

The logo for KMEA (Kansas Municipal Energy Agency) features the letters "KMEA" in a bold, white, sans-serif font. The text is set against a dark blue rectangular background that has a slightly irregular, hand-drawn appearance.

Kansas Municipal Energy Agency

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Memorandum:

DATE: October 27, 1989

TO: Kansas Municipalities with a Natural Gas Utility

FROM: Gil Hanson

CC: Louis Stroup, Jr. - KMU

RE: The Progress of Gas Joint Action in Kansas

At the National Association of Gas Consumers Annual Meeting, which was held October 25-27, 1989, I was on the program for October 26th and gave the attached remarks. Since your city has a natural gas utility, I thought you might be interested in my comments.

GEH:db

Encl.

The Progress of Gas Joint Action in Kansas

October 26, 1989

By Gilbert E. Hanson, Jr.

Several weeks ago, Charlie Wheatley asked me to describe to you what the Kansas Municipal Energy Agency is doing in joint action for gas in Kansas. Let me say at the outset of my talk, we are in the embryonic stages of doing anything for the cities. As I am going to talk about joint action, perhaps I should define it. Joint action exists when two or more cities go together contractually to achieve some goal. Usually, economic interests and efficiencies dictate the need for joint action.

First perhaps I should briefly describe what the Kansas Municipal Energy Agency is. KMEA is a quasi municipal organization established under specific state statute which provides for two or more cities in the state to go together and form an energy agency which, in essence, is a power supply utility for its member cities. The agency has various powers, such as, condemnation; ability to sell tax exempt bonds; power to contract; etc. Each member city has two members on the Agency Board of Directors. The Agency is subject to the jurisdiction of the Kansas Corporation Commission, the same as other regulated utilities, however, its members are not.

The first joint action agency in the state was formed by several cities in the Northwest part of the state in 1978 and was called the Northwest Kansas Municipal Energy Agency, which was the predecessor to the Kansas Municipal Energy Agency, that was created in 1980. Presently, KMEA has 32 member cities; however, it has contracts with 50 cities and performs services for 3 more.

There are two basic types of contracts for power supply that joint action agencies enter into with cities and I envision this would be the case for a gas agency, these are "System" and "Project" contracts. System contracts are essentially for all requirements and project contracts are associated with specific resources. KMEA has project type contracts with the cities. Many of the cities are actually in more than one project for electricity purchases from the agency.

I feel there is a parallel between the electric industry and the gas industry and that there is a need for joint action in the gas industry, the same as in the electric industry. Presently there are 64 electrical joint action agencies and at least 5 gas agencies with joint action in Georgia, Florida, Missouri, Nebraska, and Louisiana.

A few things need to be said about the need for joint action in the electric industry. Basically, I feel, power supply costs to cities became more and more expensive during the 1970's, this was because fuel and new power plant additions were more costly, also the availability of natural gas as a fuel stock for generation was diminishing, small municipal systems were seemingly being caught in a squeeze. The alternatives available to the municipals were limited compared to those of the power companies, with their greater purchasing powers, technical capabilities, ability to install power plants with economies of scale and ability to use coal and nuclear fuels for base load. Through joint action it was felt some of these differences could be overcome or at least moderated. Two major events happened which changed the economic pattern of the late 70's and early 80's and greatly affected the concept of joint action as far as generating municipals are concerned: Firstly, the companies installed too much expensive base load generation, which greatly increased their cost and secondly, natural gas did not escalate in cost nearly as much as predicted and was plentiful. Two energy "bubbles" were created, which still exist for generating municipals, excess economical electrical energy and the availability of relatively low cost natural gas for municipal generation. As long as these options are available generating municipals can remain competitive.

What about the all requirements cities? In Kansas they are not protected by joint action legislation and are trapped with the higher costs of the utility with a few exceptions which I will not go into.

The roll joint action was to play, in Kansas at least, changed in the early 80's because of the points I just mentioned. Only relative long term power supplies at the lowest possible costs were considered and then only for about one third of a city's peak load were felt to be economical. This blend of cities gas fired self generation, economy purchases and long term base load generation was felt, by the agency, to be the best power supply for the cities at this time, that is to say, while maintaining competitive short term costs it provided a long term hedge in the event one of the bubbles previously mentioned busted. In addition, the agency now plays a more active roll in technical services than originally envisioned.

What lessons has the agency learned in its ten years of service? Firstly; be responsive to the cities' needs and direction, because the best made plans will not succeed without the grass roots support of the cities. Remember that, to some degree, cities are giving up some of their autonomy to the agency and they must be assured of the benefits of joint action. The agency exists solely to serve its members, not the other way around.

Secondly; be flexible and adaptive to changes that are taking place in the electric environment. In addition to those items previously mentioned, there is acid rain legislation, open access to transmission, cogenerators, independent power producers just to mention a few.

Thirdly; develop effective ways to be of service to the municipals. Working with the cities in natural gas alternatives is an example of this.

I believe you now can see the parallel between a gas joint action agency and KMEA. It is a natural marriage I feel for one agency to provide both services to the municipalities. As a matter of fact, in many cases cities with municipal electric systems also have their own gas distribution system.

With this ground work, let me discuss with you now what Charlie asked me to talk about; "Programs For Low Cost Gas Supplies For Municipal Systems". I feel they can be characterized in a similar fashion to that which I mentioned for an electric agency. Long term purchases - for a portion of the cities' needs. Secondly, economy gas purchases based upon the reasonableness of short term gas costs. Lastly, technical services; for example helping cities negotiate supply contracts, requests for proposals in supplies from various vendors, scheduling deliveries, etc. As KMEA is a project by project oriented agency I feel gas can be handled the same way, cities can pick and choose what they feel they need.

What factors have changed the gas industry which have brought about the need for joint action. The gas industry is moving away from being a tightly regulated industry. With the advent of FERC order 436 and 500, which guides pipeline companies toward open access, 19 of 23 major pipelines are operating on a completely open basis under blanket certificates. Another pipeline was recently issued a blanket certificate, and yet another has an application pending. The pipeline companies are becoming common carriers, along with sellers of gas. there is more competition in the industry; many of the cities have been contacted by several gas suppliers. Small municipals need to take advantage of the changes in the industry rather than stay captive customers of the pipeline companies. A similar pattern takes place in the communications industry, you can get long distance service from MCI, U.S. Sprint, AT&T, etc. Municipal gas systems must be adaptive to provide the lowest cost services to their customers.

KMEA is embarking on a two prong approach to "test the waters", so to speak. A gas acquisition feasibility study for five cities and the organization of the Kansas Municipal Gas Agency under a different statute than KMEA is organized under.

KMEA has a sister agency called the Kansas Municipal Utilities, Inc. which serves as a service organization to Electric, Gas and Water municipalities. The two organizations met with a number of gas distribution cities and generating cities about a month ago to explore the thought of organizing a gas agency, which KMEA would administer. At the meeting it was determined the best approach would be for KMEA to develop a budget for organizing the agency. This cost would be prorated between the cities, based upon their 1988 gas purchases.

After the Agency is organized, I foresee the possibility of a study committee being formed to plan what the next steps should be in serving the members. For example, the members most likely will be on several different pipelines; therefore, members' problems may be different. Another consideration is some cities are generation only, others are distribution only, and still others are combination cities.

Many generation only cities do not feel they have an immediate problem as they are doing so little gas generating that their costs are not adversely effected by the price of natural gas. However, the distribution cities are presently effected. A few of these cities have already left their traditional supplier for a gas marketer who can sell gas to the city for considerably less than that of the pipeline company, including wheeling. However, most of the small distribution cities are still being served by the pipeline company.

Five cities, one distribution only, have been approached by a firm that would like to put together a gas acquisition program for them. This would involve purchasing known reserves in the ground, actually ownership of gas wells. This gas supply would be for a portion of the cities' long term gas needs and would be used as a hedge against future gas availability and cost. -

The first phase of the gas acquisition is to do a feasibility study and the cities have agreed to pay their prorata share of a \$13,500 budgeted cost to do the study. If the study proves to show the program as being feasible and the cities elect to go forward with the acquisition, then the second phase would be a search phase for proven reserves which might include; one, long-lived properties; two, short-lived properties; and 3, average-lived properties. For each of these properties certain bid levels will be established. The overall program may take several months to complete. The third phase would be selling the bonds by the Kansas Municipal Gas Agency. These bonds would be tax exempt revenue bonds which would be secured by gas purchase contracts between the Agency and the cities.

As mentioned at the outset, we are in the embryonic stages of

doing joint action with gas in Kansas, but I feel the need is there and perhaps, with the more than 10 years of experience in joint action in electricity, possibly gas municipals can benefit.

Thank you