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PADEWER, UTILICORP UNITED: "THE FUTURE IS DIFFERENT."

BY DENNIS M. McLAUGHLIN

Not long ago it seemed relatively easy to put together an IPP project. All a player in the utility and power generation had to do was put a series of contracts and agreements into

place and obtain siting. Once the structure of the deal was set, then the earnings were locked-in.

That's changed now, according to Harvey Padewer, president of Aquila and head of Utilicorp Energy Group, a key growth unit of Utilicorp

United in Kansas City. During an interview with World Cogeneration, Padewer said, "With the commoditization of electricity, you

can see that how we'll do business in the future is completely different."

In describing the current and future state of power generation in the U.S., Padewer says that demand is growing at a strong pace, in step with the strong economy. Demand in every region of the country is outstripping supply to the point where the industry needs to bring about 40,000 megawatts on stream annually for the next few years. A number of companies are developing merchant plants while some utilities are acquiring the stranded investments of other utilities.

"Now, you could ask: are these people crazy? I think that depends," says Padewer, "on how much knowledge they have beyond the traditional knowledge in power generation."

That traditional knowledge, Padewer explains, involved contract structuring, siting and financial engineering. But with the future of power generation trending toward commoditization of electricity, a solid understanding of commodity marketing and trading skills becomes not only the key to the future but also is a pre-requisite, indeed, a minimum requirement for staying in the business of providing electricity.

"Most developers and utilities don't have that kind of background," Padewer



Harvey Padewer

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PERSPECTIVE

asserts. "If you think about it, the owner of a power plant has a problem. He has a fuel supply that is fluctuating continually in price; and now, with deregulation, the power going out from the wholesale market is going to be fluctuating continually in price as well. In terms of price, gas and electricity are the most volatile commodities out there. What's more, you can't store electricity, so it is even more volatile than gas."

At the moment, Utilicorp United with its Aquila Energy unit is enjoying something of a competitive advantage as it prepares to conduct business in the near term and in the future. Aquila Energy is a gas and electricity marketing and trading company. Only three years ago, though, Aquila was basically an E&P operation with a small marketing staff. Then the gas side of the enterprise started to build its marketing and trading capabilities. To keep its focus on its merchant activities, Aquila for the most part exited the E&P business.

It apparently was a good move. In the last two years the Aquila operation has grown over 20% a year compounded. Its power marketing organization is one of the first in the industry to show a profit. Two years ago, Padewer's power marketing group ranked 200th in the industry. It has climbed presently to the fifth spot. In the gas sector, Aquila has risen from 15th place to the fourth position.

In light of these performance statistics, Padewer feels that Utilicorp's strategy worked. As is the case in any changing marketplace, those hard decisions had to be made. When Padewer arrived at Utilicorp, there were 17 IPP projects on the books. But, as he says, it was clear that the domestic market was changing radically, and Utilicorp executives felt that they shouldn't participate in the upheaval. They also saw a lot of IPP companies spending a lot of developmental money overseas.

"I was concerned" says Padewer, "that overseas projects would never see a good return because of the political risk, among others. So we made a decision at that point to shift emphasis to other areas of the business."

"One of the issues for us initially," he continues, "was whether or not we could enter into long-term gas commitments for cogen plants without owning the E&P assets. We found that because the gas market is so liquid and is a 'futures' market that we could handle the problem by laying off the risk into the futures market. You can analyze that risk really well. But electricity is not that far along

in the development of a futures market. There are no forward curves, and that is the fundamental issue right now."

So Padewer and his group have spent the last two and half years building a risk management and merchant platform for energy that allows UEG to face the risks, dis-aggregate them and trade them in the commodity market. When Padewer arrived at UEG he was responsible for the IPP business and the generation business. But he realized early on that he needed a marketing arm for the generation business.

"When we started looking into developing a marketing capability, we learned that we were dealing with a pure commodity. We also realized that a longer term sales market would emerge if we could develop and hone our commodity skills quickly."

That is what Padewer did. He merged the generation capacity with Aquila's marketing savvy and built a platform capability for commodity risk management. "Now, it also gives us this tremendous ability to do other things," says Padewer. "It gives us the ability to sell long-term gas and electric to people on the wholesale level and to the retail market as well. We can be a future supplier to our EnergyOne brand. It gives us the ability to enter any retail market we want because we have that platform."

In the future Padewer contends that energy companies will not experience any measure of success, either in owning generation assets or in developing retail business unless they have the capability to manage the risk, or can team up with an organization that can.

"I think a lot of utility people who are not familiar with commodities and have not gone through the learning process that we have just do not understand! "When I hear about retail joint ventures," Padewer goes on, "or about people developing merchant plants, I always question how they are going to manage that commodity risk."

GUARANTEED GENERATION

But more than just question the aims and operation of their industry colleagues and competitors, Padewer and his UEG strategists have positioned themselves as the company that can provide the risk management that the utilities need. Referring to 'guaranteed generation', Aquila is selling it

as a product. Aquila also has a long list of weather-related products it has developed and expanded.

"It is a commodity product and these commodity products are really the future," says Padewer. "All of those utilities around the country are looking at how they leverage their pipes and wires. They leverage them with burglary alarms, they sell their customer different things like appliances and insurance."

"But on the generation side," Padewer continues, "people have not thought about leveraging their generation by taking advantage of the built-in options that exist in their generation capacity."

FUTURE PRODUCTS

That is the future insists Padewer: "It's going to be commodity products designed to help ameliorate that risk inherent in their business. That has been our main focus on the electric side."

Aquila supports that strategy with its product development group that is charged with conceiving ideas and rapidly turning them into marketable products. The group is responsible for churning out series upon series of new products intended to give Aquila competitive advantages with commodities. According to Padewer, new commodity products have a proprietary life of six to eight weeks.

"Come up with a good new idea and as soon as a competitor finds out about it, he'll start thinking about how he can do it. He'll figure it out and introduce the same product. You need to hit the market very quickly!" says Padewer. "So, you see," he says, "our whole emphasis on the business has fundamentally changed and for me it's been a tremendous education. But what strikes me is that it is so apparent how we can use the commodity creation and marketing skills and knowledge to make generation a better business and to solve the problems that we are facing in the future."

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