Approved: March 20, 2006
Date

MINUTES OF THE JOINT HOUSE UTILITIES/TAXATION COMMITTEE

The meeting was called to order by Chairman Kenny Wilk at 9:00 A.M. on March 1, 2006 in Room 313-S of the Capitol.

All members were present except:
Representative Jim Morrison- excused
Representative Judy Morrison- excused
Representative Jason Watkins- excused

Committee staff present:
Martha Dorsey, Kansas Legislative Research Department
Mary Galligan, Kansas Legislative Research Department
Dennis Hodgins, Kansas Legislative Research Department
Heather Klaasen, Research Intern
Mary Torrence, Kansas Legislative Revisors Office
Rose Marie Glatt, Committee Secretary
Renae Hansen, Utilities Committee Secretary

Conferees appearing before the committee:
Representative Carl Holmes
Tim Rens, CFO, Coffeyville
Jim Loving, President, Nat'l Cooperative of Refinery Association, McPherson
Leslie Kaufman, Kansas Cooperative Council (written only)
Donald P. Schnacke, Attorney, TransCanada PipeLines Limited
Ron Gaches, President, Gaches, Braden, Barbee & Associates
Michael Hopkins, MidStream Gas & Liquids for the Williams Companies, Inc.
Mark Schrieber, Manager, Government Affairs, Westar Energy
Phil Wages, Director of Member Services and External Affairs for KEPCO
Gene L. Merry, Coffey County Commissioners
Ronald F. Hammerschmidt, Ph.D., Director, Division of Environment, KH&E

Others attending:
See attached list.

HB 2900 - Oil refineries; tax incentives; KDFA bonds; permits
HB 2901 - Crude oil pipelines; tax incentives; KDFA financing
HB 2902 - Integrated coal or coke gasification nitrogen fertilizer plants; tax incentives; KDFA bonds
HB 2903 - Cellulosic alcohol plants; tax incentives; KDFA financing
HB 2904 - Electric generation facilities; tax credits and exemptions; KDFA bonds; safety requirements

The Chairman explained that all conferees for the bills would be heard, followed by committee questions. He asked Martha Dorsey to brief the committee on the five energy bills. She explained the similarity and differences of the bills. A memo, prepared by Mary Galligan, Assistant Director for Information Management and Mary Torrence, Revisor of Statutes Office, was distributed. The memo was comprised of short summaries for each of the Committee bills and gave definitions and what the bill would provide if enacted (Attachment 1).

Representative Carl Holmes said that they had an opportunity to move Kansas forward into the position of being a major ENERGY PROCESSOR, due to passage of the Energy Policy Act of 2005. Companies are currently making decisions where to spend their capital investment dollars to develop new energy plants. Work still needs to be done on the demand side of energy usage. That side was not included in this legislation, but would be considered at a later date. He gave an overview of each of the bills: Refinery Legislation, Pipeline Legislation, Integrated Gasification Nitrogen Fertilizer, Cellulosic Alcohol and Integrated Combined Cycle & Nuclear Power Plant Construction (Attachment 2). He used a power point presentation to provide a general overview of the energy picture for the world, the country and for Kansas (Attachment 3).

He called attention to the following reports included in his testimony: 1) Press release - TransCanada secures

long-term commitments for Keystone Oil Pipeline project, 2) Maps of the Keystone Pipeline Project, 3) Policy paper on *Oil & Security* by George P. Shultz and R. James Woolsey, and 4) Executive Summary regarding the "Importance of Electricity," the website of perclimate.org.(Attachment 4).

Tim Rens, CFO, Coffeyville, testified in support of two bills: **HB 2900** - the refinery bill and **HB 2902** - the nitrogen fertilizer legislation. He provided background of Coffeyville Resources, whose operations have been in place since 1906. He described: Petroleum Refining Operations, Coke Gasification - Fertilizer Operations, and Status of Coffeyville Resources' Operations. In conclusion he said these bills would not only provide economic support for their operations, but would encourage additional economic stimulus to their industry counterparts (Attachment 5).

Jim Loving, President, Nat'l Cooperative of Refinery Association (NCRA), testified in support of **HB 2900.** NCRA believes that refinery expansion investments are huge and those investments will occur where investors believed they would reap the best returns. Kansas' access to crude oil, excellent work force, existing refineries and petroleum product distribution assets, along with encouragement from the legislature, would make Kansas a prime target for investor dollars (Attachment 6).

Ronald F. Hammerschmidt, Ph.D., Director, Division of Environment, KH&E, presented written testimony that included suggested changes to **HB 2900** that would require the refinery owner or operator to submit a request to the Department of Health and Environment that includes: a detailed description of the construction project; a list of the environmental statutes or regulations that required the completion of the project; the cost associated with the project; and a certification regarding the data submitted. In addition, they proposed the addition of authority for the Secretary to adopt any needed administrative regulation to implement the provisions of the bill. The authority to adopt administrative regulations also includes a provision that would allow the Secretary to implement a fee to recover the costs of implementing the application review (Attachment 7).

Leslie Kaufman, Kansas Cooperative Council, submitted written testimony in support of **HB 2900** and **HB 2902** (Attachment 8).

Donald P. Schnacke, Attorney, TransCanada PipeLines Limited rose in support of **HB 2901.** He spoke of the potential benefits and economic multiplier effect that communities would experience if the Keystone Pipeline Project were to include the Cushing branch through Kansas. He added that relief from the use and sales tax for equipment would provide an even more attractive incentive to his company and suggested that perhaps an amendment could be considered (Attachment 9).

Ron Gaches, President, Gaches, Braden, Barbee & Associates appeared in support of **HB 2901.** He said there were several changes they would amend into the existing bill and he introduced Mr. Hopkins, from the Williams Company for continued testimony.

Michael Hopkins, MidStream Gas & Liquids for the Williams Companies, Inc., explained the operations of the Conway fractionator located near McPherson. The proposed tax credit, in its current form, only applies to pipelines located in Kansas that primarily engage in the transportation of crude oil. They suggested the bill should be amended to include pipelines transporting natural gas liquids within Kansas to further stimulate the economic environment to the state. Language to that effect was attached (Attachment 10).

Mark Schrieber, Manager, Government Affairs, Westar Energy, said that although Westar had no plans to pursue construction of either an IGCC or nuclear plant, they support the tax credit in **HB 2904.** They believe it was large enough to truly incent a company with the necessary size and financial resources to undertake such a project. The key is the size of the credit and the ability to use it over a period of up to 15 years (Attachment 11).

Phil Wages, Director of Member Services and External Affairs for KEPCO said they support **HB 2904** which establishes property tax exemptions for the construction or expansion of an integrated coal gasification power plant or nuclear generation facility. The passage of the bill would place Kansas in a better position to keep native utility generation investment in Kansas, as well as attract out-of-state utility investment (Attachment 12).

MINUTES OF THE House Taxation Committee at 9:00 A.M. on in Room 519-S of the Capitol.

Gene L. Merry, Coffey County Commissioners, said that nuclear power must be an essential component of long term plans for energy independence for our state and country. To that end, he spoke in support of **HB 2904.** There are more than 20 nuclear power plants under construction throughout the world. While there are no nuclear power plants being built in the United States, this legislation recognizes that should change in the near future (Attachment 13).

Discussions followed regarding: time line for completion; fiscal impact of each bill; EPA regulations; and refinery and pipeline locations.

Representative Holmes assigned Utility Sub-Committee members: Representatives Holmes, Krehbiel and Hawk to work on the energy bills. Chairman Wilk said that he would appoint Representative Carlson and would announce the other two members on the floor.

Chairman Holmes acknowledged the hard work as well as the many hours it has taken to provide the material for the meeting. He thanked Mary Galligan, Mary Torrence and Renae Hanson for all their help.

The Chairman adjourned the meeting at 10:58 A.M. The next meeting on the Taxation Committee is March 2, 2006.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: March 1, 2006

NAME	REPRESENTING
Mark Schreiber	Westar Energy
GINA BOWMAN-MORRILL	Coffeyville Resources
Tim Rens	Coffeyville Resources
Mary Jane Stankiewicz	KGFA
Roger Randall	KCPL
LON STANTON	NORTHERN NATURAL GAS Co
David Springe	Curb
PHIL WAGGS	KEPCo
Tom Gross	KAHE
Ray Hammarlund	KDOC
Stan Ahlerich	KS Inc
Leslie Kaufman	Ks Coop Council
David Kensinger	Kensinger & Assoc.
TOM DAY	KCC

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Revised
March 1, 2006

To: Representative Carl Holmes **Office No.:** 115-S

From: Mary Galligan, Assistant Director for Information Management
Mary Torrence, Revisor of Statutes Office

Re: 2006 House Bills 2900-2904

In response to your request for short summaries of recently introduced committee bills, we have prepared the following:

HB 2900—Oil Refineries. (Defined as an industrial process plant, located in Kansas, where crude oil is processed and refined into petroleum products.) The bill would:

- Provide an income tax credit, beginning with the 2006 tax year, for investments in new construction or expansion (minimum of ten percent of capacity) of an existing refinery if the taxpayer agrees to operate the plant for at least ten years.;
  - The credit would be in an amount equal to the sum of ten percent of the investment for the first $500 million invested and 5 percent of the amount of investment over $500 million;
  - The credit would be awarded in ten annual installments; and
  - The installment could not exceed 25% of the lesser of: (a) the credit amount divided by 10; or (b) the taxpayer's income tax liability in a single tax year.
- Provide for accelerated depreciation for ten years (55 percent first year, 5 percent for nine years);
- Provide a ten-year (beginning with purchase or the start of construction) property tax exemption for new equipment and refinery construction or expansion of capacity of at least ten percent;
- Provide for expedited permit handling by the Department of Health and Environment; and
- Provide for KDFA financing assistance.

HB 2901—Crude Oil Pipelines. (Defined to be a pipeline, at least 190 miles of which is located in Kansas, that is used primarily for transportation of crude oil.) The bill would:

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ATTACHMENT 1

- Provide an income tax credit, beginning with the 2006 tax year, for investments in new construction or expansion (minimum of ten percent of capacity) of pipelines if the taxpayer agrees to operate the pipeline for at least ten years;

    - The credit would be in an amount equal to the sum of ten percent of the investment for the first $500 million invested and 5 percent of the amount of investment over $500 million;

    - The credit would be awarded in ten annual installments; and

    - The installment could not exceed 25% of the lesser of: (a) the credit amount divided by 10; or (b) the taxpayer's income tax liability in a single tax year.

- Provide for accelerated depreciation (55 percent first year, 5 percent for nine years);

- Provide a ten-year (beginning with purchase or the start of construction) property tax exemption for new equipment and refinery construction or expansion of capacity of at least ten percent; and

- Provide for KDFA financing assistance.

HB 2902—Integrated Coal or Coke Gasification(ICCG) Nitrogen Fertilizer Plant. (Defined to be a plant in Kansas where coal or petroleum coke is used to synthesize gas and that gas is used to produce nitrogen fertilizer.) The bill would:

- Provide an income tax credit, beginning with the 2006 tax year, for investments in new construction or expansion (minimum of ten percent of capacity) of an ICCG nitrogen fertilizer plant if the taxpayer agrees to operate the plant for at least ten years, and if the taxpayer uses Kansas coal in any coal gasification process at the plant, as required by the Secretary of Commerce;

    - The credit would be in an amount equal to the sum of ten percent of the investment for the first $500 million invested and 5 percent of the amount of investment over $500 million;

    - The credit would be awarded in ten annual installments; and

    - The installment could not exceed 25% of the lesser of: (a) the credit amount divided by 10; or (b) the taxpayer's income tax liability in a single tax year.

- Provide for accelerated depreciation (55 percent first year, 5 percent for nine years);

- Provide a ten-year (beginning with purchase or the start of construction) property tax exemption for new equipment and plant construction or expansion of capacity of at least ten percent; and

- Provide for KDFA financing assistance.

HB 2903—Cellulosic Alcohol Plants. (Defined to be a plant in Kansas where matter containing cellulose and which is available on a renewable basis is processed to produce cellulosic alcohol.) The bill would:

- Provide an income tax credit, beginning with the 2006 tax year, for investments in new construction or expansion (minimum of ten percent of capacity) of a cellulosic alcohol plant if the taxpayer agrees to operate the plant for at least ten years;

    - The credit would be in an amount equal to the sum of ten percent of the investment for the first $500 million invested and 5 percent of the amount of investment over $500 million;

    - The credit would be awarded in ten annual installments; and

    - The installment could not exceed 25% of the lesser of: (a) the credit amount divided by 10; or (b) the taxpayer's income tax liability in a single tax year.

- Provide for accelerated depreciation (55 percent first year, five percent for nine years);

- Provide a ten-year (beginning with purchase or the start of construction) property tax exemption for new equipment and plant construction or expansion of capacity of at least ten percent; and

- Provide for KDFA financing assistance.

HB 2904—Nuclear generation facility expansion and new or expanded Integrated Coal Gasification Power Plant (ICGPP). (Defined to be a facility in Kansas that synthesizes coal into gas that can be used as a fuel to generate electricity, uses that synthetic gas as a fuel to generate electricity, and primarily serves retail electric customers in Kansas.) The bill would:

- Provide an income tax credit, beginning with the 2006 tax year, for investments in new construction or expansion (minimum of ten percent of capacity) of an ICGPP if the taxpayer agrees to operate the plant for at least ten years and agrees to use coal produced in Kansas as required by the Kansas Corporation Commission;

    - The credit would be in an amount equal to the sum of ten percent of the investment for the first $500 million invested and five percent of the amount of investment over $500 million;

  - The credit would be awarded in ten annual installments; and

  - The installment could not exceed 25% of the lesser of: (a) the credit amount divided by 10; or (b) the taxpayer's income tax liability in a single tax year.

- Provide for accelerated depreciation (55 percent first year, five percent for nine years) for ICGPPs;

- Provide a 12-year (beginning with purchase or the start of construction) property tax exemption for new equipment and plant construction or expansion of ICGPP capacity of least ten percent. The property tax exemption would specifically extend to equipment needed to comply with federal or state air emission standards;

- Provide a 12-year (beginning with purchase or the start of construction) property tax exemption for expansion of existing nuclear generation facility capacity by at least ten percent;

- Exempt new nuclear generating facilities from the power plant siting act if built within five miles of existing nuclear plant; and

- Provide for KDFA financing assistance for ICGPPs.

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(785) 296-7670
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TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
CHAIRMAN: UTILITIES COMMITTEE
CHAIRMAN: JOINT COMMITTEE ON ADMINISTRATIVE RULES AND REGULATIONS
MEMBER: AGRICULTURE & NATURAL RESOURCES BUDGET COMMITTEE
CHAIRMAN: KANSAS ELECTRIC TRANSMISSION AUTHORITY
CHAIRMAN: NATIONAL CONFERENCE OF STATE LEGISLATURES—ENERGY & ELECTRIC UTILITIES COMMITTEE
CHAIRMAN: NATIONAL CONFERENCE OF STATE LEGISLATURES—ADVISORY COUNCIL ON ENERGY

LEGISLATIVE HOTLINE
1-800-432-3924

Chairman Wilk, House Tax and Utilities committee members, I appreciate the opportunity to discuss HB 2900, HB 2901, HB 2902, HB 2903 and HB 2904. We have the opportunity to move Kansas forward into the position of being a major ENERGY PROCESSOR. With the passage of the Energy Policy Act of 2005 by the United States Congress last year, we have the opportunity in Kansas to move forward with the supply part of the Act. Companies are currently making decisions where to spend their capital investment dollars to develop new energy plants.

We will still need to work on the demand side of energy usage and that is not included in this legislation.

Background documents have been provided including: TransCanada Pipeline proposal, Oil & Security policy paper by George Shultz and James Woolsey, Kansas Legislative Research Department outline of the 5 bills prepared by Mary Galligan, and Pew Climate Executive Summary.

General Overview

- Kansas net energy exporter to net energy importer
- Renewable, coal and gas electric generation Kansas legislation in early 2000's
- Currently built or announced 3 wind farms and several more coming soon
- Currently 3 coal fired electric power plants announced and 3 more to be announced shortly
- Currently 1 gas peaking power plant built
- Kansas Electric Transmission Authority established
- Transmission expansion announced (siting legislation passed early 2000's
- Kansas needs to be an Energy Processor
    - Refinery Legislation
    - Pipeline Legislation
    - Integrated Gasification Nitrogen Fertilizer
    - Cellulous Alcohol
    - Electric Generation

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- Katrina & Rita 9/11 wakeup call for past non US energy policy
- Epact 2005
- Unstable US import crude oil suppliers (Venezuela, Nigeria, Iraq [#4-#6] 3MBPD)
- Canadian Tar Sands Oil Production
- Kansas 8th largest oil producing state in nation
- 90,000 barrels per day production
- 310,000 barrels per day refinery consumption
- 220,000 barrels per day imported into Kansas
- US imports 2,500,000 barrels per day of finished product (gasoline, diesel, jet fuel, etc)
- US building Liquefied Natural Gas off loading facilities (Venezuela announcement)
- Kansas has opportunity to become a major energy processor

Refinery Legislation

- Kansas 1980 17 refineries
- Kansas today 3 refineries
- Refineries need retrofitting to process "heavy oil" from Canada
- This legislation provides incentives for new refineries and refinery expansion

Pipeline Legislation

- TransCanada Pipeline announced (handout)
- Cushing extension proposed
- Canadian Tar Sands oil expansion
- Kansas advantage
- This legislation provides incentives for the Cushing extension

Integrated Gasification Nitrogen Fertilizer

- Coffeyville Resources has only plant in US
- Explain process
- Replaces 20,000 cu ft of natural gas per ton of NH_3 production
- Incentive for Kansas high sulfur coal usage as well as refinery coke
- This legislation provides incentives for non natural gas nitrogen fertilizer production

Cellulosic Alcohol

- New technology needed to lower production price
- Brazil past 30 years
- Grain ethanol cannot supply all the long term demand
- Will help to supply future ethanol needs
- This legislation provides incentives for cellulosic alcohol production

Integrated Gasification Combined Cycle & Nuclear Power Plant Construction

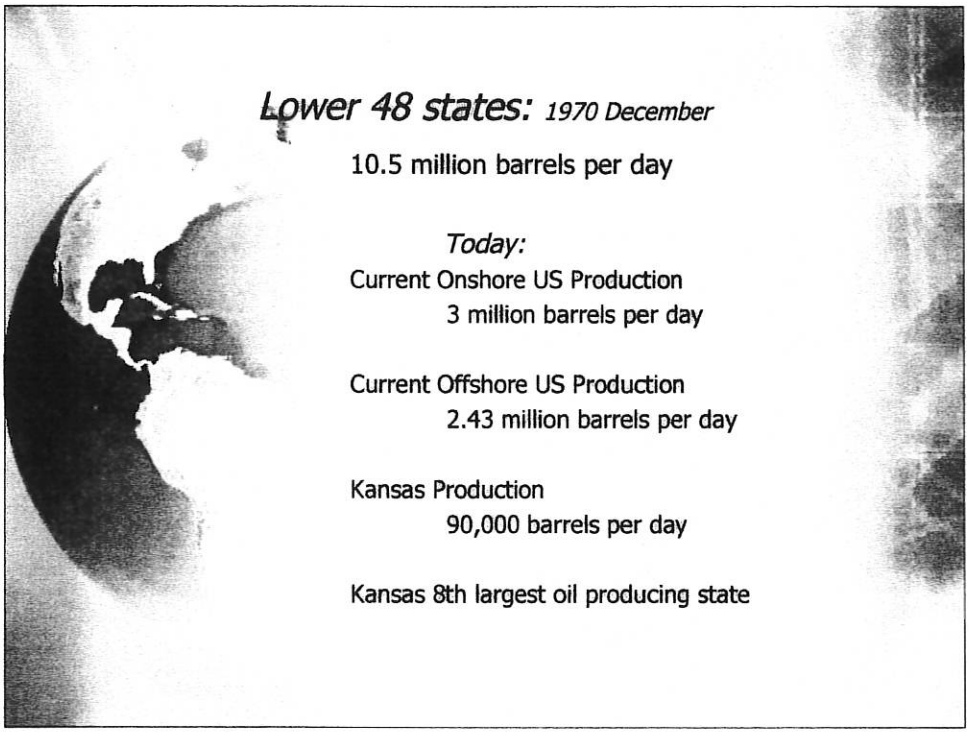
- Concerns regarding Global Warming
- Epact 2005 tax credits
- Possible new Missouri nuclear power plant
- Exempt from siting requirement for plant built within 5 miles of existing nuclear power plant
- Integrated gasification combined cycle reduces power plant emissions
- Incentive for Kansas high sulfur coal
- This legislation provides incentives for new electric power plants that reduce global warming

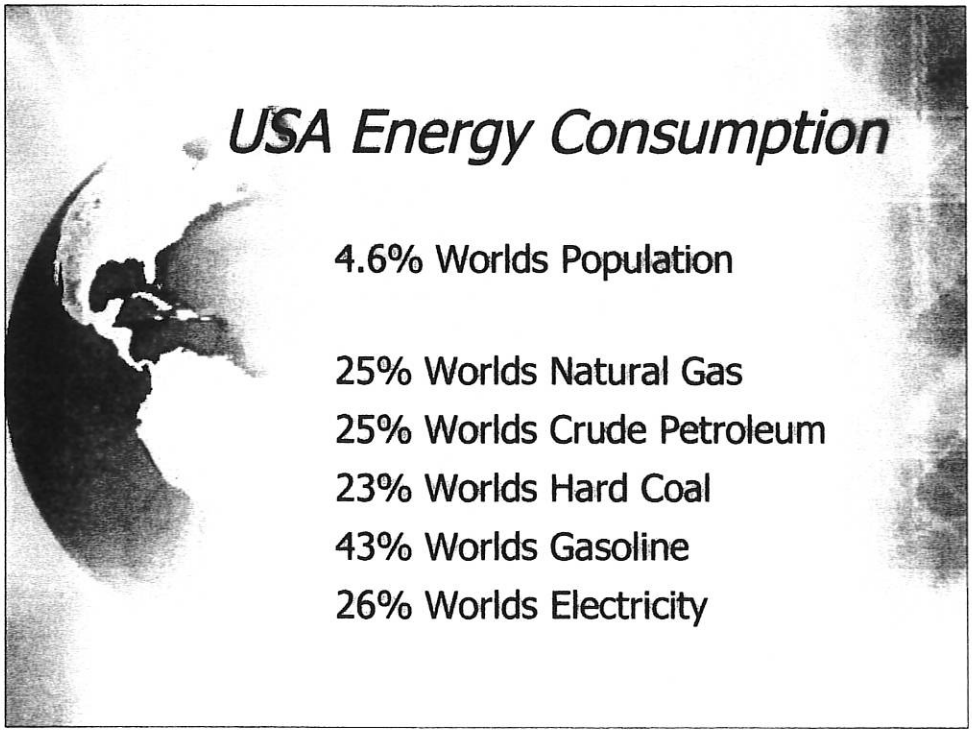
Closing

- Bills provide the opportunity for Kansas to become a major ENERGY PROCESSOR.

I appreciate your time and will be glad to answer questions at the appropriate time.

Carl Holmes





HOUSE UTILITIES

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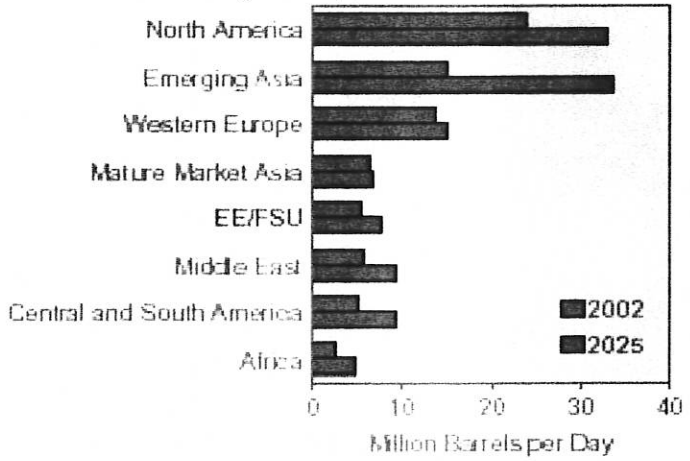
ATTACHMENT 3

US Petroleum Imports Per Day

Source EIA 2004 Barrels

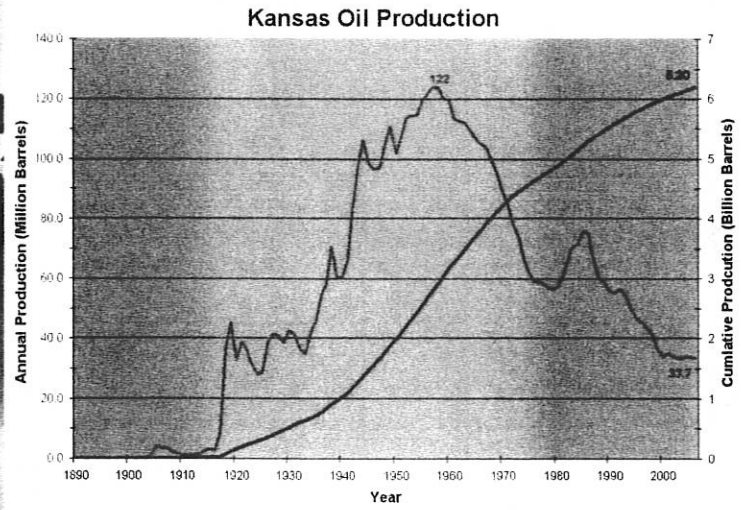
Canada	2,118,000
Mexico	1,642,000
Saudi Arabia	1,556,000
Venezuela	1,521,000
Nigeria	1,119,000
Iraq	652,000
Algeria	452,000
United Kingdom	369,000
Norway	238,000
Columbia	168,000

Figure 29. World Oil Consumption by Region and Country Group, 2002 and 2025

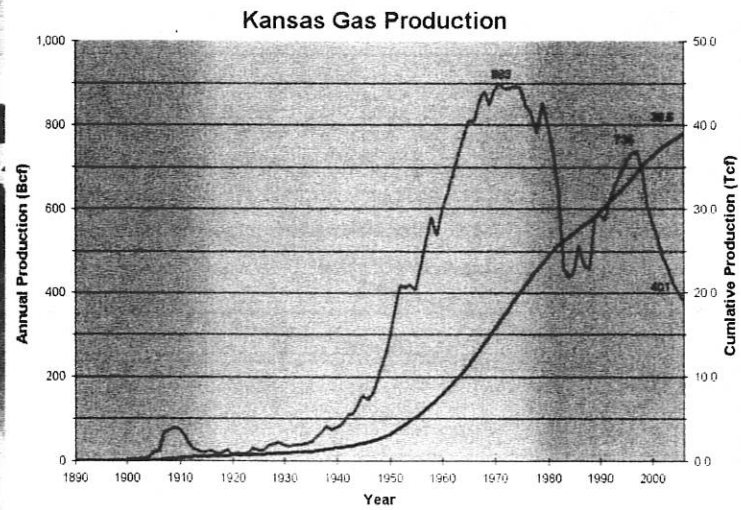


Sources: 2002: Energy Information Administration (EIA),

Kansas Historical Oil Production



Kansas Historical Gas Production



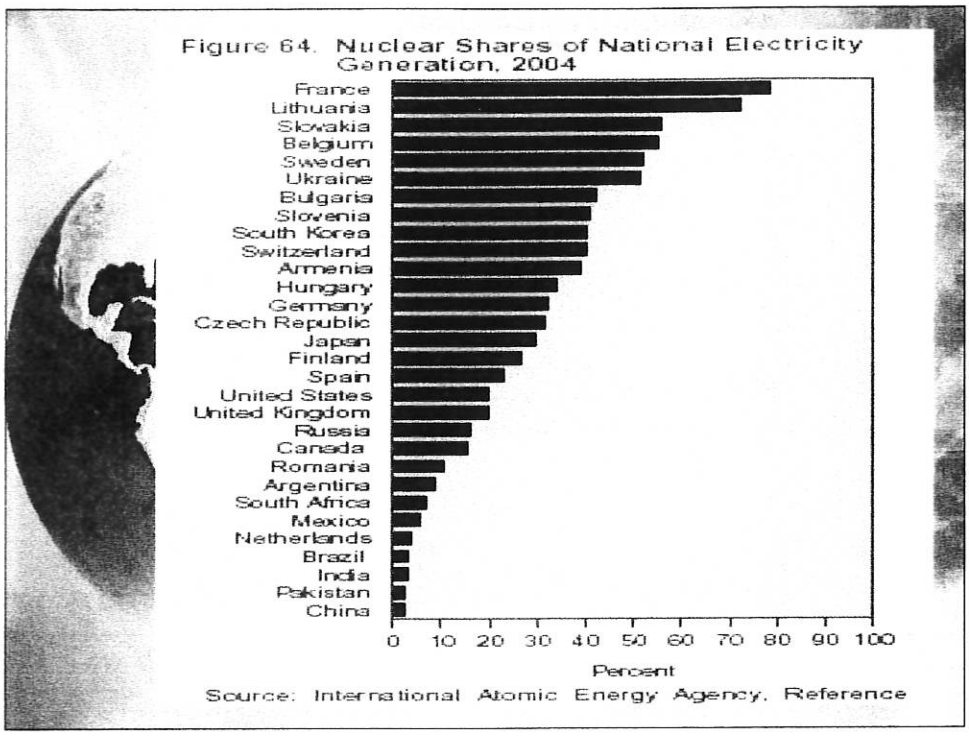
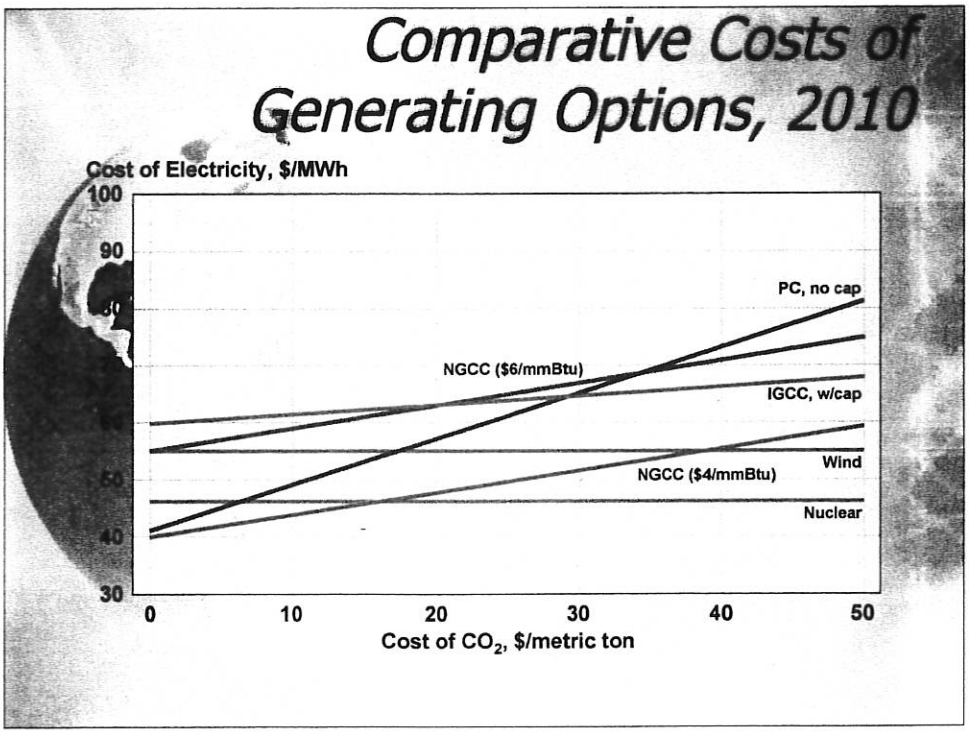
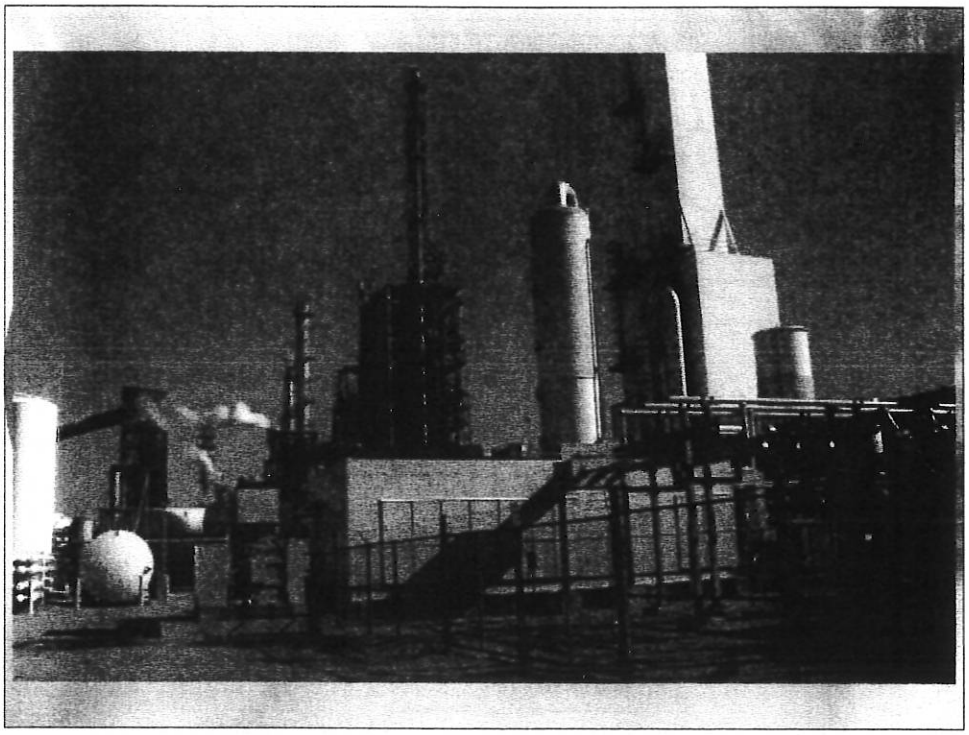
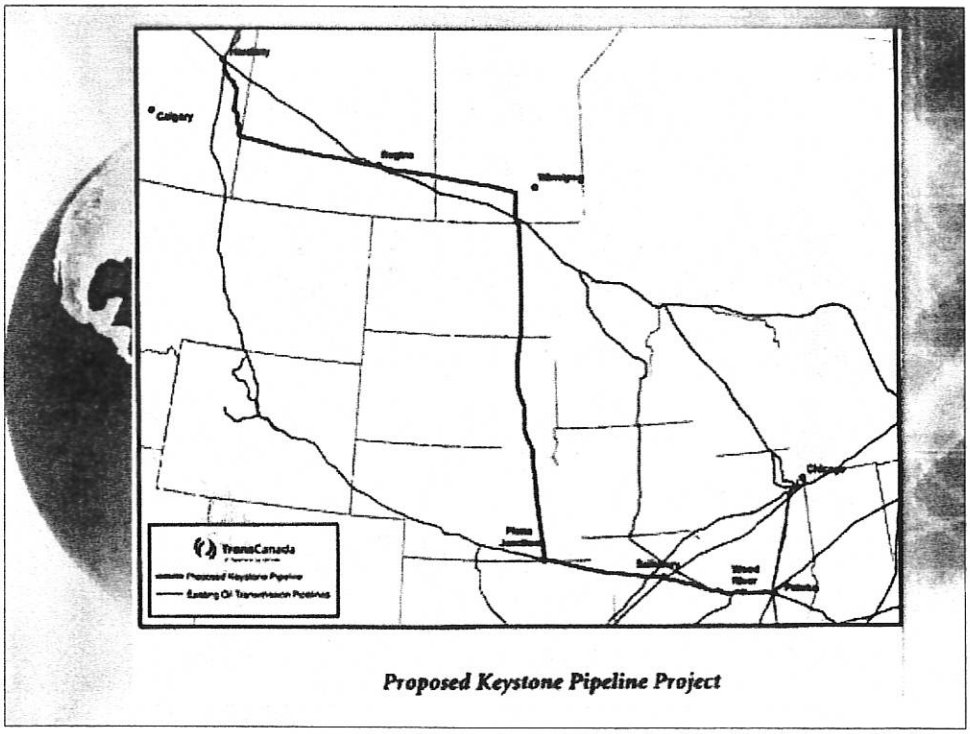


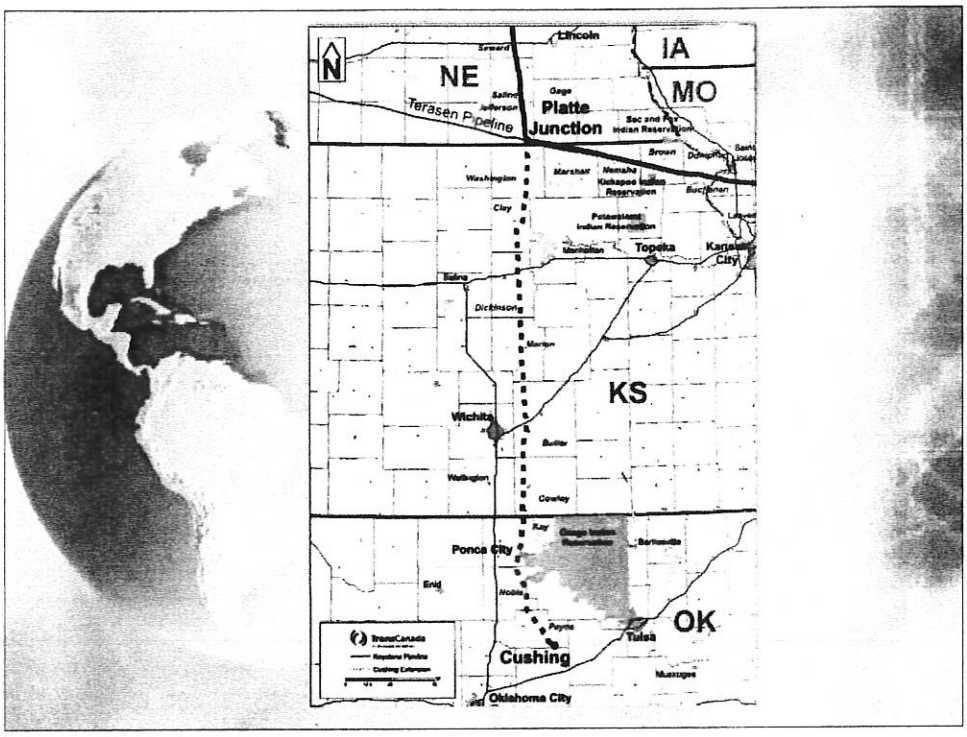
Figure 64. Nuclear Shares of National Electricity Generation, 2004
France
Lithuania
Slovakia
Belgium
Sweden
Ukraine
Bulgaria
Slovenia
South Korea
Switzerland
Armenia
Hungary
Germany
Czech Republic
Japan
Finland
Spain
United States
United Kingdom
Russia
Canada
Romania
Argentina
South Africa
Mexico
Netherlands
Brazil
India
Pakistan
China
0 10 20 30 40 50 60 70 80 90 100
Percent
Source: International Atomic Energy Agency, Reference


Comparative Costs of Generating Options, 2010
Cost of Electricity, $/MWh
100
90
40
30
PC, no cap
NGCC ($6/mmBtu)
IGCC, w/cap
Wind
NGCC ($4/mmBtu)
Nuclear
0
10
20
30
40
50
Cost of CO_2, $/metric ton





Proposed Keystone Pipeline Project


N
NE
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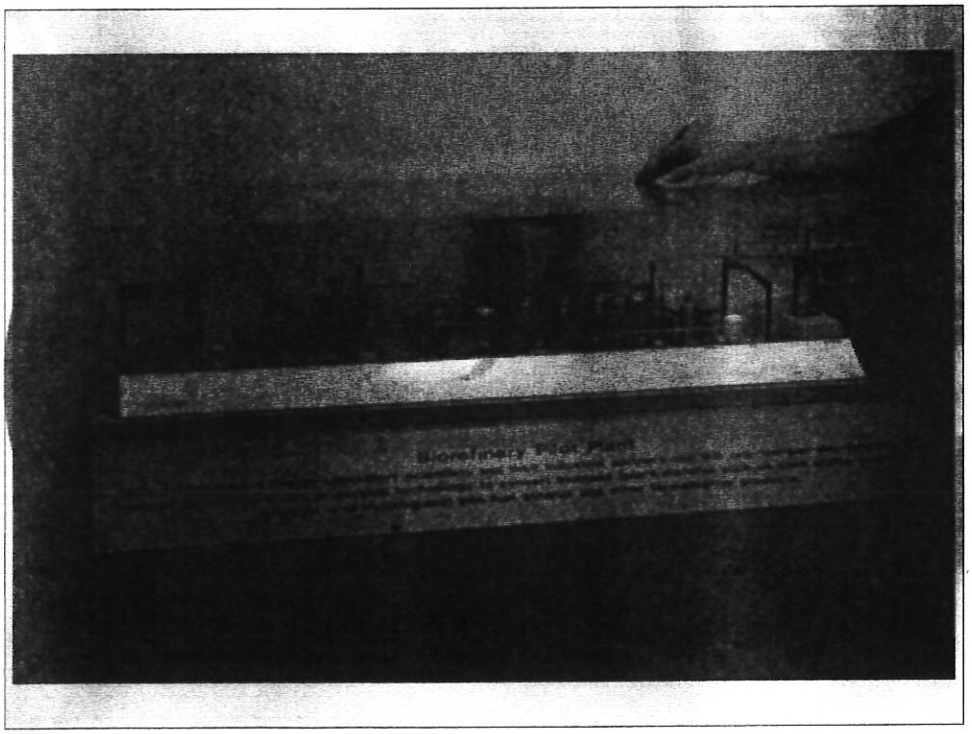
Lincoln
Seward
Platte Junction
Terasen Pipeline
Topeka
Kansas City
Wichita
Ponca City
Enid
Tulsa
Cushing
Oklahoma City
TransCanada
Keystone Pipeline
Cushing Extension



TransCanada secures long-term commitments for Keystone Oil Pipeline project

CALGARY, Alberta – January 31, 2006 – TransCanada Corporation (TSX, NYSE: TRP) (TransCanada) today announced the Keystone Oil Pipeline project has secured firm, long-term contracts totalling 340,000 barrels per day with duration averaging 18 years. The commitments were obtained through the successful completion of a binding Open Season held during the fourth quarter of 2005. With these commitments from shippers, TransCanada will proceed with regulatory filings for approval of the estimated US$2.1 billion pipeline project that will transport crude oil from Alberta to U.S. mid-west refineries.

"The positive commercial response we received confirms that shippers recognize the value of our project as a cost-competitive way to link growing oil sands supply to U.S. energy markets," said TransCanada chief executive officer, Hal Kvisle. "With crude oil production from the oil sands expected to grow by approximately 1.5 million barrels per day over the next 10 years, TransCanada's Keystone project will help meet a critical need for additional pipeline infrastructure."

Public and stakeholder consultation and detailed engineering work will continue throughout 2006. Before construction can begin, Keystone will require regulatory approvals from a variety of Canadian and U.S. agencies. Specifically, TransCanada will file applications with the National Energy Board in 2006 for project approvals. Construction is proposed to begin in late 2007, with commercial operations scheduled to commence by the fourth quarter of 2009.

As outlined in the memorandum of understanding (MOU) signed between TransCanada and ConocoPhillips Pipe Line Company (CPPL) on Nov. 3, 2005, CPPL has the right, upon certain conditions, to acquire up to a 50 per cent participating interest in the project. ConocoPhillips Company, CPPL's parent, has committed to ship crude oil on the pipeline system.

Once constructed, the Keystone Oil Pipeline will be capable of transporting approximately 435,000 barrels per day o f crude oil from Hardisty, Alberta, to Patoka, Illinois, through a 1,830-mile (2,960-kilometre) pipeline system. The pipeline can be expanded to 590,000 barrels per day with additional pump stations. In addition to approximately 1,070 miles (1,730 kilometres) of new pipeline construction in the United States, the Canadian portion of the proposed project includes the construction of approximately 230 miles (370 kilometres) of new pipeline and the conversion of approximately 530 miles (860 kilometres) of existing TransCanada pipeline facilities from natural gas to crude oil transmission.

Shippers have also expressed interest in proposed extensions of the Keystone pipeline system to Cushing, Oklahoma and Fort Saskatchewan, Alberta. TransCanada expects to hold a binding Open Season for these two extensions later this year.

TransCanada is a leader in the responsible development and reliable operation of North American energy infrastructure. TransCanada's network of approximately 25,600 miles (41,000 kilometres) of pipeline transports the majority of Western Canada's natural gas production to key Canadian and U.S. markets. A growing independent power producer, TransCanada owns, or has interests in, approximately 6,700 megawatts of power generation in Canada and the United States. TransCanada's common shares trade on the Toronto and New York stock exchanges under the symbol TRP.

HOUSE UTILITIES

DATE: 3/1/06

ATTACHMENT 4

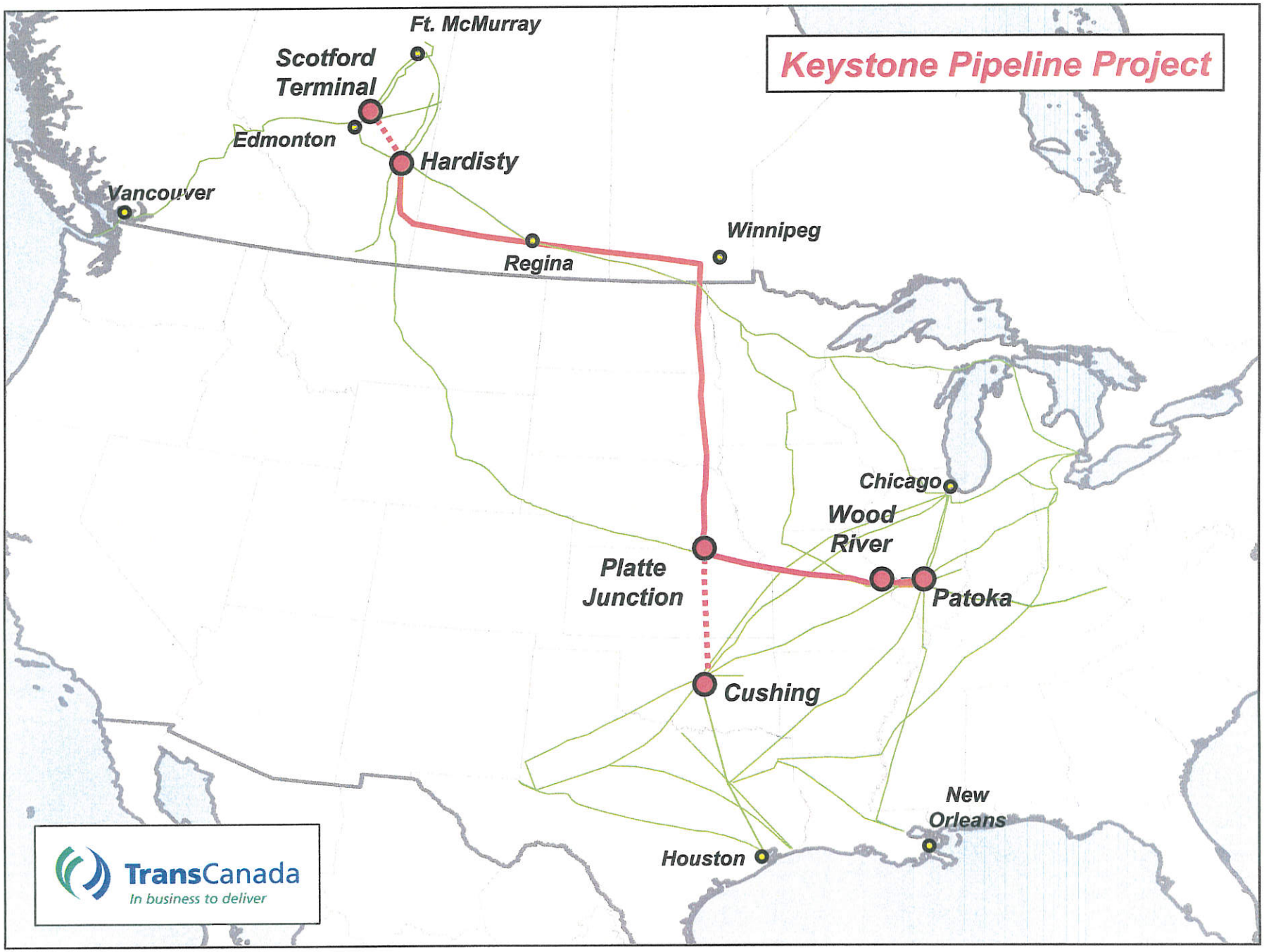
TransCanada begins binding Open Season on proposed Keystone oil pipeline

CALGARY, Alberta – November 4, 2005 – (TSX: TRP) (NYSE: TRP) TransCanada Corporation (TransCanada) today announced the start of a binding Open Season process for the proposed Keystone oil pipeline. A successful non-binding Expression of Interest phase took place in April 2005 and indicated sufficient volume support for the Keystone Project.

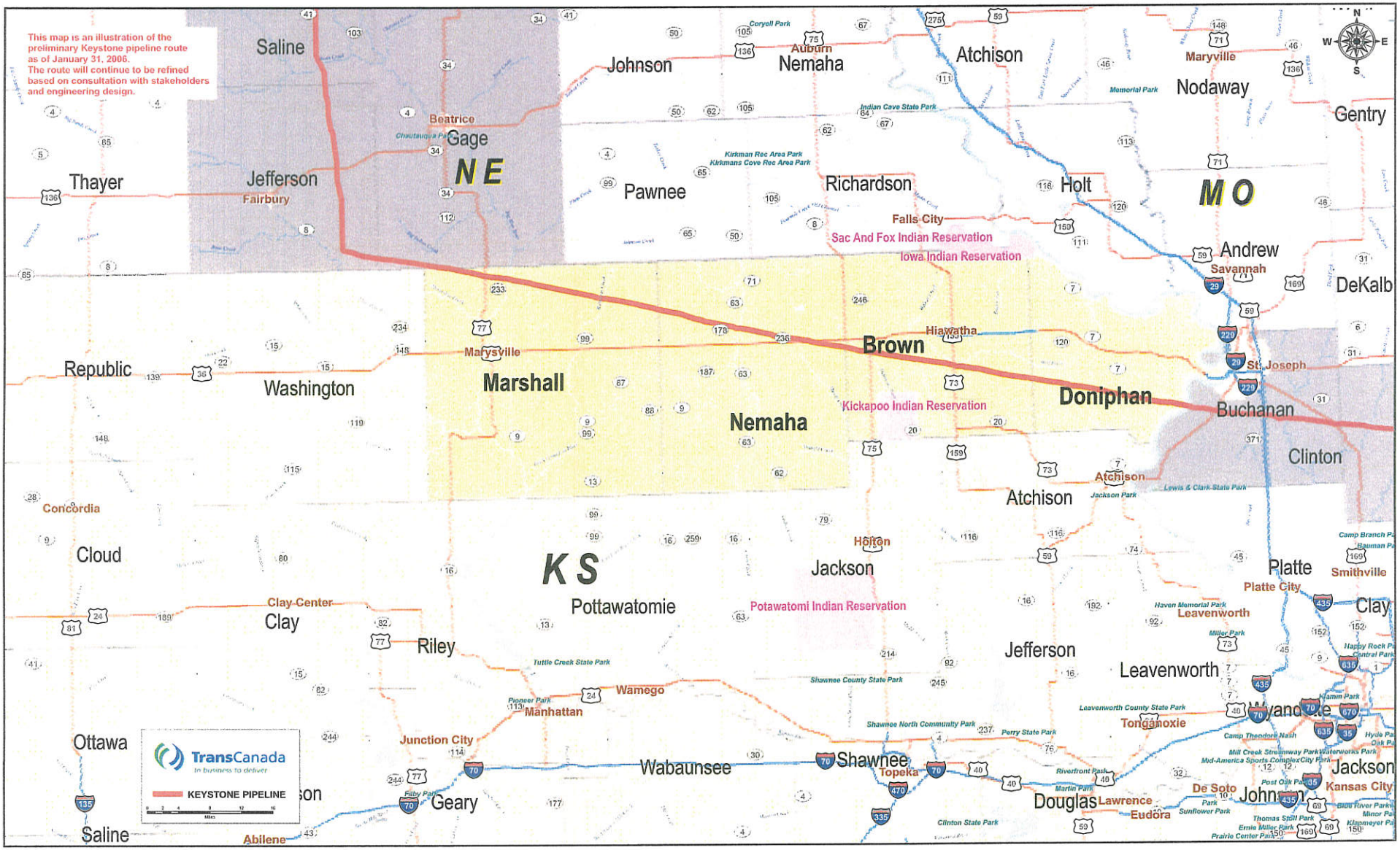
Valued at approximately US$2.1 billion, the Keystone pipeline is intended to transport approximately 435,000 barrels per day of crude oil from Hardisty, Alberta, to Patoka, Illinois, through a 1,840-mile (2,950 kilometre) pipeline system. In addition to approximately 1,100 miles (1,700 kilometres) of new pipeline construction in the United States, the Canadian portion of the proposed project includes the construction of approximately 220 miles (355 kilometres) of new pipeline and the conversion of approximately 540 miles (870 kilometres) of existing TransCanada pipeline facilities from natural gas to crude oil transmission.

The Open Season process follows an announcement on November 3 by TransCanada and ConocoPhillips Pipe Line Company (CPPL), a wholly owned subsidiary of ConocoPhillips Company, that the two companies have entered into a Memorandum of Understanding which commits ConocoPhillips Company to ship crude oil on the proposed Keystone oil pipeline and gives CPPL the right to acquire up to a fifty per cent ownership interest in the pipeline, subject to certain conditions being met.

During the Open Season period, which expires at noon MST on December 1, 2005, TransCanada will accept binding bids from shippers for transportation capacity. In addition, TransCanada is requesting responses on two non-binding Expressions of Interest relating to potential extensions to the Keystone Project. The first Expression of Interest is requesting shipper interest in having an additional Keystone originating point in the Fort Saskatchewan area of Alberta. The second Expression of Interest is proposing an extension of the Keystone system to Cushing, Oklahoma.


Keystone Pipeline Project
Ft. McMurray
Scotford Terminal
Edmonton
Hardisty
Vancouver
Regina
Winnipeg
Chicago
Wood River
Platte Junction
Patoka
Cushing
New Orleans
Houston
TransCanada
In business to deliver

KEYSTONE PIPELINE PROJECT



A Committee on the Present Danger Policy Paper:

OIL & SECURITY

by George P. Shultz and R. James Woolsey

(An earlier version of this paper was posted in June on the CPD Web-site just prior to the Senate debate of the Energy Bill to help inform that debate and for discussion and commentary by interested parties prior to CPD board and membership approval. That discussion and commentary has informed this draft, dated August 5, 2005. Board and membership approval is not yet final.)

SUMMARY

This paper could well be called, "It's the Batteries, Stupid." Four years ago, on the eve of 9/11, the need to reduce radically our reliance on oil was not clear to many and in any case the path of doing so seemed a long and difficult one. Today both assumptions are being undermined by the risks of the post-9/11 world and by technological progress in fuel efficiency and alternative fuels.

We spell out below the risks of petroleum dependency, particularly the vulnerability of the petroleum infrastructure in the Middle East to terrorist attack – a single well-designed attack could send oil to well over $100/barrel and devastate the world's economy. That reality, among other risks, and the fact that our current transportation infrastructure is locked in to oil, should be sufficient to convince any objective observer that oil dependence today creates serious and pressing dangers for the US and other oil-importing nations.

We propose in this paper that the government vigorously encourage and support at least six technologies: two types of alternative fuels that are beginning to come into the market (cellulosic ethanol and biodiesel derived from a wide range of waste streams), two types of fuel efficient vehicles that are now being sold to the public in some volume (hybrid gasoline-electric and modern clean diesels), and one vehicle construction technique, the use of manufactured carbon-carbon composites, that is now being used for aircraft and racing cars and is quite promising as a way of reducing vehicle weight and fuel requirements while improving safety.

The sixth technology, battery improvement to permit "plug-in" hybrid vehicles, will require some development – although nothing like the years that will be required for hydrogen fuel cells. It holds, however, remarkable promise. Improving batteries to permit them to be given an added charge when a hybrid is garaged, ordinarily at night, can substantially improve mileage because it can permit hybrids to use battery power alone for the first 10-30 miles. Since a great many trips fall within this range this can improve the mileage of a hybrid vehicle from, say, 50 mpg to over 100 mpg (of oil products). Also, since the average residential electricity cost is 8.5 . cents/kwh (and in many areas, off-peak nighttime cost is 2-4 cents/kwh) this means that, after taking account of the differential efficiencies of electric and gasoline power, much of a plug-in hybrid's travel would be on electricity that is the equivalent of $1/gallon gasoline (or, off-peak, 25-50 cents/gallon) as contrasted with the same vehicle's use of today's approximately $2.50/gallon gasoline.

A plug-in hybrid averaging 125 mpg, if its fuel tank contains 85 per cent cellulosic ethanol, would be getting on the order of 500 mpg (of oil products). If it were constructed from carbon composites that mileage could double, and, if it were a diesel and powered by biodiesel or renewable diesel derived from waste, it would be using no oil products at all.

What are we waiting for?

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There are at least seven major reasons why dependence on petroleum and its products for the lion's share of the world's transportation fuel creates special dangers in our time. These dangers are all driven by rigidities and potential vulnerabilities that have become serious problems because of the geopolitical realities of the early 21st century. Those who reason about these issues solely on the basis of abstract economic models that are designed to ignore such geopolitical realities will find much to disagree with in what follows. Although such models have utility in assessing the importance of more or less purely economic factors in the long run, as Lord Keynes famously remarked: "In the long run, we are all dead."

These dangers in turn give rise to two proposed directions for government policy in order to reduce our vulnerability rapidly. In both cases we believe that existing technology should be used, i.e. technology that is already in the market or can be so in the very near future and that is compatible with the existing transportation infrastructure. To this end government policies in the United States and other oil-importing countries should: (1) encourage a shift to substantially more fuel-efficient vehicles, including fostering battery development for plug-in hybrid vehicles; and (2) encourage biofuels and other alternative and renewable fuels that wherever possible can be derived from waste products.

PETROLEUM DEPENDENCE: THE DANGERS:

1. The current transportation infrastructure is committed to oil and oil-compatible products.

This fact substantially increases the difficulty of responding to oil price increases or disruptions in supply by substituting other fuels.

There is a range of fuels that can be used to produce electricity and heat and that can be used for other industrial uses, but petroleum and its products dominate the fuel market for vehicular transportation. With the important exception, described below, of a plug-in version of the hybrid gasoline/electric vehicle, which will allow recharging hybrids from the electricity grid, substituting other fuels for petroleum in the vehicle fleet as a whole has generally required major, time-consuming, and expensive infrastructure changes. One exception has been some use of liquid natural gas (LNG) and other fuels for fleets of buses or delivery vehicles, although not substantially for privately-owned ones, and the use of corn-derived ethanol mixed with gasoline in proportions up to 10 per cent ethanol ("gasohol") in some states. Neither has appreciably affected petroleum's dominance of the transportation fuel market.

Moreover, in the 1970's about 20 per cent of our electricity was made from oil - so shifting electricity generation toward, say, renewables or nuclear power could save oil. But since today only about two per cent of our electricity is oil-generated, a shift in the way we produce electricity would have almost no effect on the transportation or oil market. This could change, however, with the advent of plug-in hybrid vehicles, discussed below.

There are imaginative proposals for transitioning to other fuels for transportation, such as hydrogen to power automotive fuel cells, but this would require major infrastructure investment

and restructuring. If privately-owned fuel cell vehicles were to be capable of being readily refueled, this would require reformers (equipment capable of reforming, say, natural gas into hydrogen) to be located at filling stations, and would also require natural gas to be available there as a hydrogen feed-stock. So not only would fuel cell development and technology for storing hydrogen on vehicles need to be further developed, but the automobile industry's development and production of fuel cells also would need to be coordinated with the energy industry's deployment of reformers and the fuel for them.

Moving toward automotive fuel cells thus requires us to face a huge question of pace and coordination of large-scale changes by both the automotive and energy industries. This poses a sort of industrial Alphonse and Gaston dilemma: who goes through the door first? (If, instead, it were decided that existing fuels such as gasoline were to be reformed into hydrogen on board vehicles instead of at filling stations, this would require on-board reformers to be developed and added to the fuel cell vehicles themselves - a very substantial undertaking.)

It is because of such complications that the National Commission on Energy Policy concluded in its December, 2004, report "Ending The Energy Stalemate" ("ETES") that "hydrogen offers little to no potential to improve oil security and reduce climate change risks in the next twenty years." (p. 72)

To have an impact on our vulnerabilities within the next decade or two, any competitor of oil-derived fuels will need to be compatible with the existing energy infrastructure and require only modest additions or amendments to it.

2. <u>The Greater Middle East will continue to be the low-cost and dominant petroleum producer for the foreseeable future.</u>

Home of around two-thirds of the world's proven reserves of conventional oil -- 45% of it in just Saudi Arabia, Iraq, and Iran -- the Greater Middle East will inevitably have to meet a growing percentage of world oil demand. This demand is expected to increase by more than 50 per cent in the next two decades, from 78 million barrels per day ("MBD") in 2002 to 118 MBD in 2025, according to the federal Energy Information Administration. Much of this will come from expected demand growth in China and India. One need not argue that world oil production has peaked to see that this puts substantial strain on the global oil system. It will mean higher prices and potential supply disruptions and will put considerable leverage in the hands of governments in the Greater Middle East as well as in those of other oil-exporting states which have not been marked recently by stability and certainty: Russia, Venezuela, and Nigeria, for example (ETES pp. 1-2). Deep-water drilling and other opportunities for increases in supply of conventional oil may provide important increases in supply but are unlikely to change this basic picture.

Even if other production comes on line, e.g. from unconventional sources such as tar sands in Alberta or shale in the American West, their relatively high cost of production could permit low-cost producers, particularly Saudi Arabia, to increase production, drop prices for a time, and undermine the economic viability of the higher-cost competitors, as occurred in the mid-1980's. For the foreseeable future, as long as vehicular transportation is dominated by oil as it is today, the Greater Middle East, and especially Saudi Arabia, will remain in the driver's seat.

3. <u>The petroleum infrastructure is highly vulnerable to terrorist and other attacks.</u>

The radical Islamist movement, including but not exclusively al Qaeda, has on a number of

occasions explicitly called for worldwide attacks on the petroleum infrastructure and has carried some out in the Greater Middle East. A more well-planned attack than what has occurred to date -- such as that set out in the opening pages of Robert Baer's recent book, *Sleeping With the Devil,* (terrorists flying an aircraft into the unique sulfur-cleaning towers in northeastern Saudi Arabia) -- could take some six million barrels per day off the market for a year or more, sending petroleum prices sharply upward to well over $100/barrel and severely damaging much of the world's economy. Domestic infrastructure in the West is not immune from such disruption. U.S. refineries, for example, are concentrated in a few places, principally the Gulf Coast. The recent accident in the Texas City refinery-- producing multiple fatalities--points out potential infrastructure vulnerabilities. The Trans-Alaska Pipeline has been subject to several amateurish attacks that have taken it briefly out of commission; a seriously planned attack on it could be far more devastating.

In view of these overall infrastructure vulnerabilities we do not suggest that policy should focus exclusively on petroleum imports, although such infrastructure vulnerabilities are likely to be the most severe in the Greater Middle East. It is there that terrorists have the easiest access and the largest proportion of proven oil reserves, and low-cost production are also located there. Nor do we hold the view that by changing trade patterns anything particularly is accomplished. To a first approximation there is one worldwide oil market and it is not generally useful for the U.S., for example, to import less from the Greater Middle East and for others then to import more from there. In effect, all of us oil-importing countries are in this together.

4. <u>The possibility exists, particularly under regimes that could come to power in the Greater Middle East, of embargoes or other disruptions of supply.</u>

It is often said that whoever governs the oil-rich nations of the Greater Middle East will need to sell their oil. This is not true, however, if the rulers choose to try to live, for most purposes, in the seventh century. Bin Laden has advocated, for example, major reductions in oil production.

In 1979 there was a serious attempted coup in Saudi Arabia. Much of what the outside world saw was the seizure by Islamist fanatics of the Great Mosque in Mecca, but the effort was more widespread. Even if one is optimistic that democracy and the rule of law will spread in the Greater Middle East and that this will lead after a time to more peaceful and stable societies there, it is undeniable that there is substantial risk that for some time the region will be characterized by chaotic change and unpredictable governmental behavior. Reform, particularly if it is hesitant, has in a number of cases been trumped by radical takeovers (Jacobins, Bolsheviks). There is no reason to believe that the Greater Middle East is immune from these sorts of historic risks.

5. <u>Wealth transfers from oil have been used, and continue to be used, to fund terrorism and Its ideological support.</u>

Estimates of the amount spent by the Saudis in the last 30 years spreading Wahhabi beliefs throughout the world vary from $70 billion to $100 billion. Furthermore, some oil-rich families of the Greater Middle East fund terrorist groups directly. The spread of Wahhabi doctrine – fanatically hostile to Shi'ite and Suffi Muslims, Jews, Christians, women, modernity, and much else – plays a major role with respect to Islamist terrorist groups: a role similar to that played by angry German nationalism with respect to Nazism in the decades after World War I. Not all angry German nationalists became Nazis and not all those schooled in Wahhabi beliefs become

terrorists, but in each case the broader doctrine of hatred has provided the soil in which the particular totalitarian movement has grown. Whether in lectures in the *madrassas* of Pakistan, in textbooks printed by Wahhabis for Indonesian schoolchildren, or on bookshelves of mosques in the US, the hatred spread by Wahhabis and funded by oil is evident and influential.

It is sometimes contended that we should not seek substitutes for oil because disruption of the flow of funds to the Greater Middle East could further radicalize the population of some states there. The solution, however, surely lies in helping these states diversify their economies over time, not in perpetually acquiescing to the economic rent they collect from oil exports and to the uses to which these revenues are put.

6. The Current Account deficits for a number of countries create risks ranging from major world economic disruption to deepening poverty, and could be substantially reduced by reducing oil imports.

The U.S. in essence borrows about $2 billion a day, every day, principally now from major Asian states, to finance its consumption. The single largest category of imports is the approximately $1 billion per working day borrowed to import oil. The accumulating debt increases the risk of a flight from the dollar or major increases in interest rates. Any such development could have major negative economic consequences for both the U.S. and its trading partners.

For developing nations, the service of debt is a major factor in their continued poverty. For many, debt is heavily driven by the need to import oil that at today's oil prices cannot be paid for by sales of agricultural products, textiles, and other typical developing nation exports.

If such deficits are to be reduced, however, say by domestic production of substitutes for petroleum, this should be based on recognition of real economic value such as waste cleanup, soil replenishment, or other tangible benefits.

7. Global-warming gas emissions from man-made sources create at least the risk of climate change.

Although the point is not universally accepted, the weight of scientific opinion suggests that global warming gases (GWG) produced by human activity form one important component of potential climate change. Oil products used in transportation provide a major share of U.S. man-made global warming gas emissions.

THREE PROPOSED DIRECTIONS FOR POLICY:

The above considerations suggest that government policies with respect to the vehicular transportation market should point in the following directions:

1. Encourage improved vehicle mileage, using technology now in production.

Three currently available technologies stand out to improve vehicle mileage.

Diesels

First, modern diesel vehicles are coming to be capable of meeting rigorous emission standards (such as Tier 2 standards, being introduced into the U.S., 2004-08). In this context it is possible without compromising environmental standards to take advantage of diesels' substantial mileage advantage over gasoline-fueled internal combustion engines.

Substantial penetration of diesels into the private vehicle market in Europe is one major reason why the average fleet mileage of such new vehicles is 42 miles per gallon in Europe and only 24 mpg in the US. Although the U.S. has, since 1981, increased vehicle weight by 24 per cent and horsepower by 93 per cent, it has actually somewhat lost ground with respect to mileage over that near-quarter century. In the 12 years from 1975 to 1987, however, the US improved the mileage of new vehicles from 15 to 26 mpg.

Hybrid gasoline-electric

Second, hybrid gasoline-electric vehicles now on the market show substantial fuel savings over their conventional counterparts. The National Commission on Energy Policy found that for the four hybrids on the market in December 2004 that had exact counterpart models with conventional gasoline engines, not only were mileage advantages quite significant (10-15 mpg) for the hybrids, but in each case the horsepower of the hybrid was higher than the horsepower of the conventional vehicle. (ETES p. 11) If automobile companies wish to market hybrids by emphasizing hotter performance rather than fuel conservation they can do so, consistent with the facts.

Light-weight Carbon Composite Construction

Third, constructing vehicles with inexpensive versions of the carbon fiber composites that have been used for years for aircraft construction can substantially reduce vehicle weight and increase fuel efficiency while at the same time making the vehicle considerably safer than with current construction materials. This is set forth thoroughly in the 2004 report of the Rocky Mountain Institute's *Winning the Oil Endgame* ("WTOE"). Aerodynamic design can have major importance as well. This breaks the traditional tie between size and safety. Much lighter vehicles, large or small, can be substantially more fuel-efficient and also safer. Such composite use has already been used for automotive construction in Formula 1 race cars and is now being adopted by BMW and other automobile companies. The goal is mass-produced vehicles with 80% of the performance of hand-layup aerospace composites at 20% of the cost. Such construction is expected to approximately double the efficiency of a normal hybrid vehicle without increasing manufacturing cost. (WTOE 64-66).

2. Encourage the commercialization of alternative transportation fuels that can be available soon, are compatible with existing infrastructure, and can be derived from waste or otherwise produced cheaply.

Biomass (cellulosic) ethanol.

The use of ethanol produced from corn in the U.S. and sugar cane in Brazil has given birth to the commercialization of an alternative fuel that is coming to show substantial promise, particularly as new feedstocks are developed. Some six million vehicles in the U.S. and all vehicles in Brazil other than those that use solely ethanol are capable of using ethanol in mixtures of up to 85 percent ethanol and 15 per cent gasoline (E-85); these are called Flexible Fuel Vehicles ("FFV")

consumed in the process of fertilizing, plowing, and harvesting. Even starch-based ethanol, however, does reduce greenhouse gas emissions by around 30 per cent. Because so little energy is required to cultivate crops such as switchgrass for cellulosic ethanol production, and because electricity can be co-produced using the residues of such cellulosic fuel production, reductions in greenhouse gas emissions for celluslosic ethanol when compared to gasoline are greater than 100 per cent. The production and use of cellulosic ethanol is, in other words, a carbon sink. (ETES p. 73)

Biodiesel and Renewable Diesel

The National Commission on Energy Policy pointed out some of the problems with most current biodiesel "produced from rapeseed, soybean, and other vegetable oils - as well as . . . used cooking oils." It said that these are "unlikely to become economic on a large scale" and that they could "cause problems when used in blends higher than 20 percent in older diesel engines". It added that "waste oil is likely to contain impurities that give rise of undesirable emissions." (ETES p. 75)

The Commission notes, however, that biodiesel is generally "compatible with existing distribution infrastructure" and outlines the potential of a newer process ("thermal depolymerization") that produces renewable diesel without the above disadvantages, from "animal offal, agricultural residues, municipal solid waste, sewage, and old tires". It points to the current use of this process at a Conagra turkey processing facility in Carthage, Missouri, where a "20 million commercial-scale facility" is beginning to convert turkey offal into "a variety of useful products, from fertilizer to low-sulfur diesel fuel" at a potential average cost of "about 72 cents per gallon." (ETES p. 77)

Other Alternative Fuels

Progress has been made in recent years on utilizing not only coal but slag from strip mines, via gasification, for conversion into diesel fuel using a modern version of the gasified-coal-to-diesel process used in Germany during World War II.

Qatar has begun a large-scale process of converting natural gas to diesel fuel.

Outside the realm of conventional oil, the tar sands of Alberta and the oil shale of the Western U.S. exist in huge deposits, the exploitation of which is currently costly and accompanied by major environmental difficulties, but both definitely hold promise for a substantial increases in oil supply.

3. Plug-in hybrids and battery improvements

A modification to hybrids could permit them to become "plug-in-hybrids," drawing power from the electricity grid at night and using all electricity for short trips. The "vast majority of the most fuel-hungry trips are under six miles" and "well within the range" of current (nickel-metal hydride) batteries' capacity, according to Huber and Mills (*The, Bottomless Well,* 2005, p. 84). Other experts, however, emphasize that whether with existing battery types (2-5 kwh capacity) or with the emerging (and more capable) lithium batteries, it is important that any battery used in a plug-in hybrid be capable of taking daily charging without being damaged and be capable of powering the vehicle at an adequate speed. By most assessments some battery development will be necessary in order for this to be the case. Such development should have the highest research

and development priority because it promises to revolutionize transportation economics and to have a dramatic effect on the problems caused by oil dependence.

With a plug-in hybrid vehicle one has the advantage of an electric car, but not the disadvantage. Electric cars cannot be recharged if their batteries run down at some spot away from electric power. But since all hybrids have tanks containing liquid fuel plug-in hybrids have no such disadvantage.

Moreover the attractiveness to the consumer of being able to use electricity from overnight charging for a substantial share of the day's driving is stunning. The average residential price of electricity in the US is about 8.5 cents/kwh, and many utilities sell off-peak power for 2-4 cents/kwh (id at 83). When one takes into consideration the different efficiencies of liquid-fueled and electric propulsion, then where the rubber meets the road the cost of powering a plug-in hybrid with average-cost residential electricity would be about 40 per cent of the cost of powering the same vehicle with today's approximately $2.50/gallon gasoline, or, said another way, for the consumer to be able to buy fuel in the form of electricity at the equivalent of $1/gallon gasoline.* Using off-peak power would then equate to being able to buy 25-to-50 cent/gallon gasoline. Given the burdensome cost imposed by current fuel prices on commuters and others who need to drive substantial distances, the possibility of powering one's family vehicle with fuel that can cost as little as one-tenth of today's gasoline (in the U.S. market) should solve rapidly the question whether there would be public interest in and acceptability of plug-in hybrids.

Although the use of off-peak power for plug-in hybrids should not initially require substantial new investments in electricity generation, greater reliance on electricity for transportation should lead us to look particularly to the security of the electricity grid as well as the fuel we use to generate electricity. In the U.S. the 2002 report of the National Academies of Science, Engineering, and Medicine ("Making the Nation Safer") emphasized particularly the need to improve the security of transformers and of the Supervisory Control and Data Acquisition (SCADA) systems in the face of terrorist threats. The National Commission on Energy Policy has seconded those concerns. With or without the advent of plug-in hybrids, these electricity grid vulnerabilities require urgent attention.

Conclusion

The dangers from oil dependence in today's world require us both to look to ways to reduce demand for oil and to increase supply of transportation fuel by methods beyond the increase of oil production.

The realistic opportunities for reducing demand soon suggest that government policies should encourage hybrid gasoline-electric vehicles, particularly the battery developments needed to bring plug-in versions thereof to the market, and modern diesel technology. The realistic opportunities for increasing supply of transportation fuel soon suggest that government policies should encourage the commercialization of alternative fuels that can be used in the existing infrastructure: cellulosic ethanol and biodiesel/renewable diesel. Both of these fuels could be introduced more quickly and efficiently if they achieve cost advantages from the utilization of waste products as feedstocks.

The effects of these policies are multiplicative. All should be pursued since it is impossible to predict which will be fully successful or at what pace, even though all are today either beginning commercial production or are nearly to that point. The battery development for plug-in hybrids

is of substantial importance and should for the time being replace the current r&d emphasis on automotive hydrogen fuel cells.

If even one of these technologies is moved promptly into the market, the reduction in oil dependence could be substantial. If several begin to be successfully introduced into large-scale use, the reduction could be stunning. For example, a 50-mpg hybrid gasoline/electric vehicle, on the road today, if constructed from carbon composites would achieve around 100 mpg. If it were to operate on 85 percent cellulosic ethanol or a similar proportion of biodiesel or renewable diesel fuel, it would be achieving hundreds of miles per gallon of petroleum-derived fuel. If it were a plug-in version operating on upgraded lithium batteries so that 20-30 mile trips could be undertaken on its overnight charge before it began utilizing liquid fuel at all, it could be obtaining in the range of 1000 mpg (of petroleum).

A range of important objectives – economic, geopolitical, environmental – would be served by our embarking on such a path. Of greatest importance, we would be substantially more secure.

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*In the original June 2005 draft of this paper the reader would have seen an estimate that the cost of powering a hybrid with average (8.5 cents/kwh) residential electricity from the grid would be about one-quarter the cost of powering the same vehicle in its normal operating mode using $2/gallon gasoline. This was because we were utilizing an estimate in Huber and Mills that "Burning $2-a-gallon gasoline, the power generated by current hybrid-car engines runs about 35 cents per kilowatt-hour (kWh)." (id p. 83). After assessing comments received on the June draft paper we are now convinced that, whatever the proper number for hybrids' power generation at an earlier time, the better estimate for the cost of operating the most modern hybrids in their normal mode as of August 2005 is a little less than half this 35-cents/kwh estimate. Thus the use of average-cost electricity from the grid would equate to about half the cost of using $2/gallon gasoline, not one-quarter. We would stress that these comparisons take account of the different efficiencies of gasoline and electric power and represent differences where the rubber meets the road, not differences between the cost of different types of energy as stored in a tank or a battery.

Executive Summary

Measured by environmental impact and economic importance, the electricity industry is one of the most important sectors of the American economy. The generation of electricity is responsible for 38 percent of all U.S. carbon dioxide (CO2) emissions and one third of all U.S. greenhouse gas (GHG) emissions. This sector is the largest single source of these emissions. It is also the largest source of sulfur dioxide (SO2), oxides of nitrogen (NOX), small particles, and other air pollutants.

At the same time, electricity is critical to the U.S. economy. Recent annual national expenditures on electricity totaled $250 billion—making the electricity sector's share of overall GDP larger than that of the automobile manufacturing industry and roughly equal in magnitude to that of the telecommunications industry. Expenditures alone, however, understate the importance of electricity to the U.S. economy. Nearly every aspect of productive activity and daily life in a modern economy depends on electricity for which there is, in many cases, no close substitute. As the most desirable form of energy for many uses, electricity use has grown faster than GDP. The Internet and computers would not operate without very reliable, high-quality electricity. Electricity also plays a major role in delivering modern comforts and easing household tasks, from running heating and cooling systems to washing clothes and dishes. It plays an even more important role in the commercial, manufacturing, and agricultural sectors, where it provides lighting and powers a variety of machines. In short, it is hard to imagine a modern economy functioning without large amounts of reliable, high-quality electricity.

The economic and environmental importance of the electric power industry is, moreover, likely to grow in coming decades. Electricity demand has increased steadily over the last three decades and is projected to continue rising in the future, despite ongoing improvements in end-use efficiency. The industry, meanwhile, has undergone dramatic structural changes over the last 10 years, moving from a system of monopolies subject to state price regulation to a mixed system that now includes some elements of market competition in many states. After declining for 75 years, electricity prices have risen since 1970, making expenditures for carbon control a difficult proposition in the absence of mandatory GHG policy. The uncertain state of electricity market restructuring efforts around the country, particularly since the California crisis of 2001-2002, has increased perceptions of investor risk and sharply raised the cost of borrowing for capital investments by investor-owned utilities.

In this context, reconciling growing demand for affordable and reliable electricity supplies with the need for substantial reductions in GHG and criteria pollutant emissions presents a significant challenge for policy-makers and for the electricity industry itself. Indeed, even if worldwide growth in demand for electric power ceased today, the industry's current level of emissions is not sustainable. Stabilizing atmospheric carbon dioxide concentrations at twice the level of pre-industrial times is likely to require emissions reductions of 65-85 percent below current levels by 2100. Clearly, reductions of this magnitude can be achieved only by taking action globally and across all sectors of the economy.1 But the electricity sector will undoubtedly need to assume a major share of the burden—in the United States and worldwide—given its centralized structure and contribution to overall emissions.

This report explores the electric power industry's options for reducing its GHG emissions over the next half century. Those options include new technologies that are still being developed—such as coal gasification with carbon capture and sequestration—as well as strategies that rely on existing technologies at different stages of commercial and technical readiness (such as nuclear and renewable generation), lower-carbon fuels (like natural gas), and efficiency improvements (both at the point of electricity production and end use). Many of these options, in addition to reducing CO2 emissions, also reduce conventional air pollutants.

Although a power generating plant has a lifetime of 30-50 years, low-carbon technologies could claim a substantial fraction of the generation mix by mid-century—in time to help stabilize atmospheric GHG concentrations within the next century or two. Some of these technologies, such as coal-based integrated gasification and combined cycle (IGCC) generation, still need to overcome basic cost, reliability, and market-acceptance hurdles; others, such as carbon capture and sequestration, have yet to be demonstrated on a large scale. Still others, such as wind, nuclear, or even (given recent fuel price increases) natural gas combined cycle power, are relatively well developed but face constraints in terms of siting, public acceptability, cost, or other factors.

Nevertheless, the analysis presented in this report suggests that substantial GHG reductions could be achieved by the power sector—without major impacts on the economy or on consumer lifestyles—through the gradual deployment of lower-carbon options over the next several decades. At the same time, more immediate emissions reductions can be achieved through lowering demand by increasing the efficiency with which electricity is used; substituting natural gas for coal; improving efficiency at existing plants including highly efficient combined heat and power systems at suitable sites; expanding deployment of renewable generation technologies, including biomass co-firing of coal plants; and through the use of carbon offsets such as forestry projects and methane capture and collection. These immediate measures can reasonably be expected to reduce electricity growth and expand low-carbon electricity production in the United States from its 28 percent share in 2003, while also reducing emissions from higher-carbon generators.

While initial steps to limit electricity sector CO2 emissions will have only a modest impact on total U.S. emissions, steady and deliberate efforts to promote long-term technological change in this sector eventually could produce

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significant climate benefits, given the industry's share of current emissions. The dollar cost of achieving GHG reductions will depend to a significant extent on which of several possible technology pathways emerge as both feasible and cost-effective in the decades ahead. Increasing the efficiency with which electricity is used is important to any energy future. In one scenario, the successful commercialization of carbon capture and sequestration technology would allow for continued use of fossil fuels in combination with somewhat increased reliance on similarly priced wind resources. In another scenario, a new generation of nuclear technology proves acceptable and plays an expanded role in meeting future electricity needs. Future emissions reductions might need to be achieved chiefly through increased reliance on relatively more expensive natural gas and renewable energy. Some forms of renewable energy can certainly play a role, but just how large a role depends on a range of uncertain issues in terms of cost, technical performance, and power system architecture. A major scale-up of renewable energy would likely require a greatly enhanced transmission network and expensive energy storage technologies to compensate for the remoteness and intermittency of much of the wind and solar resource base. These issues will be resolved only through further research and expanded field experience.

In all cases, however, long-term reductions will be achieved at lower cost if climate considerations are incorporated into the industry's investment decisions sooner rather than later. Building another round of conventional pulverized coal plants that comply with new pollution control requirements for SO2, NOX, particulate matter, mercury, and other toxic emissions, but that later need to be scrapped, or retrofitted with costly and inefficient CO2 scrubbers, would likely be the most costly path.

To ensure that climate considerations figure in the industry's planning decisions and to provide effective market incentives for investment in low-carbon technologies, a clear timetable for the regulation of GHG emissions is essential. Many industry experts and utility executives see such regulations as inevitable over the next 10-20 years, but cannot—without some certainty about future regulation—justify added expenditures for low-carbon technologies today, either to their shareholders or to state regulators concerned about the local economic impacts of higher-priced power. Voluntary efforts to reduce CO2 emissions simply will not be sufficient in an increasingly cost-competitive and risk-averse market. If, however, GHG emission limits are implemented in concert with other pollution control requirements, long-term air quality and climate objectives will be achieved more quickly and at lower total cost than under a piecemeal approach.

Four major policy recommendations emerge from the findings in this report concerning prospects for a long-term transition to a low-carbon electricity power sector:

- *Establish a firm regulatory timetable for reducing CO2 emissions from the electricity industry that parallels the timetable for reducing discharges of conventional pollutants.* To assure that emissions targets are met at minimum cost, they should be set well in advance and should be implemented using market-based mechanisms such as a cap-and-trade system or a carbon tax. Avoiding high costs later requires accounting for CO2 in current investment decisions and technology choices.

- *Address the most serious institutional and regulatory barriers to the development of low-carbon and carbon-free energy technologies by implementing policies aimed at:* (1) developing an adaptive regulatory framework for managing geologic carbon sequestration, in order to provide an alternative (coal gasification with carbon capture) to building new conventional coal plants; (2) determining if it is feasible to mitigate the safety, proliferation, and waste-management concerns that currently inhibit the expansion of nuclear power; (3) facilitating the adoption of cost-effective low- or no-carbon renewable technologies such as wind and biomass and promoting distributed resources and micro-grids—that is, clusters of small, modular generators interconnected through a low-voltage distribution system that can function either in concert with, or independent of, the larger grid; and (4) creating financial arrangements that decrease the risk penalty assigned by investors to new capital in the restructured era that have tended to discourage major electricity industry investments and that present further hurdles to the deployment of new technologies.

- *Promote greater end-use efficiency through policies that encourage power companies to invest in cost-effective, demand-side energy savings.* Impose stricter federal efficiency standards for appliances and buildings (as detailed in the Pew Center report, Towards a Climate Friendly Built Environment) and promote the deployment of efficient combined heat and power systems. California has succeeded in slowing per capita electricity demand growth significantly through a variety of efficiency initiatives; these and other programs should be examined to estimate their potential to reduce demand more broadly and to identify "best practices" that can be documented and implemented elsewhere.

- *Create a federal requirement that all parties in the electricity industry invest at least one percent of their value added in R&D in order to explore how promising new technologies can solve the difficult reliability, efficiency, security, environmental, cost, and other problems facing the industry.* Firms should have the choice to make the investments themselves or contribute to a fund managed by the U.S. Department of Energy. In parallel with this industry mandate, the Department of Energy needs to develop a more effective program of needs-based research into power generation and storage, electricity transmission and distribution, conservation, demand management, and other electric power technologies and systems.

Testimony

before the

House Taxation Committee
House Utilities Committee

State of Kansas

March 1, 2006

by

Tim Rens, CFO
Coffeyville Resources, LLC
Kansas City, KS

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DATE: 3/1/06
ATTACHMENT 5

Thank you for this opportunity to speak before you today. I am Tim Rens, Chief Financial Officer of Coffeyville Resources, LLC.

I'm testifying today in support of two bills: HB 2900 – the refinery bill and HB 2902 – the nitrogen fertilizer legislation.

First of all, we want to offer a special thanks to the Representative Holmes for the support and leadership he has provided in recognizing our industry.

Background on Coffeyville Resources, LLC

While Coffeyville Resources is relatively a new name, our operations have been in place since 1906. We are a long-standing member of the Coffeyville community, and equally proud to be a part of the Kansas economy with nearly 475 employees and approximately $2.5 billion in revenues.

Today, Coffeyville Resources, LLC is a unique company which includes a sophisticated petroleum refinery and a state-of-the-art nitrogen fertilizer manufacturing plant, which is adjacent to the refinery. While our headquarters office is located in Kansas City, Kansas, our major operations are located in Coffeyville and Phillipsburg, KS, with offices in Plainville, McPherson, Winfield, KS; Bartlesville, OK and Houston, TX.

We are an important economic catalyst for the city, county, state and region via jobs, payroll, and taxes. The payroll at our operations is approximately $35 million. The vast majority of these jobs are among the highest paying jobs in the area, which provide a higher salary range than most factory jobs. While most of the employee workforce is from Kansas, these jobs attract employees from Oklahoma and Missouri as well.

Petroleum Refining Operations

Coffeyville Resources is one of only 3 small Midwestern refineries located in Kansas.

We refine 100,000 barrels per day and we market unbranded petroleum products throughout the Midwest, with a large portion going through the Kansas City market.

We also have a significant crude oil gathering system, purchasing 25,000 barrels of crude per day from domestic producers located in Kansas and Oklahoma.

We own and operate a refined fuels and asphalt terminal in Phillipsburg, KS. This facility supplies the region with nearly 4,500 barrels per day of asphalt and other refined transportation products.

Late last summer, during the energy crisis, many national leaders talked about resolving the fuel shortage by new construction of oil refineries. It is true that no new refineries have been built for more than 30 years. As you are well aware, Kansas Inc. conducted a study to determine the likelihood for Kansas to build a new refinery.

While this would be a good opportunity for the state, we strongly believe that expansion of the existing small refineries will provide additional fuel supply more quickly to support the state's needs. New construction can take an estimated 4 years, while expansion of small refineries no more than 2 years.

Coffeyville Resources is currently expanding its operations from the current 100,000 barrels per day to 115,000 bpd. We believe it is critical to our operations and to the region to reinvest into improvements and other expansion endeavors.

Coke Gasification – Fertilizer Operations

In 1998, Coffeyville Resources decided to bring together two significantly different production operations – petroleum refining and nitrogen fertilizer – by binding them together with one common product: petroleum coke.

Petroleum coke, also known as "pet coke," is a waste byproduct from the petroleum refining process. Normally a refinery would sell pet coke to power plants for energy recovery. However it is used at Coffeyville Resources as a main feedstock for manufacturing anhydrous ammonia (NH3) and urea ammonium nitrate (UAN) through gasification.

Coffeyville Resources is the **only** nitrogen fertilizer facility in North America that uses petroleum coke rather than natural gas as a feedstock to produce nitrogen fertilizer.

It is important to note that there is a reason that the petroleum coke gasification process is very rare in North America. It is an extremely expensive investment.

When we pursued this process in 1998, the gasification facility was largely built with "used" equipment and the entire facility cost the company more than $260

million. If we were to build a new facility, with new equipment, the estimated cost would be more than $600 million.

Status of Coffeyville Resources' Operations

During the next two years Coffeyville Resources is investing more than $350 million into both the refining and fertilizer manufacturing operations.

Coffeyville Resources' expansion and upgrades will include a series of interrelated projects which will increase crude oil throughput by 15% to more than 115,000 bpd.

More than $32 million of the total investment for expansion will go specifically to the nitrogen fertilizer production operation. This expansion will significantly increase UAN production capacity from 650,000 tons to more than one million tons annually. Ammonia production will increase considerably as well.

In Conclusion

While our expansion efforts actually began in August 2005, we strongly encourage both committees to support HB 2900 and HB 2902. These measures will not only provide economic support for our operations, but will encourage additional economic stimulus to our industry counterparts.

Again, thank you for this opportunity to testify before you.

I will be glad to respond to questions from the committee.

Coffeyville Resources Contact Information:

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Coffeyville Resources, LLC
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NATIONAL COOPERATIVE REFINERY ASSOCIATION

Testimony re: HB 2900 Refinery Tax Credits
Joint Meeting of the House Taxation and House Utilities Committees

Presented by James Loving
on behalf of
National Cooperative Refinery Association
March 1, 2006

Mr. Chairman, Members of the Committee:

My name is Jim Loving and I am President of National Cooperative Refinery Association (NCRA). NCRA, a petroleum refinery based in McPherson, Kansas, is a cooperative organized under the Cooperative Marketing Act.

First of all, NCRA wants to express appreciation to the Chairman of this Committee who graciously contacted us for our input prior to finalization and introduction of this bill. We did express some ideas and concerns that we hope did improve the proposed legislation.

HB 2900 sets up a mechanism for an oil refinery in this state to apply to the Secretary of Commerce for an income tax credit for qualified investments (construction of a new refinery or expansion of an existing refinery) under certain circumstances. In general, the incentives are available for use when the refinery is incurring expenditures required to bring the refinery into compliance with new federal or state environmental standards adopted after December 31, 2006.

Oil production and oil refining have been a major piece of the Kansas economy for many years. In 1990 the state of Kansas Produced 151,858 barrels per day of crude oil. Oil production in Kansas has declined to approximately 87,000 barrels per day in January of 2006. Correspondingly, in 1990 there were eight operating petroleum refineries in Kansas. Today there are three operating refineries. NCRA is typical of the three remaining refineries in Kansas. We employ about 560 people and have an annual payroll of $34 million. We process about 100,000 input barrels per day and sell the petroleum products both locally and regionally.

It is important for the committees to understand that, although there has been recent governmental emphasis on alternative energy, the core source of energy for Kansas' mobility and agricultural production is petroleum based and will remain so for years to come. And, the petroleum is economically produced and refined right here in Kansas.

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Recent Federal regulations (which include: fuel sulfur removal, ozone NAAQS, particulate NAAQS, regional haze, NOx SIP Calls, new source review, renewable fuels mandate and MTBE bans) have all had a negative effect on the economic viability of the refining industry. Regulations and the poor economic returns of the 1990's have forced five of the Kansas refineries to close.

A petroleum industry consultant has recently identified approximately 500 announced refinery expansion projects around the globe. Market forces will encourage refinery expansions. We at NCRA believe some of this work should occur in Kansas. Kansas is a good place for refinery expansion because of its historic involvement in the petroleum industry. The crude oil supply pipelines are in place. At NCRA, we can receive crude oil produced essentially anywhere in the world. Our petroleum products are distributed at our refinery truck loading rack or shipped on one of four different petroleum product pipelines. This existing infrastructure is why the state of Kansas should encourage refinery expansion in Kansas. Expansion here is efficient, provides Kansas jobs and is a natural outgrowth of our hydrocarbon heritage.

We at NCRA have recently completed our $325 million Clean Fuels Project. NCRA averaged about 700 construction jobs in McPherson over a nearly two year period. The impact on our community and local businesses has been extensive and widespread. I have been stopped many times over the past two years by landlords, restaurant owners, car dealers, insurance agents and many others to express their interest in NCRA's project and express their appreciation for the economic benefit provided by NCRA's project.

NCRA believes Kansas should encourage refinery expansion here in the state. Refinery expansion investments are huge and those investments will occur where investors believe they will reap the best returns. Kansas' access to crude oil, excellent work force, existing refineries and petroleum product distribution assets - along with some legislative encouragement - will make Kansas a prime target for investor dollars.

HB 2900 is a good approach to encourage and stimulate the industry in Kansas. As this bill progresses through the legislative process, we would be pleased to work with the Chairman, the Committee, and the Legislature to draft legislation that would help make Kansas an attractive locale for future refinery expansion.

Thank you very much for permitting me to testify, and I will be happy to yield to questions.

K A N S A S

RODERICK L. BREMBY, SECRETARY

DEPARTMENT OF HEALTH AND ENVIRONMENT

KATHLEEN SEBELIUS, GOVERNOR

Testimony on House Bill 2900 to
House Committee on Utilities
Submitted by
Ronald F. Hammerschmidt, Ph.D.
Director, Division of Environment

March 1, 2006

Chairman Holmes and members of the House Utilities Committee, I appreciate the opportunity to comment on House Bill 2900 regarding tax benefits for oil refiners in Kansas. New Section 6 of House Bill 2900 contains language that would provide a tax credit for expenditures by a refinery if the Secretary of Health and Environment certifies that the expenditures are required for the refinery to comply with federal or state statutes or regulations. Our primary concern with this provision of the bill is that it does not describe a process to be used by the Department to evaluate requests from a refinery owner or operator for the tax credit.

We have provided suggested changes to the bill that would prescribe a process for obtaining the required certification from the Secretary. These changes would require the refinery owner or operator to submit a request to the Department that includes: a detailed description of the construction project; a list of the environmental statutes or regulations that required the completion of the project; the cost associated with the project; and a certification regarding the data submitted. In addition, we would propose the addition of authority for the Secretary to adopt any needed administrative regulation to implement the provisions of the bill. The authority to adopt administrative regulations also includes a provision that would allow the Secretary to implement a fee to recover the costs of implementing the application review.

The opportunity to submit comments is appreciated. I will gladly respond to questions directed to me by the committee.

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DIVISION OF ENVIRONMENT

CURTIS STATE OFFICE BUILDING, 1000 SW JACKSON ST., STE 400, TOPEKA, KS 66612-1367
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Session of 2006

HOUSE BILL No. 2900

By Committee on Utilities

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AN ACT concerning oil refineries; providing for certain income tax credits, income tax deductions and property tax exemptions relating thereto; providing for issuance of bonds and other financing for certain purposes; relating to certain permits; amending K.S.A. 79-32,120 and 79-32,138 and K.S.A. 2005 Supp. 79-32,117 and repealing the existing sections.

Be it enacted by the Legislature of the State of Kansas:

New Section 1. As used in sections 1 through 5, and amendments thereto:

(a) "Pass-through entity" means any: (1) Corporation which is exempt from income tax under section 1363 of the Internal Revenue Code and which complies with the requirements of K.S.A. 79-32,100e, and amendments thereto; (2) limited liability company; (3) partnership; or (4) limited liability partnership.

(b) "Qualified investment" means expenditures made in construction of a new refinery, or in expansion of the capacity of an existing refinery by at least 10% of such capacity, for: (1) Real and tangible personal property incorporated in and used as part of such refinery and (2) other real and personal property which are located at the site of such refinery and which are employed specifically to serve such refinery.

(c) "Refinery" means an industrial process plant, located in this state, where crude oil is processed and refined into petroleum products.

New Sec. 2. (a) For taxable years commencing after December 31, 2005, any taxpayer who is awarded a tax credit under this act by the secretary of commerce and complies with the conditions set forth in this act and the agreement entered into by the secretary and the taxpayer under this act shall be allowed a credit against the taxpayer's tax liability under the Kansas income tax act as provided in subsection (c).

(b) Subject to the provisions of subsection (c), the amount of the credit to which a taxpayer is entitled shall be equal to the sum of: (1) An amount equal to 10% of the taxpayer's qualified investment for the first $500,000,000 invested and (2) an amount equal to 5% of the amount of the taxpayer's qualified investment that exceeds $500,000,000.

(c) Except as provided by subsection (d), a credit pursuant to this act

shall be taken in 10 annual installments, beginning with the year in which the taxpayer places into service the refinery or the expansion of an existing refinery. Subject to the provisions of section 3, and amendments thereto, the amount of an annual installment of the credit awarded under this act shall be an amount equal to 25% of the lesser of: (1) The credit amount determined under subsection (b), divided by 10; or (2) the taxpayer's total tax liability under the Kansas income tax act for the taxable year.

(d) If the amount of an annual installment of a tax credit allowed under this section exceeds the taxpayer's income tax liability for the taxable year in which the annual installment is allowed, the amount thereof which exceeds such tax liability may be carried over for deduction from the taxpayer's income tax liability in the next succeeding taxable year or years until the total amount of the annual installment of the tax credit has been deducted from tax liability, except that: (1) No such tax credit shall be carried over for deduction after the 14th taxable year succeeding the taxable year in which the first annual installment is allowed; and (2) in no taxable year shall such tax credit exceed 50% of the taxpayer's income tax liability for the taxable year.

(e) (1) Before making a qualified investment, a taxpayer may apply to the secretary of commerce to enter into an agreement for a tax credit under this act. The secretary shall prescribe the form of the application. After receipt of such application, the secretary may enter into an agreement with the applicant for a credit under this act if the secretary determines that the taxpayer's proposed investment satisfies the requirements of this act. The secretary shall enter into an agreement with an applicant which is awarded a credit under this act. The agreement shall include: (A) A detailed description of the refinery project that is the subject of the agreement, (B) the first taxable year for which the credit may be claimed, (C) the maximum amount of tax credit that will be allowed for each taxable year and (D) a requirement that the taxpayer shall maintain operations at the project location for at least 10 years during the term that the tax credit is available.

(2) A taxpayer must comply with the terms of the agreement described in subsection (e)(1) to receive an annual installment of the tax credit awarded under this act. The secretary of commerce, in accordance with rules and regulations of the secretary, shall annually determine whether the taxpayer is in compliance with the agreement. If the secretary determines that the taxpayer is in compliance, the secretary shall issue a certificate of compliance to the taxpayer.

(3) The secretary of commerce may adopt rules and regulations to administer the provisions of this subsection (e).

New Sec. 3. (a) If a qualified investment is made by a pass-through entity and the credit allowed by this act for a taxable year is greater than

the entity's tax liability against which the tax credit may be applied, a shareholder, partner or member of the entity is entitled to a tax credit equal to: (1) The tax credit determined for the entity for the taxable year in excess of the entity's tax liability under the Kansas income tax act for the taxable year multiplied by the percentage of the entity's distributive income to which the shareholder, partner or member is entitled if the entity is an entity described in subsection (e)(1), (2), (3) or (4) of section 1, and amendments thereto; or (2) the relative percentage of the entity's patronage dividends allocable to the member for the taxable year if the entity is an entity described in subsection (e)(5) or (6) of section 1, and amendments thereto.

(b) If a refinery is co-owned by two or more taxpayers, the amount of the credit that may be allowed to a co-owner in a taxable year is equal to the tax credit determined under section 2, and amendments thereto, with respect to the total qualified investment in such refinery multiplied by the co-owner's percentage of ownership in such refinery.

(c) Except as provided by subsection (d), the amount of an annual installment of the credit allowed to a shareholder, partner or member of a pass-through entity or a co-owner under this act shall be an amount equal to 25% of the lesser of: (1) That portion of the credit allowed to the shareholder, partner, member or co-owner under this section divided by 10; or (2) the total tax liability of the shareholder, partner, member or co-owner under the Kansas income tax act for the taxable year.

(d) If the amount of an annual installment of a tax credit allowed a shareholder, partner, member or co-owner under this section exceeds the taxpayer's income tax liability for the taxable year in which the annual installment is allowed, the amount thereof which exceeds such tax liability may be carried over for deduction from the taxpayer's income tax liability in the next succeeding taxable year or years until the total amount of the tax credit has been deducted from tax liability, except that: (1) No such tax credit shall be carried over for deduction after the 14th taxable year succeeding the taxable year in which the first annual installment is allowed; and (2) in no taxable year shall such tax credit exceed 50% of the taxpayer's income tax liability for the taxable year.

New Sec. 4. To receive the credit awarded by this act, a taxpayer must claim the credit on the taxpayer's annual state income tax return or returns in the manner prescribed by the director of taxation. The taxpayer shall submit to the director a copy of the taxpayer's certificate of compliance issued under subsection (d)(2) of section 2, and amendments thereto, and all information that the director determines necessary for the calculation of the credit provided by this act.

New Sec. 5. (a) In addition to the income tax credit allowable pursuant to sections 1 through 4, and amendments thereto, a taxpayer shall

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be entitled to a deduction from Kansas adjusted gross income with respect to the amortization of the amortizable costs of a new refinery or an expansion of a refinery based upon a period of 10 years. Such amortization deduction shall be an amount equal to 55% of the amortizable costs of such new refinery or expansion of a refinery for the first taxable year in which such refinery or expansion of a refinery is in production and 5% of the amortizable costs of such new refinery or expansion of a refinery for each of the next nine taxable years.

(b) The election of the taxpayer to claim the deduction allowed by subsection (a) shall be made by filing a statement of such election with the secretary of revenue in the manner and form and within the time prescribed by rules and regulations adopted by the secretary.

(c) The provisions of this section shall apply to all taxable years commencing after December 31, 2005.

(d) The secretary of revenue shall adopt such rules and regulations as deemed necessary to carry out the provisions of this section.

(e) As used in this section:

(1) "Expansion of a refinery" means expansion, construction of which begins after December 31, 2005, of the capacity of an existing refinery by at least 10% of such capacity.

(2) "New refinery" means a refinery, construction of which begins after December 31, 2005.

(3) "Refinery" has the meaning provided by section 1, and amendments thereto.

New Sec. 6. (a) As used in this section:

(1) "Refinery" has the meaning provided by section 1, and amendments thereto.

(2) "Qualified expenditures" means expenditures which the secretary of health and environment certifies to the director of taxation are required ~~to bring~~ a new or existing refinery ~~into compliance~~ with environmental standards or requirements established pursuant to federal statute or regulation, or state statute or rules and regulation, adopted after December 31, 2006.

(b) There shall be allowed as a credit against the tax liability of a taxpayer imposed under the Kansas income tax act an amount equal to the taxpayer's qualified expenditures. The tax credit allowed by this subsection shall be deducted from the taxpayer's income tax liability for the taxable year in which the expenditures are made by the taxpayer. If the amount of such tax credit exceeds the taxpayer's income tax liability for such taxable year, the taxpayer may carry over the amount thereof that exceeds such tax liability for deduction from the taxpayer's income tax liability in the next succeeding taxable year or years until the total amount of the tax credit has been deducted from tax liability, except that no such

In line 30, strike "to bring" and insert "for" and strike "into compliance" and insert "to comply"

tax credit shall be carried over for deduction after the fourth taxable year succeeding the year in which the costs are incurred.

(c) The provisions of this section shall be applicable to all taxable years commencing after December 31, 2006.

Sec. 7. K.S.A. 2005 Supp. 79-32,117 is hereby amended to read as follows: 79-32,117. (a) The Kansas adjusted gross income of an individual means such individual's federal adjusted gross income for the taxable year, with the modifications specified in this section.

(b) There shall be added to federal adjusted gross income:

(i) Interest income less any related expenses directly incurred in the purchase of state or political subdivision obligations, to the extent that the same is not included in federal adjusted gross income, on obligations of any state or political subdivision thereof, but to the extent that interest income on obligations of this state or a political subdivision thereof issued prior to January 1, 1988, is specifically exempt from income tax under the laws of this state authorizing the issuance of such obligations, it shall be excluded from computation of Kansas adjusted gross income whether or not included in federal adjusted gross income. Interest income on obligations of this state or a political subdivision thereof issued after December 31, 1987, shall be excluded from computation of Kansas adjusted gross income whether or not included in federal adjusted gross income.

(ii) Taxes on or measured by income or fees or payments in lieu of income taxes imposed by this state or any other taxing jurisdiction to the extent deductible in determining federal adjusted gross income and not credited against federal income tax. This paragraph shall not apply to taxes imposed under the provisions of K.S.A. 79-1107 or 79-1108, and amendments thereto, for privilege tax year 1995, and all such years thereafter.

(iii) The federal net operating loss deduction.

(iv) Federal income tax refunds received by the taxpayer if the deduction of the taxes being refunded resulted in a tax benefit for Kansas income tax purposes during a prior taxable year. Such refunds shall be included in income in the year actually received regardless of the method of accounting used by the taxpayer. For purposes hereof, a tax benefit shall be deemed to have resulted if the amount of the tax had been deducted in determining income subject to a Kansas income tax for a prior year regardless of the rate of taxation applied in such prior year to the Kansas taxable income, but only that portion of the refund shall be included as bears the same proportion to the total refund received as the federal taxes deducted in the year to which such refund is attributable bears to the total federal income taxes paid for such year. For purposes of the foregoing sentence, federal taxes shall be considered to have been deducted only to the extent such deduction does not reduce Kansas taxable income below zero.

In line 3 after (c), insert the following:

(1) To qualify the expenditures for the tax credit allowed by this subsection, a taxpayer may apply to the secretary of health and environment for a certification that the costs were incurred to comply with environmental standards or requirements as specified in subsection (a). The secretary shall prescribe the form of the application which shall include, but not be limited to, the following information: (A) A detailed description of the refinery project that is the subject of the expenditure; (B) a citation to the applicable federal or state statutes or regulations that require the environmental compliance; (C) a detailed accounting of the costs incurred for the environmental compliance; and (D) a certification by a responsible official that based on information and belief formed after reasonable inquiry, the statements and information in the application are true, accurate, and complete.

(2) If the secretary of health and environment determines that the expenditures were incurred to comply with environmental standards or requirements as specified in subsection (a), the secretary shall issue a certificate of compliance to the director of taxation.

(3) The secretary of health and environment may adopt rules and regulations to administer the provisions of this subsection (c), including rules and regulations to fix, charge, and collect an application fee to cover all or any part of the agency's cost of certifying the taxpayer's qualified expenditures under this section.

Following new subsection (c), insert (d).

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(v) The amount of any depreciation deduction or business expense deduction claimed on the taxpayer's federal income tax return for any capital expenditure in making any building or facility accessible to the handicapped, for which expenditure the taxpayer claimed the credit allowed by K.S.A. 79-32,177, and amendments thereto.

(vi) Any amount of designated employee contributions picked up by an employer pursuant to K.S.A. 12-5005, 20-2603, 74-4919 and 74-4965, and amendments to such sections.

(vii) The amount of any charitable contribution made to the extent the same is claimed as the basis for the credit allowed pursuant to K.S.A. 79-32,196, and amendments thereto.

(viii) The amount of any costs incurred for improvements to a swine facility, claimed for deduction in determining federal adjusted gross income, to the extent the same is claimed as the basis for any credit allowed pursuant to K.S.A. 2005 Supp. 79-32,204 and amendments thereto.

(ix) The amount of any ad valorem taxes and assessments paid and the amount of any costs incurred for habitat management or construction and maintenance of improvements on real property, claimed for deduction in determining federal adjusted gross income, to the extent the same is claimed as the basis for any credit allowed pursuant to K.S.A. 79-32,203 and amendments thereto.

(x) Amounts received as nonqualified withdrawals, as defined by K.S.A. 2005 Supp. 75-643, and amendments thereto, if, at the time of contribution to a family postsecondary education savings account, such amounts were subtracted from the federal adjusted gross income pursuant to paragraph (xv) of subsection (c) of K.S.A. 79-32,117, and amendments thereto, or if such amounts are not already included in the federal adjusted gross income.

(xi) The amount of any contribution made to the same extent the same is claimed as the basis for the credit allowed pursuant to K.S.A. 2005 Supp. 74-50,154, and amendments thereto.

(xii) For taxable years commencing after December 31, 2004, amounts received as withdrawals not in accordance with the provisions of K.S.A. 2005 Supp. 74-50,204, and amendments thereto, if, at the time of contribution to an individual development account, such amounts were subtracted from the federal adjusted gross income pursuant to paragraph (xiii) of subsection (c), or if such amounts are not already included in the federal adjusted gross income.

(xiii) The amount of any deductions claimed for expenditures claimed for deduction in determining federal adjusted gross income, to the extent the same is claimed as the basis for any credit allowed pursuant to sections 1 through 4 or section 6, and amendments thereto.

(xiv) The amount of any amortization deduction claimed in determin-

ing federal adjusted gross income to the extent the same is claimed for deduction pursuant to section 5, and amendments thereto.

(c) There shall be subtracted from federal adjusted gross income:

(i) Interest or dividend income on obligations or securities of any authority, commission or instrumentality of the United States and its possessions less any related expenses directly incurred in the purchase of such obligations or securities, to the extent included in federal adjusted gross income but exempt from state income taxes under the laws of the United States.

(ii) Any amounts received which are included in federal adjusted gross income but which are specifically exempt from Kansas income taxation under the laws of the state of Kansas.

(iii) The portion of any gain or loss from the sale or other disposition of property having a higher adjusted basis for Kansas income tax purposes than for federal income tax purposes on the date such property was sold or disposed of in a transaction in which gain or loss was recognized for purposes of federal income tax that does not exceed such difference in basis, but if a gain is considered a long-term capital gain for federal income tax purposes, the modification shall be limited to that portion of such gain which is included in federal adjusted gross income.

(iv) The amount necessary to prevent the taxation under this act of any annuity or other amount of income or gain which was properly included in income or gain and was taxed under the laws of this state for a taxable year prior to the effective date of this act, as amended, to the taxpayer, or to a decedent by reason of whose death the taxpayer acquired the right to receive the income or gain, or to a trust or estate from which the taxpayer received the income or gain.

(v) The amount of any refund or credit for overpayment of taxes on or measured by income or fees or payments in lieu of income taxes imposed by this state, or any taxing jurisdiction, to the extent included in gross income for federal income tax purposes.

(vi) Accumulation distributions received by a taxpayer as a beneficiary of a trust to the extent that the same are included in federal adjusted gross income.

(vii) Amounts received as annuities under the federal civil service retirement system from the civil service retirement and disability fund and other amounts received as retirement benefits in whatever form which were earned for being employed by the federal government or for service in the armed forces of the United States.

(viii) Amounts received by retired railroad employees as a supplemental annuity under the provisions of 45 U.S.C. 228b (a) and 228c (a)(1) et seq.

(ix) Amounts received by retired employees of a city and by retired

employees of any board of such city as retirement allowances pursuant to K.S.A. 13-14,106, and amendments thereto, or pursuant to any charter ordinance exempting a city from the provisions of K.S.A. 13-14,106, and amendments thereto.

(x) For taxable years beginning after December 31, 1976, the amount of the federal tentative jobs tax credit disallowance under the provisions of 26 U.S.C. 280 C. For taxable years ending after December 31, 1978, the amount of the targeted jobs tax credit and work incentive credit disallowances under 26 U.S.C. 280 C.

(xi) For taxable years beginning after December 31, 1986, dividend income on stock issued by Kansas Venture Capital, Inc.

(xii) For taxable years beginning after December 31, 1989, amounts received by retired employees of a board of public utilities as pension and retirement benefits pursuant to K.S.A. 13-1246, 13-1246a and 13-1249 and amendments thereto.

(xiii) For taxable years beginning after December 31, 2004, amounts contributed to and the amount of income earned on contributions deposited to an individual development account under K.S.A. 2005 Supp. 74-50,201, et seq., and amendments thereto.

(xiv) For all taxable years commencing after December 31, 1996, that portion of any income of a bank organized under the laws of this state or any other state, a national banking association organized under the laws of the United States, an association organized under the savings and loan code of this state or any other state, or a federal savings association organized under the laws of the United States, for which an election as an S corporation under subchapter S of the federal internal revenue code is in effect, which accrues to the taxpayer who is a stockholder of such corporation and which is not distributed to the stockholders as dividends of the corporation.

(xv) For all taxable years beginning after December 31, 1999, amounts not exceeding $2,000, or $4,000 for a married couple filing a joint return, for each designated beneficiary which are contributed to a family postsecondary education savings account established under the Kansas postsecondary education savings program for the purpose of paying the qualified higher education expenses of a designated beneficiary at an institution of postsecondary education. For all taxable years beginning after December 31, 2004, amounts not exceeding $3,000, or $6,000 for a married couple filing a joint return, for each designated beneficiary which are contributed to a family postsecondary education savings account established under the Kansas postsecondary education savings program for the purpose of paying the qualified higher education expenses of a designated beneficiary at an institution of postsecondary education. The terms and phrases used in this paragraph shall have the meaning

respectively ascribed thereto by the provisions of K.S.A. 2005 Supp. 75-643, and amendments thereto, and the provisions of such section are hereby incorporated by reference for all purposes thereof.

(xvi) For the tax year beginning after December 31, 2004, an amount not exceeding $500; for the tax year beginning after December 31, 2005, an amount not exceeding $600; for the tax year beginning after December 31, 2006, an amount not exceeding $700; for the tax year beginning after December 31, 2007, an amount not exceeding $800; for the tax year beginning December 31, 2008, an amount not exceeding $900; and for all taxable years commencing after December 31, 2009, an amount not exceeding $1,000 of the premium costs for qualified long-term care insurance contracts, as defined by subsection (b) of section 7702B of public law 104-191.

(xvii) For all taxable years beginning after December 31, 2004, amounts received by taxpayers who are or were members of the armed forces of the United States, including service in the Kansas army and air national guard, as a recruitment, sign up or retention bonus received by such taxpayer as an incentive to join, enlist or remain in the armed services of the United States, including service in the Kansas army and air national guard, and amounts received for repayment of educational or student loans incurred by or obligated to such taxpayer and received by such taxpayer as a result of such taxpayer's service in the armed forces of the United States, including service in the Kansas army and air national guard.

(xviii) For all taxable years beginning after December 31, 2004, amounts received by taxpayers who are eligible members of the Kansas army and air national guard as a reimbursement pursuant to K.S.A. 48-281, and amendments thereto, and amounts received for death benefits pursuant to K.S.A. 48-282, and amendments thereto, or pursuant to section 1 or section 2 of chapter 207 of the 2005 session laws of Kansas, and amendments thereto, to the extent that such death benefits are included in federal adjusted gross income of the taxpayer.

(d) There shall be added to or subtracted from federal adjusted gross income the taxpayer's share, as beneficiary of an estate or trust, of the Kansas fiduciary adjustment determined under K.S.A. 79-32,135, and amendments thereto.

(e) The amount of modifications required to be made under this section by a partner which relates to items of income, gain, loss, deduction or credit of a partnership shall be determined under K.S.A. 79-32,131, and amendments thereto, to the extent that such items affect federal adjusted gross income of the partner.

Sec. 8. K.S.A. 79-32,120 is hereby amended to read as follows: 79-32,120. (a) If federal taxable income of an individual is determined by itemizing deductions from such individual's federal adjusted gross in-

7-10

come, such individual may elect to deduct the Kansas itemized deduction in lieu of the Kansas standard deduction. The Kansas itemized deduction of an individual means the total amount of deductions from federal adjusted gross income, other than federal deductions for personal exemptions, as provided in the federal internal revenue code with the modifications specified in this section.

(b) The total amount of deductions from federal adjusted gross income shall be reduced by the total amount of income taxes imposed by or paid to this state or any other taxing jurisdiction to the extent that the same are deducted in determining the federal itemized deductions and by the amount of all depreciation deductions claimed for any real or tangible personal property upon which the deduction allowed by ~~K.S.A. 79-32,168~~ *section 5*, and amendments thereto, is or has been claimed.

Sec. 9. K.S.A. 79-32,138 is hereby amended to read as follows: 79-32,138. (a) Kansas taxable income of a corporation taxable under this act shall be the corporation's federal taxable income for the taxable year with the modifications specified in this section.

(b) There shall be added to federal taxable income: (i) The same modifications as are set forth in subsection (b) of K.S.A. 79-32,117, and amendments thereto, with respect to resident individuals.

~~(ii) The amount of all depreciation deductions claimed for any real or tangible personal property upon which the deduction is allowed by K.S.A. 79-32,161, and amendments thereto.~~

~~(iii)~~ *(ii)* The amount of all depreciation deductions claimed for any property upon which the deduction allowed by ~~K.S.A. 79-32,168~~ *section 5*, and amendments thereto, is claimed.

~~(iv)~~ *(iii)* The amount of any charitable contribution deduction claimed for any contribution or gift to or for the use of any racially segregated educational institution.

(c) There shall be subtracted from federal taxable income: (i) The same modifications as are set forth in subsection (c) of K.S.A. 79-32,117, and amendments thereto, with respect to resident individuals.

(ii) The federal income tax liability for any taxable year commencing prior to December 31, 1971, for which a Kansas return was filed after reduction for all credits thereon, except credits for payments on estimates of federal income tax, credits for gasoline and lubricating oil tax, and for foreign tax credits if, on the Kansas income tax return for such prior year, the federal income tax deduction was computed on the basis of the federal income tax paid in such prior year, rather than as accrued. Notwithstanding the foregoing, the deduction for federal income tax liability for any year shall not exceed that portion of the total federal income tax liability for such year which bears the same ratio to the total federal income tax liability for such year as the Kansas taxable income, as computed before

any deductions for federal income taxes and after application of subsections (d) and (e) of this section as existing for such year, bears to the federal taxable income for the same year.

~~(iii) An amount for amortization of the amortizable costs of a certified oil production process as computed under K.S.A. 79-32,161, and amendments thereto.~~

~~(iv)~~ *(iii)* An amount for the amortization deduction ~~for a solar energy system~~ allowed pursuant to ~~K.S.A. 79-32,168~~ *section 5*, and amendments thereto.

~~(v)~~ *(iv)* For all taxable years commencing after December 31, 1987, the amount included in federal taxable income pursuant to the provisions of section 78 of the internal revenue code.

~~(vi)~~ *(v)* For all taxable years commencing after December 31, 1987, 80% of dividends from corporations incorporated outside of the United States or the District of Columbia which are included in federal taxable income.

(d) If any corporation derives all of its income from sources within Kansas in any taxable year commencing after December 31, 1979, its Kansas taxable income shall be the sum resulting after application of subsections (a) through (c) hereof. Otherwise, such corporation's Kansas taxable income in any such taxable year, after excluding any refunds of federal income tax and before the deduction of federal income taxes provided by subsection (c)(ii) shall be allocated as provided in K.S.A. 79-3271 to K.S.A. 79-3293, inclusive, and amendments thereto, plus any refund of federal income tax as determined under paragraph (iv) of subsection (b) of K.S.A. 79-32,117, and amendments thereto, and minus the deduction for federal income taxes as provided by subsection (c)(ii) shall be such corporation's Kansas taxable income.

(e) A corporation may make an election with respect to its first taxable year commencing after December 31, 1982, whereby no addition modifications as provided for in subsection (b)(ii) of K.S.A. 79-32,138 and subtraction modifications as provided for in subsection (c)(iii) of K.S.A. 79-32,138, as those subsections existed prior to their amendment by this act, shall be required to be made for such taxable year.

New Sec. 10. (a) The following described property, to the extent herein specified, shall be exempt from all property taxes levied under the laws of the state of Kansas: Any new refinery property or any expanded refinery property.

(b) The provisions of subsection (a) shall apply from and after purchase or commencement of construction or installation of such property and for the 10 taxable years immediately following the taxable year in which construction or installation of such property is completed.

(c) The provisions of this section shall apply to all taxable years com-

7-12

mencing after December 31, 2005.

(d) As used in this section:

(1) "Expanded refinery property" means any real or tangible personal property purchased, constructed or installed for incorporation in and use as part of an expansion of a refinery, construction of which expansion begins after December 31, 2005, and any other real and personal property which are located at the site of such refinery and are employed specifically to serve such expansion.

(2) "Expansion of a refinery" means expansion of the capacity of an existing refinery by at least 10% of such capacity.

(3) "New refinery property" means any real or tangible personal property purchased, constructed or installed for incorporation in and use as part of a refinery, construction of which begins after December 31, 2005, and any other real and personal property which are located at the site of such refinery and are employed specifically to serve such refinery.

(4) "Refinery" has the meaning provided by section 1, and amendments thereto.

New Sec. 11. (a) For the purpose of financing the construction of a new refinery or expansion of an existing refinery, the Kansas development finance authority is hereby authorized to issue revenue bonds pursuant to the Kansas development finance act, K.S.A. 74-8901 et seq., and amendments thereto, in amounts sufficient to pay the costs of such construction or expansion, including any required interest on the bonds during construction and installation, plus all amounts required for the costs of bond issuance, costs of credit enhancement or other financial contracts, capitalized interest and any required reserves on the bonds. The bonds, and interest thereon, issued pursuant to this section shall be payable from revenues pledged to the Kansas development finance authority for such purpose, which may include revenues derived from sales of petroleum products produced at the refinery.

(b) The provisions of subsection (a) of K.S.A. 74-8905, and amendments thereto, shall not prohibit the issuance of bonds by the Kansas development finance authority for the purposes of this section and any such issuance of bonds is exempt from the provisions of subsection (a) of K.S.A. 74-8905, and amendments thereto, which would operate to preclude such issuance.

(c) Revenue bonds, including refunding revenue bonds, issued under this section shall not constitute an indebtedness of the state of Kansas, nor shall they constitute indebtedness within the meaning of any constitutional or statutory provision limiting the incurring of indebtedness.

(d) Revenue bonds, including refunding revenue bonds, issued hereunder and the income derived therefrom are and shall be exempt from all state, county and municipal taxation in the state of Kansas, except

Kansas estate taxes.

(e) As used in this section:

(1) "Expansion of an existing refinery" means expansion, beginning after December 31, 2005, of the capacity of an existing refinery by at least 10% of such capacity.

(2) "New refinery" means a refinery, construction of which begins after December 31, 2005.

(3) "Refinery" has the meaning provided by section 1, and amendments thereto.

New Sec. 12. (a) The department of health and environment shall expedite processing and issuance of any permit required to be issued by the department for construction or operation of a refinery.

(b) As used in this section, "refinery" means an industrial process plant where crude oil is processed and refined into petroleum products.

Sec. 13. K.S.A. 79-32,120 and 79-32,138 and K.S.A. 2005 Supp. 79-32,117 are hereby repealed.

Sec. 14. This act shall take effect and be in force from and after its publication in the statute book.

KANSAS COOPERATIVE COUNCIL
816 S.W. Tyler, Suite 300 — Topeka, Kansas 66612
Phone: 785-233-4085 — Fax: 785-233-1038 — Toll Free: 888-603-COOP (2667)
www.kansasco-op.coop — Email: council@kansasco-op.coop

House Committees on Utilities and Taxation

March 1, 2006

HB 2900/2902 - Incentives for Refineries and Coke Gasification Operations.

Chairmen Holmes and Wilk and members of the House Utilities and Taxation Committees, thank you for the opportunity to comment today regarding HB 2900 and 2902. I am Leslie Kaufman and I serve the Kansas Cooperative Council as Executive Director.

The Kansas Cooperative Council represents all forms of cooperatively structured, member-owned/member-controlled businesses. We have nearly 200 members across Kansas. Approximately one-half of these members are engaged in grain storage and farm supply enterprises. These agricultural cooperatives are owned by producers. Rising in-put costs, including fuel and fertilizer, are a concern for our producer-owners and our cooperative businesses.

In addition to cost, continued availability, dependable supplies and alternatives to foreign petroleum sources are important issues to consider. As we see it, the intent of measures such as HB 2900 and HB 2902 is to help address many of these concerns. As such, we appreciate and support the basic concepts contained in these bills.

Thank you.

HOUSE UTILITIES
DATE: 3/1/06
ATTACHMENT 8

DONALD P. SCHNACKE, P.A.
ATTORNEY AT LAW
COUNSELOR OF GOVERNMENTAL PUBLIC AFFAIRS
800 SW Jackson Street, Suite 1400 Topeka, KS 66612-1216
TEL (785) 232-4100 • FAX (785) 232-0917

Statement of Donald P. Schnacke for the Joint hearing by the House Utilities Committee and of the House Taxation Committee – HB 2901 March 1, 2006

I am Don Schnacke, representing TransCanada PipeLines Limited in Kansas. The company is currently planning to build a crude oil pipeline from Hardisty, Alberta, to Wood River/Patoka, Illinois – a 1,840-mile system that will transport heavy oil produced in the Alberta Province. The mainline to Illinois crosses four Kansas counties in the northeast corner of the state, including Marshall, Nemaha, Brown and Doniphan counties – roughly 100 miles.

In addition to the mainline, there is a plan to construct an extension beginning at the Washington-Marshall county line at the Nebraska line, south through Washington, Clay, Dickinson, Marion, Butler and Cowley counties – a distance of 211 miles – ending at the crude oil hub located at Cushing, Oklahoma. This line is still in the planning stage. Construction would follow the mainline construction to Illinois and tentatively will be ready for service in 2009. (See attached map).

The potential benefits and economic multiplier effect would include serving refinery needs at Phillipsburg, McPherson, El Dorado and Coffeyville, Kansas. Additionally, the line would serve refineries in Oklahoma and Texas.

Other benefits to the Kansas economy include the employment of 300-350 workers at peak times of construction. Increased refinery capacity will result in additional permanent refinery personnel. There will be a modest number of pipeline employees monitoring the pipeline and pumping stations in Kansas. The Company anticipates an interaction and relationship with all communities through personal contact, and involvement. It is anticipated the Company will pay sales and use tax totaling $4.5 million for pipe and compressors.

Many of you heard President Bush indicate recently the need for increased refinery capacity in the United States. The reliance on Middle East crude oil, unfriendly foreign supply and the fact the recent hurricanes in the Gulf shut down 16 refineries and destroyed 115 oil drilling platforms has resulted in an attitude of the oil industry to support this new supply of crude oil from Canada.

For these reasons, TransCanada PipeLines Limited supports the passage of HB 2901 which will greatly encourage economic development in Kansas.

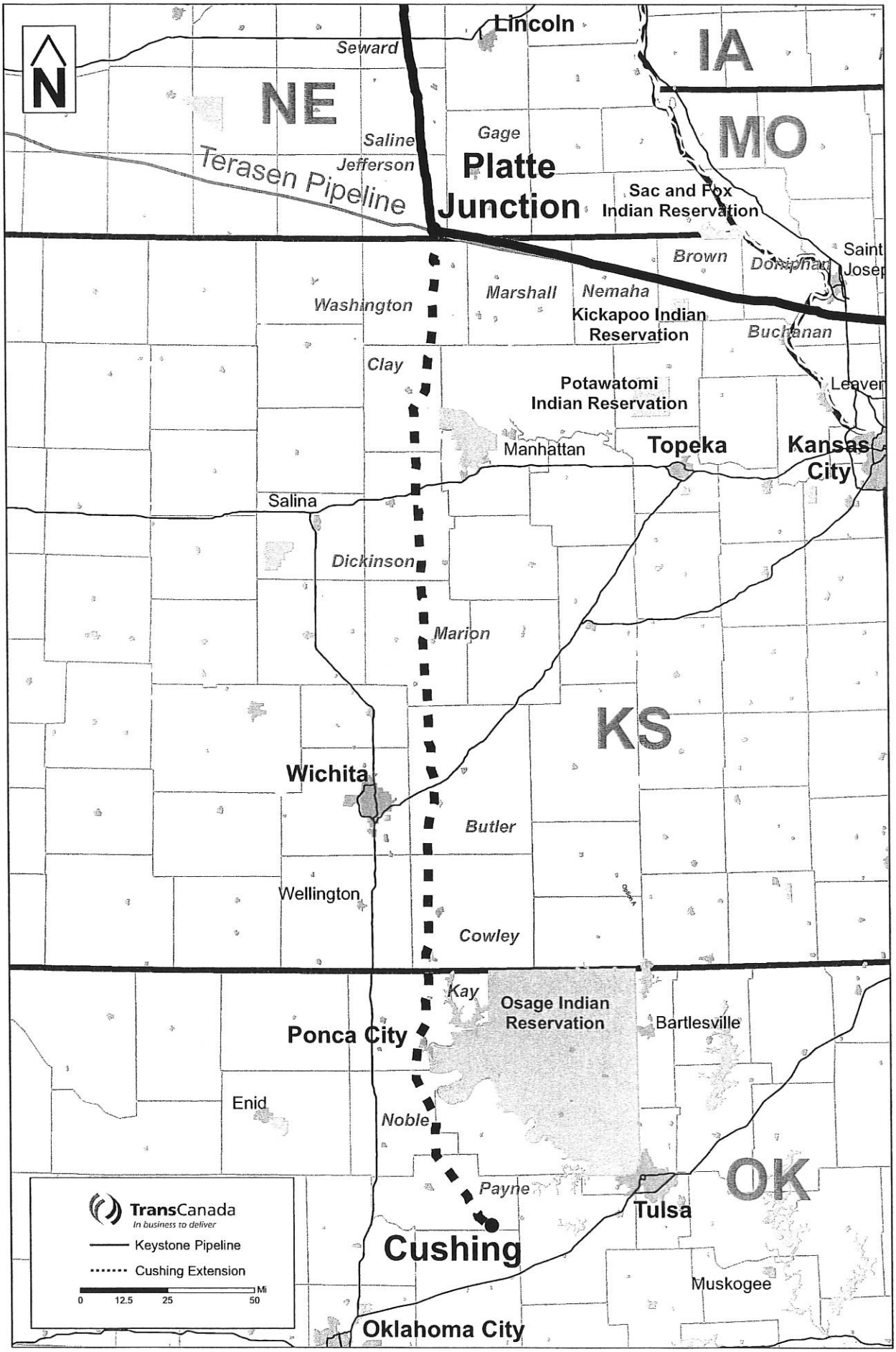
Donald P. Schnacke

Attachment – Kansas Map

CELL (785) 231-8877 • EMAIL schnacke@earthlink.net

HOUSE UTILITIES
DATE: 3/1/06
ATTACHMENT 9

KEYSTONE PIPELINE PROJECT



GACHES, BRADEN, BARBEE & ASSOCIATES
PUBLIC AFFAIRS & ASSOCIATION MANAGEMENT
825 S. Kansas Avenue, Suite 500 • Topeka, Kansas 66612 • Phone: (785) 233-4512 • Fax: (785) 233-2206

JOINT MEETING OF HOUSE TAX COMMITTEE AND
HOUSE UTILITIES COMMITTEE
TESTIMONY OF MICHAEL HOPKINS
WITH THE WILLIAMS COMPANIES, INC.
REGARDING HB 2901 – PIPELINE INCENTIVES
WEDNESDAY, MARCH 1, 2006

Thank you Chairman Holmes and Chairman Wilk and members of the Legislature.

My name is Michael Hopkins and I am a Principal Engineer and Director of Midstream Technical Services for MidStream Gas & Liquids for the Williams Companies, Inc., based in Tulsa, Oklahoma. Williams' Midstream group operates the Conway fractionator located near McPherson, Kansas. The facility fractionates mixed products delivered via the Mid-America pipeline, rail and truck at a capacity of 107,000 barrels per day. Approximately 50% of the cavern capacity is propane with the remainder being raw NGL mix, iso-butane normal, butane, E-P ix and natural gasoline. Williams currently employs 38 full-time employees in the state. Currently, Williams have a fixed asset base of $180,307,578, pay $404,710 in property taxes, and generate revenue of $87,592,064.

WILLIAMS PROPOSED PIPELINE INVESTMENT

Williams, through its business units, is engaged in a study of the possible $400MM to $500MM overall investment in the construction of a 750-mile 12/20" natural gas liquids (NGLs) pipeline. Over 300 miles of this pipeline would be located in Kansas.

HOUSE UTILITIES
DATE: 3/1/06
ATTACHMENT 10

This proposed pipeline would transport NGLs from Wyoming and Colorado to processing and storage facilities in Conway, Kansas for further refinement and distribution. No final decision has been made on this project.

The proposed project would impact 12 to 13 counties in Kansas and would represent a significant investment by Williams within the state. Williams anticipates a total pipeline volume of 90,000 to 150,000 barrels per day. The investment in Kansas would be between $120MM to $140MM. Estimated property taxes would be $7MM. The project would require the hiring of 4 permanent employees and could require more than 500 employees during the construction phase.

In addition, the increased volume of NGLs from the pipeline will create an increase in downstream investment in capacity and storage, and increased NGL products in the Kansas market. Currently, NGL products are piped out of southern Wyoming and northwestern Colorado by a pipeline that runs south of Wyoming to the Four Corners area and then to Texas. Williams believes that taking these new NGLs to Kansas is the optimum investment to make, as it takes advantage of under-utilized assets that already exist in the state. The connection to the new supply region would help keep Williams current assets (will enhance the value of the McPherson facility) and other assets in the mid-continent region from declining in value and extend the useful life of the storage and processing operations. The new line should also provide increased competition to the mid-continent market and possibly reduce the price differentials typically seen between Mont Belvue, Texas and Conway, Kansas for propane and heavier products.

The proposed tax credit provided in HB2901 in its current form only applies to pipelines located in the state of Kansas who primarily engage in the transportation of

crude oil. While Williams is always in support of incentives for economic development, Williams does not believe the bill goes far enough. We believe HB2901 should be amended to also include pipelines transporting natural gas liquids (NGLs) within the state of Kansas to further stimulate the economic environment to the state. As my earlier testimony indicates, the transportation of NGLs within the state of Kansas will provide significant value to the state through taxes, additional employment through permanent jobs, construction jobs and secondary jobs, access to additional NGL for the Kansas market place, and additional investment in the state. We have attached language to my prepared comments that sets forth the language to allow pipelines transporting NGLs to also qualify for the credit provided in HB2901. In addition, we have a few suggested technical changes that are also attached to my prepared comments.

I thank you for the opportunity to present Williams' proposed project to the committee, as well as, the opportunity to suggest a few proposed changes to HB2901. I will be happy to address any questions you may have.

Proposed Language Kansas HB 2901

Language allowing NGL Pipelines to qualify for the credit:

Current New Sec. 1(a):
"Crude oil pipeline" means a pipeline which is located in this state, is used primarily for transportation of crude oil and has a length of more than 190 miles in this state.

Proposed New Sec. 1(a):
"Qualifying Pipeline" means a pipeline which is located in this state, is used primarily for transportation of crude oil or natural gas liquids and has a length of more than 190 miles in this state

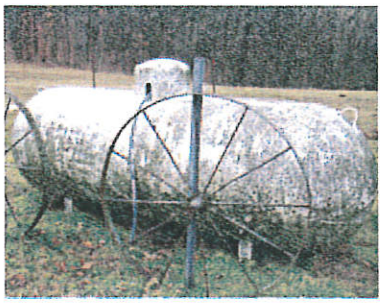
The wording "Crude oil pipeline" will need to be replaced with Qualifying Pipeline" within HB 2901. (30 occurrences)

Language allowing the transfer of credits in a multi-tiered pass-through entity structure:

Current New Sec. 3:
If a qualified investment is made by a pass-through entity and the credit allowed by this act for a taxable year is greater than the entity's tax liability against which the tax credit may be applied, a shareholder, partner or member of the entity is entitled to a tax credit equal to: (1) The tax credit determined for the entity for the taxable year in excess of the entity's tax liability under the Kansas income tax act for the taxable year multiplied by the percentage of the entity's distributive income to which the shareholder, partner or member is entitled if the entity is an entity described in subsection (e)(1), (2), (3) or (4) of section 1, and amendments thereto, or (2) the relative percentage of the entity's patronage dividends allocable to the member for the taxable year if the entity is an entity as described in subsection (e) (5) or (6) of section 1,

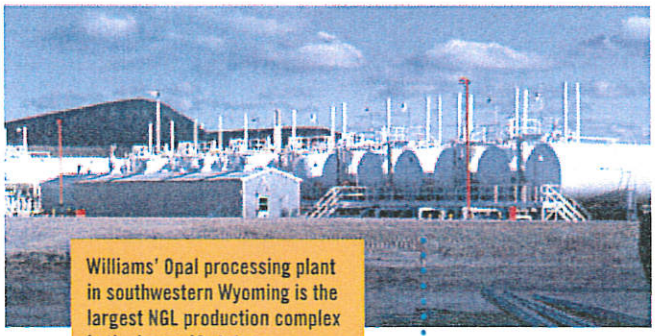
Proposed New Sec. 3:
If a qualified investment is made by or transferred to a pass-through entity and the credit allowed by this act for a taxable year is greater than the entity's tax liability against which the tax credit may be applied, a shareholder, partner or member of the entity is entitled to a tax credit equal to: (1) The tax credit determined for the entity for the taxable year in excess of the entity's tax liability under the Kansas income tax act for the taxable year multiplied by the percentage of the entity's distributive income to which the shareholder, partner or member is entitled if the entity is an entity described in subsection (b)(1), (2), (3) or (4) of section 1, and amendments thereto.

New Pipeline Being Considered in Your Area

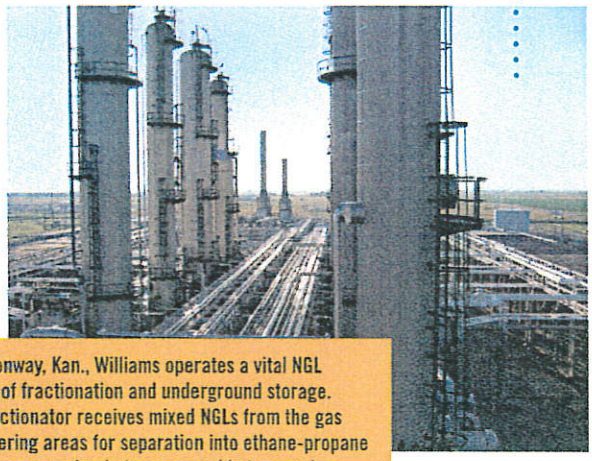


Williams, a Tulsa, Okla.-based energy company with nearly 100 years of experience, is considering the construction of a natural gas liquids pipeline in your area. Natural gas liquids, or NGLs, include ethane, propane, butane and natural gasoline. NGLs are used in plastics, home heating, agriculture and motor fuels.

The proposed 750-mile pipeline, known as Overland Pass Pipeline, would originate in Opal, Wyo., and end in Conway, Kan. The pipeline would pass through six counties in Wyoming, six in Colorado and 12 in Kansas, following an existing pipeline right of way as much as possible.



Williams' Opal processing plant in southwestern Wyoming is the largest NGL production complex in the lower 48 states.



In Conway, Kan., Williams operates a vital NGL hub of fractionation and underground storage. A fractionator receives mixed NGLs from the gas gathering areas for separation into ethane-propane mix, propane, iso-butane, normal butane and natural gasoline.

More Drilling in the West Means More NGL Pipeline Capacity Needed

Natural gas and its associated NGLs are clean-burning fuels that are in high demand in our nation. As you probably know, drilling for natural gas in the Western states has been increasing tremendously during the last several years, trying to keep pace with demand.

Williams is proposing the construction of this new, more energy-efficient pipeline because the existing NGL pipeline serving this region is currently reaching its capacity. Pipelines are the safest, most reliable and efficient manner of transporting energy products. The pipeline will be designed, constructed and operated using proven technology, advanced pipeline control systems and continuous safety monitoring.

Survey of Study Corridor

Williams has hired Willbros Engineering to evaluate a possible pipeline route from Wyoming to Kansas. We will work closely with landowners and local, state and federal agencies to determine the safest, most environmentally friendly route possible.

Prior to construction, pipeline companies are required to evaluate the potential route, as well as complete numerous safety and environmental studies. In order to prepare these studies, Williams is required to survey the proposed routes.

You are receiving this information because you are being asked to grant Williams access to your property for survey work. This simply means that you allow the appropriate engineering and environmental analysis to take place along the pipeline route being evaluated. It is NOT a grant of permanent right of way, nor is it permission for construction. Survey assessments are simply part of the overall project evaluation phase.

Survey work on your property may include people walking across your property, taking measurements and readings to evaluate routing alternatives, placing colored flags and markers. In addition, we are required by governmental agencies to conduct environmental, archeological and cultural assessments that may require digging small holes and sifting the soil. After inspection, this soil will be replaced.

Please note that there is no compensation for granting permission to survey your property. If your property is selected as the best route for the pipeline, you will be contacted again and offered fair compensation in exchange for a grant of pipeline right of way.

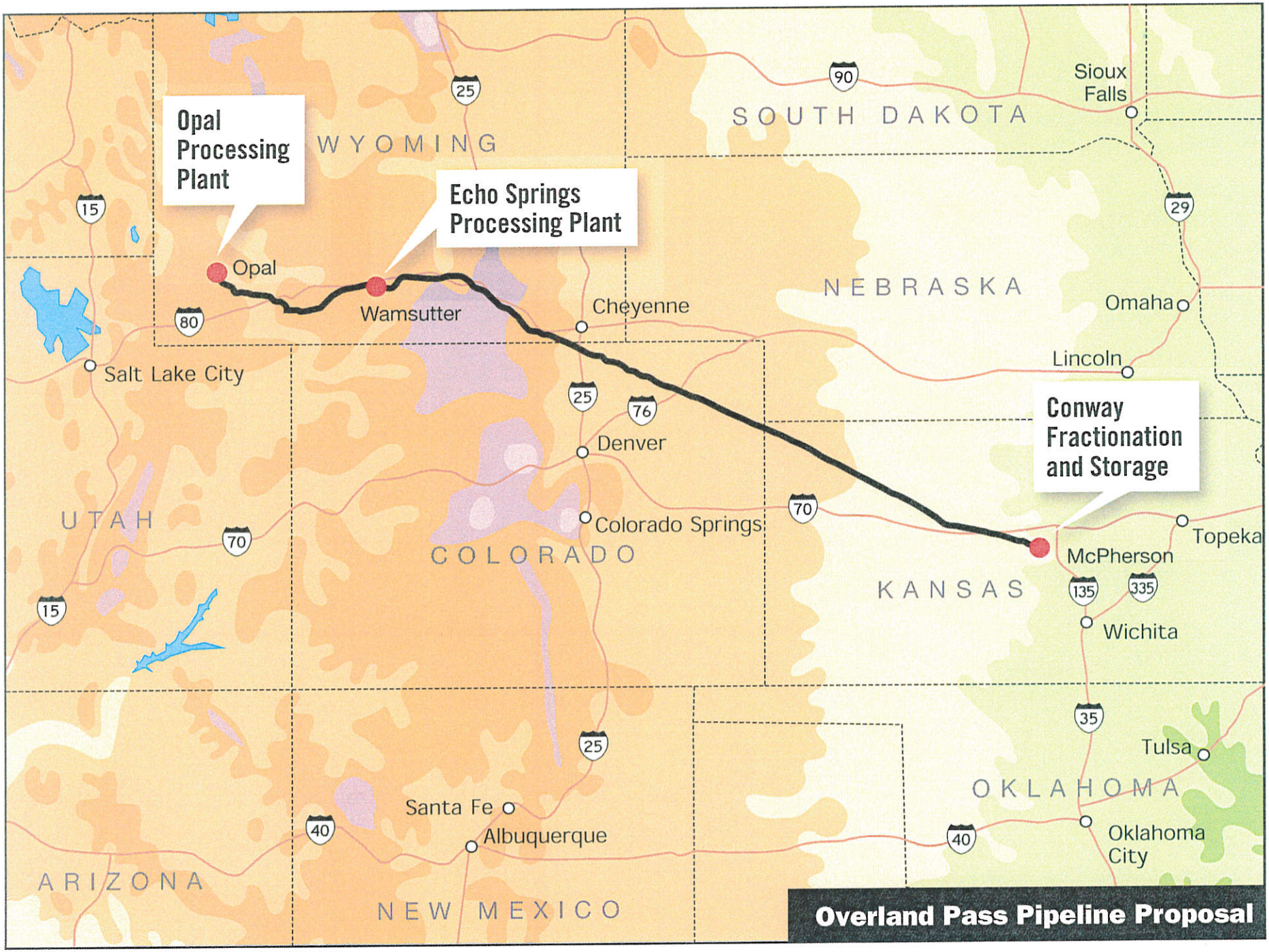
Your Input Is Important

While we are in the preliminary stages of evaluating this pipeline project, we would like to work with you to identify any issues or concerns you may have about the project. We value your feedback and would like your involvement throughout the process.

To learn more about Williams, visit our Web site at www.williams.com. If you have questions, please contact the right-of-way agent whose name and phone number are on the attached business card or send an e-mail to overlandpass@williams.com.

Project Web site: www.williams.com/overlandpass

10-5


Opal Processing Plant
Echo Springs Processing Plant
Conway Fractionation and Storage
WYOMING
SOUTH DAKOTA
NEBRASKA
COLORADO
UTAH
KANSAS
OKLAHOMA
ARIZONA
NEW MEXICO
Opal
Wamsutter
Cheyenne
Sioux Falls
Omaha
Lincoln
Salt Lake City
Denver
Colorado Springs
Topeka
McPherson
Wichita
Tulsa
Oklahoma City
Santa Fe
Albuquerque
15
80
25
90
29
76
70
135
335
35
40
Overland Pass Pipeline Proposal

Testimony on HB 2904 before the
House Utilities Committee and House Taxation Committee
By
Mark Schreiber, Manager, Government Affairs
Westar Energy
March 1, 2006

Chairman Holmes and Chairman Wilk and members of the committees, I am Mark Schreiber, manager government affairs for Westar Energy.

Westar Energy supports House Bill 2904. It allows an income tax credit for those entities that pursue the construction of an integrated coal gasification (IGCC) plant. It also provides for the opportunity of using Kansas Development Finance Authority (KDFA) revenue bonds for the construction. In addition, House Bill 2904 allows a 12-year property tax exemption for the construction of new nuclear generation. These types of plants are considered base load generation and as the economy grows and strengthens, more base-load generation will be required.

I would like to make it clear that Westar Energy has no plans to pursue the construction of either an IGCC or nuclear plant. Both have advantages, but are expensive to construct, most likely in the billions of dollars. At this time, only the largest utilities with the most substantial financial resources can seriously consider building such plants.

The tax credit allowed for construction of an IGCC plant is large enough to truly incent a company with the necessary size and financial resources. The calculation of the credit is a bit cumbersome, but the key is the size of the credit and the ability to use it over a period of up to 15 years. The accelerated depreciation allowed for new plant offsets much or all of the income in the first few years of the operational life of the plant. After a few years of depreciation, the credit becomes beneficial for the company. Likewise, the 12-year property tax exemption for new nuclear generation provides an important incentive for that technology.

As a regulatory matter, tax incentives and exemptions are "gleaned" for the benefit of customers, i.e. the savings are passed on to customers in their rates. The advantages to the utility are that it can maintain lower costs and is better able to develop financing for large construction projects. Westar Energy urges your support of House Bill 2904. It provides significant incentives for the construction of new base-load generation for Kansas retail electric customers. It also enhances long-term energy planning for the state.

Thank you for the opportunity to address you this morning. I will be glad to answer questions at the appropriate time.

HOUSE UTILITIES
DATE: 3/1/06
ATTACHMENT 11

KEPCo

Kansas Electric Power Cooperative, Inc.

HOUSE UTILITIES COMMITTEE
H.B. 2904

Testimony on behalf of Kansas Electric Power Cooperative, Inc. (KEPCo)
March 1, 2006

Mr. Chairman and members of the committee:

I am Phil Wages, Director of Member Services and External Affairs for Kansas Electric Power Cooperative. KEPCo is a not-for-profit generation and transmission utility, providing electricity to nineteen member rural electric cooperatives serving the eastern two-thirds of the state.

KEPCo, a six percent owner of the Wolf Creek Nuclear Generating Station, supports H.B. 2904 and applauds the efforts of this committee in establishing property tax exemptions for the construction or expansion of an integrated coal gasification power plant or a nuclear generation facility.

The costs associated with the construction and operation of both types of facilities is substantial. A twelve-year property tax exemption would reduce KEPCo's costs of operation of the facility, thus providing a savings to each of its nineteen member cooperatives during the exemption period. Incentives, such as the ones proposed in H.B. 2904, can be determining factors of where a utility decides to construct generation. The passage of this bill will place Kansas in a better position to keep native utility generation investment in Kansas, as well as attract out-of-state utility investment.

Mr. Chairman, this concludes my testimony and I stand for questions.

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HOUSE UTILITIES
DATE: 3/1/06
ATTACHMENT 2

Coffey unty Commissioners

Phone 620-364-2683
Courthouse
Burlington, Kansas 66839

Board of Commissioners
Gene L. Merry, District #1
Larry Crotts, District #2
Fred Rowley Jr., District #3
Timothy A. Sipe, District #4
R. Kraig Kirchner, District #5
Board Meets Every Monday

TO: House Utilities Committee
The Honorable Representative Carl Holmes, Chairman

On behalf of Coffey County I want to thank Chairman Holmes and the members of the House Utilities Committee for their insightful consideration of the nuclear power industry for inclusion in the electric generation incentive legislation proposed by ~~HB 2094.~~ 2904

I believe that nuclear power must be an essential component of long term plans for energy independence for our state and country. Many countries, including Japan, France and China, understand the need for clean, safe nuclear energy. There are more than 20 nuclear power plants under construction throughout the world. Currently, there are no nuclear power plants being built in the United States, however, I am confident that this will change in the near future.

The Wolf Creek nuclear plant located in Coffey County is a world-class electric generating facility. During its operation for the past 20 years, the ad valorem tax revenue has been a significant benefit to Coffey County, however, this revenue stream is only one component of the numerous benefits provided by this facility. In Coffey County and several surrounding counties, the quality of jobs and wage benefits have played a vital role in our local economies. In addition to the direct economic benefits, the role Wolf Creek's educated workforce has played in local government has been very significant. Wolf Creek's employees are community leaders. They serve in appointed positions on the planning and zoning board, the airport authority, the library board and as trustees of the county hospital. Wolf Creek employees also serve in elected positions on city councils and local school boards and they make many other contributions to our communities. These civic contributions are enjoyed not only in Coffey County, but also in the many surrounding counties where these citizens make their homes.

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Coffey County has seen the benefits of establishing nuclear power in Kansas and it supports the long-range benefits of expanding nuclear electrical generation. It seems a logical step to encourage the expansion of nuclear energy in Kansas by providing tax incentive benefits to this industry. The variety of ongoing benefits of expanded nuclear energy, make it worthwhile to delay the long-term benefit provided by the eventual enhancement to the ad valorem tax base. Both in the short and long term, the citizens of Kansas will benefit from the expansion of nuclear power.

Thank you for the opportunity to provide this information and for your consideration.

Board of County Commissioners
Coffey County, Kansas

Gene L. Merry