of Energy Operations for the Kansas Corporation Commission. I appreciate the opportunity to be here today to testify for the Commission on Substitute for House Bill No. 3017.

The Commission does not support Sub HB 3017. This bill attempts to provide an incentive for renewable energy by allowing an electric utility that purchases renewable energy to resell it when market conditions are favorable and keep a large portion of the profits from that transaction. While the Commission has not opposed renewable energy incentives and initiatives in the past, the Commission must oppose this bill. The Commission opposes this legislation for the following reasons:

- **This bill is unnecessary**
- **This bill is harmful**
- **There are less costly ways to subsidize renewable energy**

This Bill is Unnecessary

First, this legislation is not needed to allow the Commission to offer incentives to utilities to maximize their efficiency in utilizing off-system power markets. In fact, the Commission has already acted to implement just such regulatory incentives for several utilities, including Western Resources and Kansas City Power and Light, by removing the automatic ECA pass through mechanism from their rates. In the past, utilities immediately passed through any profits or losses from off-system power purchases or sales, as well as fuel costs, in their monthly ECA charge. Several years ago the Commission removed the ECA pass through mechanism from the

rates of Western Resources and KCPL. By removing this mechanism both utilities have an incentive to make as much profit as possible from off-system sales, and to minimize off-system purchased power and fuel costs.

Second, this mechanism is not needed to encourage renewable energy development. It is important to note that the Commission has NEVER denied any jurisdictional electric utility the inclusion of renewable energy investments in their cost of service. In fact, there is already a statute, K.S.A. 66-117 (e), that specifically allows the Commission to grant an increase in the return on such investment:

Upon a showing by a public utility before the state corporation commission at a public hearing and a finding by the commission that such utility has invested in projects or systems that can be reasonably expected (1) to produce energy from a renewable resource other than nuclear for the use of its customers, (2) to cause the conservation of energy used by its customers, or (3) to bring about the more efficient use of energy by its customers, the commission may allow a return on such investment equal to an increment of from 1/2% to 2% plus an amount equal to the rate of return fixed for the utility's other investment in property found by the commission to be used or required to be used in its services to the public. The commission may also allow such higher rate of return on investments by a public utility in experimental projects, such as load management devices, which it determines after public hearing to be reasonably designed to cause more efficient utilization of energy and in energy conservation programs or measures which it determines after public hearing provides a reduction in energy usage by its customers in a cost-effective manner.

Yet despite this incentive no Kansas electric utility has taken the initiative to invest their own money to construct a major renewable energy resource in Kansas. The only operating wind farm in Kansas was built by a Florida electric utility, acting as an independent power producer, without benefit of this incentive. This proposal would reward Kansas electric utilities for merely purchasing renewable energy from entities actually willing to make the investment.

Third, this bill is not even needed to empower the Commission to implement other types of incentives involving renewable energy. The Commission's authority for electric public utilities is broadly defined under 66-101b:

... The commission shall have the power, after notice and hearing in accordance with the provisions of the Kansas administrative procedure act, to require all electric public utilities governed by this act to establish and maintain just and reasonable rates when the same are reasonably necessary in order to maintain reasonably sufficient and efficient service from such electric public utilities.

As stated in statute, the Commission's authority over electric public utilities is sufficiently broad to implement incentives, provided that the Commission can find that any specific incentive results in "just and reasonable rates" and "reasonably sufficient and efficient service." Furthermore, no utility has ever asked the Commission to implement the type of incentive considered by this bill, even though the Commission clearly has authority to grant this incentive if it is reasonable. **The question is: If this incentive is reasonable, why is this bill necessary?**

This Bill is Harmful

This bill contemplates providing off-system sale incentives for utilities that purchase energy from entities that build and operate renewable generation facilities in Kansas. This type of incentive has the potential to affect the utilities' hourly decisions to efficiently dispatch its generating plants. Because the cost of providing electric service to its retail customers is highly dependent on the hourly power supply decisions, this bill could greatly harm retail customers.

First, it is important to consider how the utility dispatches its generation assets and participates in the off-system market on an hourly basis. Every hour utility dispatchers attempt to anticipate the load requirements of their customers. The dispatchers then contact their counterparts at nearby utilities and power marketers to determine the price that hourly electric energy can be purchased or sold off-system. The dispatcher also knows the variable cost of the utilities own generating plants, or other generating plants contracted to the utility. The dispatcher then attempts to supply power for its own customers at the least cost. The dispatcher would normally dispatch the utility's cheapest unit first, the next cheapest second and so on until enough units are operating to meet the customers demand. However, if the dispatcher finds that

off-system prices are lower than the most expensive units needed, off-system energy may be purchased instead of running the more expensive units. Similarly, if the dispatcher finds that all of the utility's demand can be met by dispatching its own units, and that more expensive idle units may be operated at less than the off-system energy price, then the utility will likely operate these more expensive units and sell the excess power off-system. The utility's dispatch order and its efficient utilization of off-system energy markets are critical to controlling the utility's cost of serving its customers. A single error for even an hour could end up costing the utility, and possibly its customers, a great deal of money.

Second, it is important to understand why the utility considers only the variable cost of generation and how this relates to the retail customers' utility rates. Kansas electric utilities have generating units, or generation contracts, that are incorporated into the utility's cost of serving its customers. The utility's ratepayers pay the fixed cost of these generating plants or contracts whether or not the units are operated. Because the ratepayers are already paying this fixed cost, the only consideration that the utility dispatcher must make is how to supply hourly energy in the least expensive manner. Thus, the variable fuel costs and off-system purchase costs or sales revenues are considered. Even though the ratepayer is already paying for the fixed cost of a given generating unit, for example, it still may be less expensive to purchase off-system energy than to operate that plant, particularly if fuel costs are high. Similarly, if that generating unit can be operated to sell power off-system above variable costs, the ratepayer can receive some benefit by having that off-system revenue help pay the fixed costs already in rates.

Third, it is important to understand how an incentive that focuses on only a portion of a utility's generation portfolio could affect the hourly energy cost of the utility, and therefore its ratepayers. If the utility has an incentive, as contemplated in this bill, to sell only a certain portion of its generation portfolio off-system, then the entire dispatch order of the utility could be affected. Recall that the utility's ratepayers are paying for the purchased renewable resource at all times, even when it is not the least expensive generation. In the case of wind generation, for example, usually the utility agrees to purchase all of the output from the wind farm at a given

rate. This means that the dispatcher must use all of the energy from the wind facility even when it is not the least expensive generation available. During these periods of time the utility's ratepayers will be paying a higher cost for this generation. However, when the off-system energy market is such that the wind energy may be sold off-system at a profit, the utility's ratepayers would no longer receive all of the benefits to offset their additional costs.

Furthermore, with this bill the utility now has the incentive to purchase wind energy even when it does not need it, and use it to replace lower cost generation when off-system prices are low, and sell the wind energy at a profit to the shareholders when off-system prices are high. As will be discussed later, if the utility were merely required to buy wind energy as a portion of its generation portfolio, then the ratepayer would at least receive complete compensation when off-system prices were high for the additional costs when prices are low. For this reason the incentive envisioned by this bill is harmful to ratepayers.

Fourth, any incentive that could cause a utility to rearrange its dispatch order for specific generating units is harmful because such actions can manipulate power markets and creates the potential for market abuse. Dispatch decisions made in California over the past two years are still being litigated and second-guessed. Additionally, the federal energy regulatory commission (FERC) is currently investigating how it will monitor wholesale markets to try and identify market abuses, and has not yet reached an conclusions. Simply put, the utility dispatcher must make hundreds of decisions each day on an hourly basis. The wholesale energy market is not transparent, meaning that hourly prices are not readily available for review after the fact. Even when hourly prices are available, they may not accurately reflect options available to the dispatcher at the time due to congestion of transmission paths. Furthermore, an audit of these dispatch decisions would require a review of the dispatch order for each hour. Several years ago the Commission Staff reviewed dispatch decisions made by Western Resources for approximately 40 hours when industrial customers were interrupted. Auditing and reviewing these 40 hours took approximately 160 man-hours of Staff time. This bill is harmful because it proposes an incentive that would be ripe for abuse and for all practicality impossible to audit.

There are Less Costly Methods to Subsidize Renewable Energy

If the legislature would like to provide an additional incentive for renewable energy development, there are far more efficient subsidies that would develop a greater amount of renewable energy at less cost to the retail electric customer. For example, electric utilities could simply be required to purchase or generate a minimum amount of renewable energy through a renewable energy portfolio. As another example, a surcharge could be placed on all electric utility customer rates that would go directly to those actually investing in renewable energy resources. In both of these examples, the Commission would still have the authority to assure the ratepayer that the costs of purchasing the required amount of renewable energy were reasonable and prudent. Additionally, both of these examples would not adversely affect the efficient dispatch of an electric utility's generation assets and the efficient utilization of the off-system energy market. The following example illustrates this point:

Assume that a utility has invested in three generating plants, a 100 MW coal unit, a 100 MW combined cycle gas unit and a 100 MW gas-fired combustion turbine. Furthermore let's assume that the variable costs (fuel, water, etc) of operating these plants is as follows:

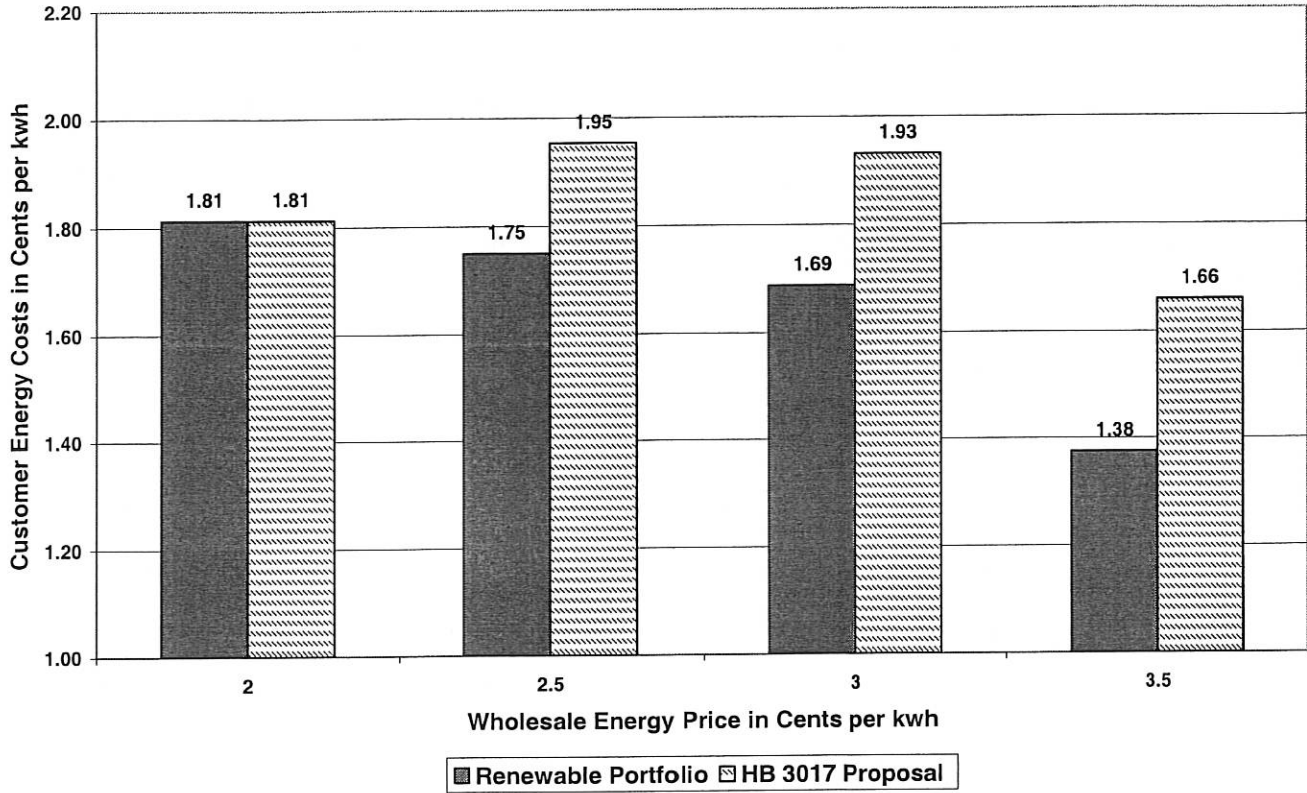
Unit	Size (MW)	Variable Costs in Cents per kwh
Coal	100	1.5
Combined Cycle	100	2
Combustion Turbine	100	3

Next, let us assume that the off-system price for energy sold, or cost for energy purchased, varies from 2 cents per kilowatt-hour to 3 ½ cents per kilowatt-hour over different periods of time. It should be noted that the variable costs and off-system energy prices assumed in this example are not unreasonable and are within the range a utility might expect to. Finally,

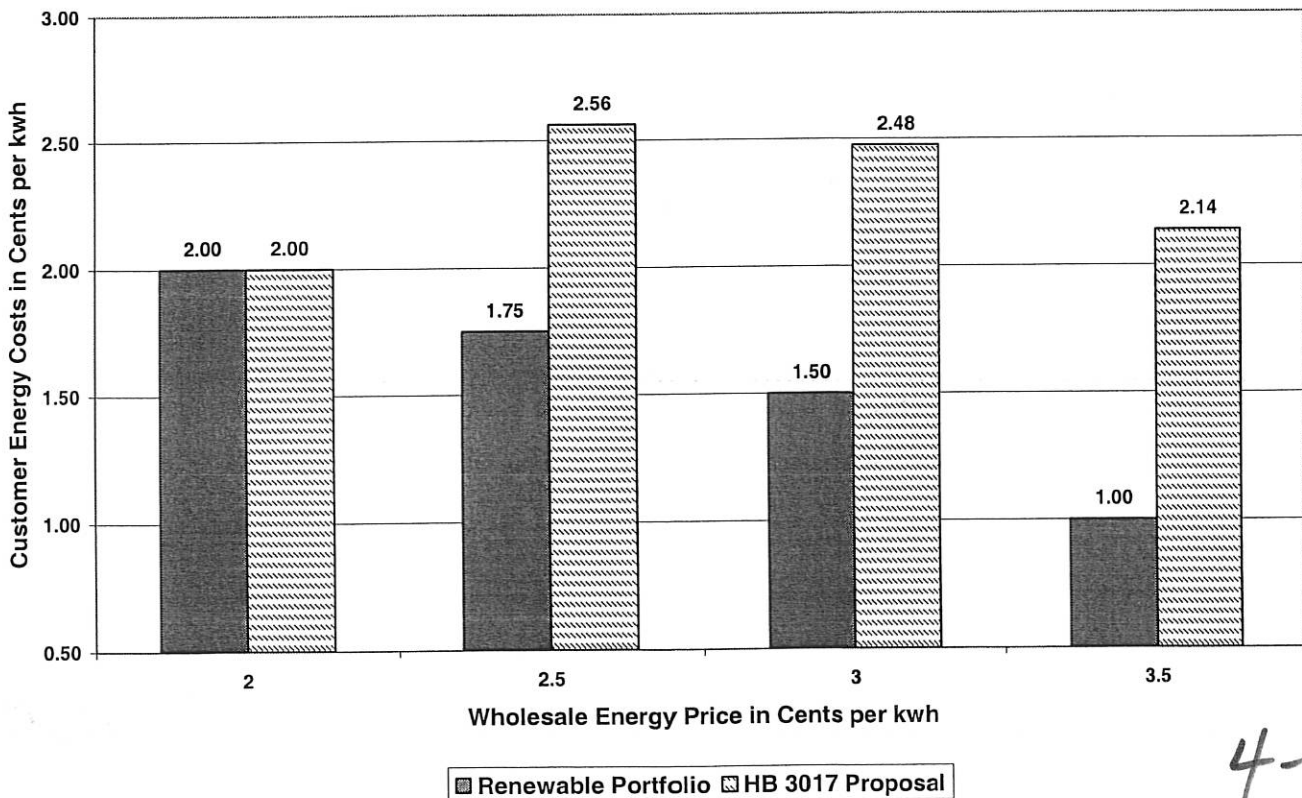
let us assume that the utility can sign an agreement to purchase all of the output from a 100 MW wind farm at 2.5 cents per kilowatt-hour. However, if the utility agrees to do this, it must take all of the output available from the wind farm. Once again this is not an unreasonable assumption and is within the range of terms and prices a Kansas utility might experience today.

Using these assumptions compare the variable energy cost to the retail electric customer under two regulatory scenarios. In the first scenario, the utility is required to purchase the wind energy through a renewable energy portfolio or similar mechanism. In the second scenario, the utility agrees to purchase the wind energy and is granted the incentive envisioned by Sub HB 3017. To adequately compare each regulatory scenario, two wind scenarios and demand scenarios will be used. In the first wind scenario it is assumed there is only a moderate wind and the 100 MW wind farm only operates at 25% capacity, or produces 25 MW. In the second wind scenario the 100 MW wind farm operates at capacity, 100 MW. The demand scenarios assume two system demands, 200 MW and 300 MW. The comparison then compares the retail electric customers cost per kwh for the utility meeting its system demand under these two regulatory scenarios. The results are as follows:

Comparison for 200 MW Demand and 25 MW Wind

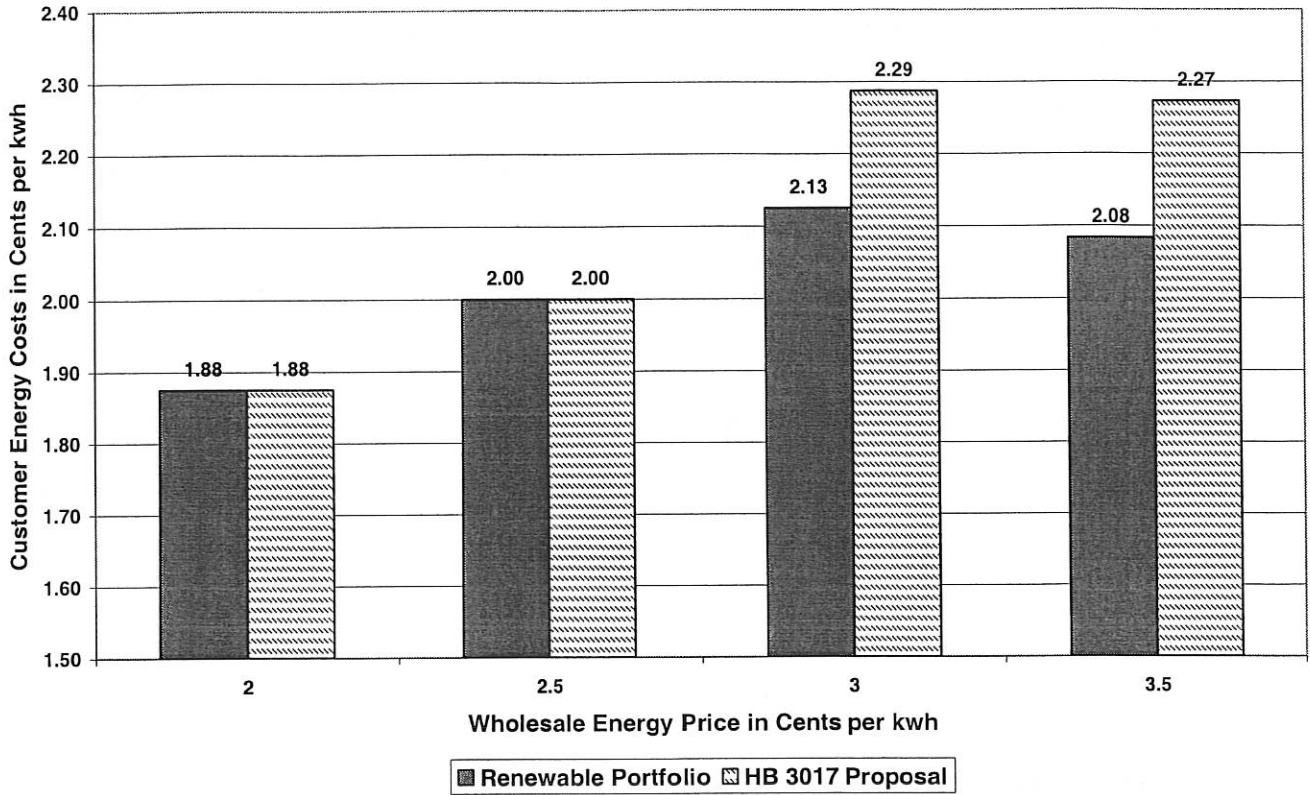


Comparison for 200 MW Demand and 100 MW Wind

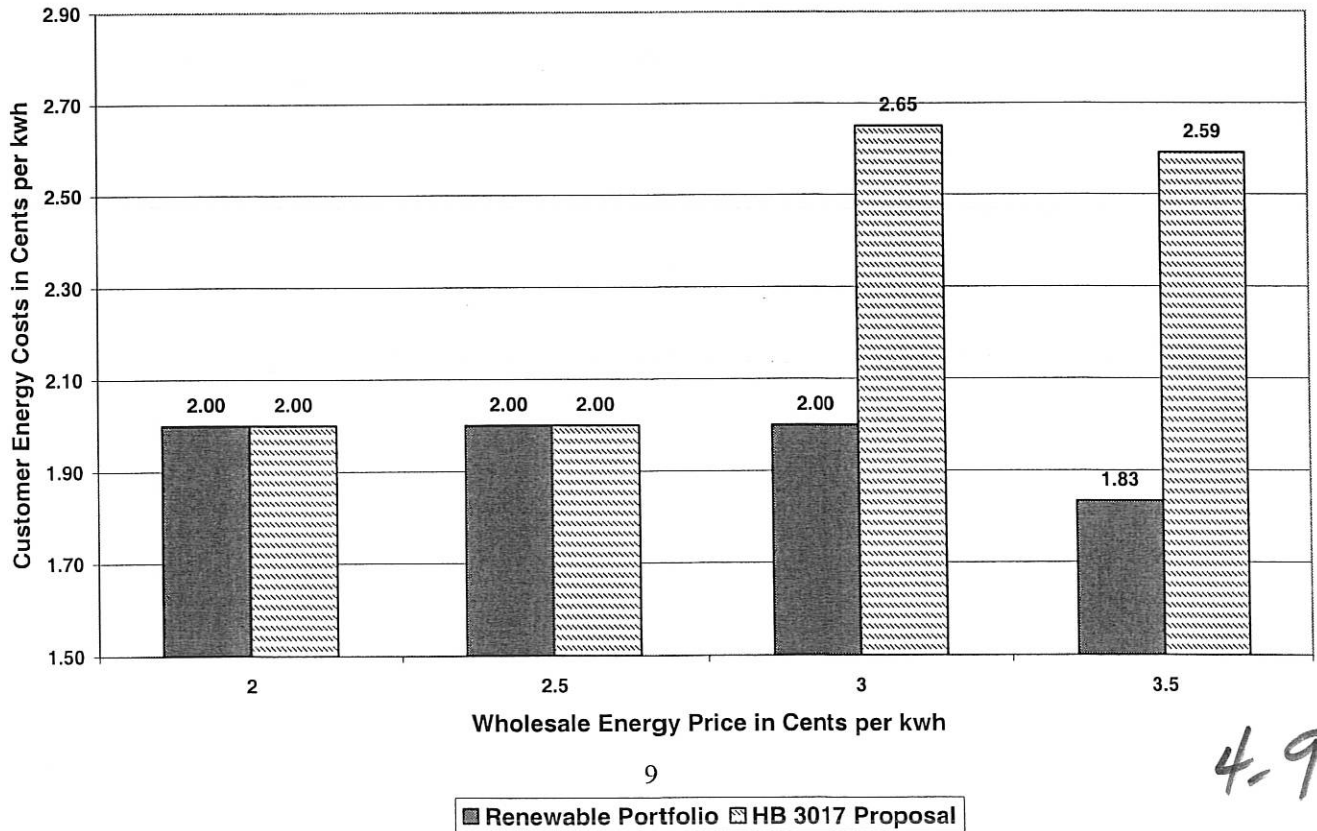


4-8

Comparison for 300 MW Demand and 25 MW Wind



Comparison for 300 MW Demand and 100 MW Wind



4.9

As shown, in many different scenarios the retail electric customer would pay far more under the incentive envisioned by SUB HB 3017 than they would if the utility were simply required to purchase a portion of its energy needs from a renewable energy provider. It is important to note that the shareholders of the entity that actually invests in the Kansas renewable energy resources receive the same compensation under either scenario. However, under the incentive envisioned by SUB HB 3017, the additional cost borne by ratepayers is a subsidy to the electric utility's shareholders, not those making the actual investment. In conclusion, as illustrated, the same investment in Kansas renewable energy resources could be achieved at a far lower cost to Kansas ratepayers than the mechanism envisioned by this bill.

Conclusion

- **This bill is unnecessary**
 - The Commission already has adequate authority to implement just and reasonable incentives.
- **This bill is harmful**
 - Manipulating the dispatch of specific generating units would increase costs to ratepayers.
 - Protecting ratepayers from market abuse would be difficult or impossible under the incentives created by this legislation.
- **There are less costly ways to subsidize renewable energy**
 - A renewable energy portfolio is an example of a subsidy that would produce more Kansas renewable resources at a lower cost to Kansas ratepayers.
 - This subsidy does not reward those actually making the investment.