

Report of the Special Committee on Natural Gas Storage Fields and Facilities to the 2011 Kansas Legislature

CHAIRPERSON: Senator Carolyn McGinn

VICE-CHAIRPERSON: Representative Carl Holmes

OTHER MEMBERS: Senators Marci Francisco, Steve Morris, Mark Taddiken, and Ruth Teichman; and Representatives Gary Hayzlett, Mitch Holmes, Forrest Knox, Ann Mah, Cindy Neighbor, Joe Siewert, and Dale Swenson

STUDY TOPICS

- Study the impact of two recent court cases and their potential effects on state law and regulations associated with natural gas storage fields and facilities in Kansas.
- Review the potential impact on the state's ability to regulate natural gas storage fields, including safety of the fields, as a result of the Federal District Court's decision in *Colorado Interstate Gas v. Thomas E. Wright*.
- Study current law and the potential impact on state law as a result of the Kansas District Court's decision in *Northern Natural Gas v. ONEOK Field Services Company*.
- Review the need to amend current state law based on these court decisions.
- Study the taxation of natural gas in underground storage facilities, the fields, storage gas, cushion gas and other minerals produced from storage fields.
- Review the current law that does not impose a tax on oil produced when storage gas is withdrawn from a natural gas storage field.

Special Committee on Natural Gas Storage Fields and Facilities

REPORT

CONCLUSIONS AND RECOMMENDATIONS

The Special Committee makes the following recommendations:

- The appropriate House and Senate standing committees should address any tax issues referenced in the Special Committee's charge;
- The Legislature should encourage the Kansas Corporation Commission (KCC) and the Interstate Oil and Gas Compact Commission (IOGCC) to bring safety issues before the March 2011 meeting of the Energy Council. In addition, the Special Committee recommends that a state resolution addressing safety be drafted and passed by the Legislature in time to accompany this effort;
- The Legislature should identify other states that may wish to join Kansas' efforts in approaching the Energy Council with regard to safety issues;
- The Special Committee recommends that an additional state resolution be drafted and passed by the Legislature, which specifies that the Kansas Corporation Commission (KCC) should be the oversight organization for natural gas storage in Kansas rather than the Federal Energy Regulatory Commission (FERC); and
- The appropriate House and Senate standing committees should review KSA 55-1210 to determine if changes need to be made to clarify the definition of "adjoining."

Proposed Legislation: The Special Committee recommends the introduction of two resolutions. The first resolution addresses natural gas storage field safety. The second resolution addresses oversight of natural gas storage.

BACKGROUND

The Special Committee on Natural Gas Storage Fields and Facilities was created by the Legislative Coordinating Council for the 2010 Interim for the purpose of studying two recent court cases and their potential effects on state law and regulations associated with natural gas storage fields and facilities in Kansas.

Underground Storage Statutes

The statutes for underground storage in Kansas originally were passed in 1951 and 1961, and were considered by the Kansas Supreme Court in a series of decisions in the 1980s. In 1993, the Legislature introduced and held hearings on SB 168, which provided that the injector would not lose title to, or the right of

possession of, gas previously injected if it could be proved by a preponderance of the evidence that the gas originally was injected by the injector. This bill language was based upon existing Oklahoma statutes dealing with underground gas storage; however, the Kansas language contained a reference to gas that migrated to adjoining property that was not mentioned in the Oklahoma statutes. The provisions of 1993 SB 168 became KSA 55-1210.

Further legislation was considered by the Legislature during the 2001 and 2003 Legislative Sessions due to a natural gas explosion in Hutchinson, Kansas, on January 17 and 18, 2001. House Bill 2200 was introduced and passed by the 2001 Legislature, which prohibited underground porosity storage of hydrocarbons in certain rock formations that contain water with relatively low salt concentrations, defined as less than 5,000 milligram of chlorides per liter. The 2003 Legislature passed legislation that allowed existing underground porosity storage to continue if it was already in use prior to July 1, 2002.

2010 Senate Bill 553

During the 2010 Legislative Session, SB 553 was introduced at the request of Senator Ruth Teichman by the Senate Committee on Ways and Means. At the time of its introduction, SB 553 addressed a dispute in Pratt County between Northern Natural Gas Company (Northern) and local property owners who received royalties from natural gas wells that are located in an area within six miles of Northern's Cunningham Storage Field.

The central issue to the dispute was determining who had title to the gas being produced at the wells in the impacted area. Northern asserted that the gas in question was actually storage gas that had migrated outside of the certified storage boundary to adjoining property and they retained title to the gas. The property owners argued that they had title to the gas being produced, either because it was native

gas, or because even if the gas was originally storage gas belonging to Northern, it had migrated beyond adjoining property and was subject to the rule of capture.

Adjoining property has been defined by the Supreme Court as any section adjacent to a storage field, or more specifically, any section of land which touches a section containing a storage field. Under the proposed bill, the rule of capture would apply to natural gas storage fields in Kansas. A gas storage operator would lose ownership of the storage gas if it is produced by someone else through a well located outside the storage field boundary. To perfect his or her ownership interest in minerals underlying the land, the landowner must produce or capture those minerals. The rule of capture would protect an adjacent landowner who, through production on his or her land, causes the minerals to migrate across surface boundaries.

The bill was referred to the Senate Committee on Natural Resources and hearings were held on the bill on March 4, 10, and 11, 2010. No further action was taken by the committee on the bill. An interim study of this topic, including the outcomes of recent court cases and their potential impact on the provisions of the bill itself, was requested by Senate President Steve Morris. The Special Committee on Natural Gas Storage Fields and Facilities received a summary prepared by the Kansas Legislative Research Department staff of all proponent and opponent testimony that was given during the hearings on 2010 SB 553.

COMMITTEE ACTIVITIES

The Special Committee on Natural Gas Storage Fields and Facilities met on November 9, 2010, and heard informational testimony from legislative and agency staff members on various court cases, and state and federal laws and regulations. Staff from the Office of the Revisor of Statutes reviewed the provisions of 2010 Senate Bill 553 and the definition of

“adjoining.” Staff from the Kansas Legislative Research Department reviewed the history of Kansas statutes on underground storage of natural gas.

Comparison of Kansas Law to Other States’ Laws

Kansas Legislative Research Department staff presented a comparison of other states’ laws regarding the migration of natural gas. The statutes of Colorado, Missouri, Nebraska, Oklahoma, and Texas were discussed. The staff member concluded that each of these states has not defined the terms “adjoining” or “rule of capture” in statute and that none of the surrounding states follow the rule of capture regarding migrating natural gas. Furthermore, these states have not addressed natural gas migration in regards to compensation to landowners.

Follow-up information provided by Northern concurred with the conclusions provided by the Kansas Legislative Research Department. However, KCC staff disagreed on whether Missouri and Nebraska have abolished the rule of capture for migrating storage gas.

Recent Court Decisions and Federal Actions

Staff from the Office of the Revisor of Statutes then reviewed several recent court decisions and federal actions for the Special Committee.

Northern Natural Gas (Northern) v. ONEOK Field Services (ONEOK) and Lumen v. Nash Oil (Nash) and L.D. Drilling (L.D.)

The *Northern v. ONEOK* and *Lumen v. Nash and L.D.* cases were reviewed for the committee. In its case, Northern claimed that the gas produced from wells operated by the third-party defendants, Nash and L.D., and purchased by defendants ONEOK and Lumen, was storage gas that had migrated from the Cunningham Storage Field, an underground gas storage field owned by

Northern. Northern claimed it had title to the gas and that ONEOK and Lumen were converting storage gas. Nash and L.D. claimed that their wells were located too far from the Cunningham Storage Field to be on adjoining property to the field. In addition, Nash and L.D. argued that Northern had lost title to the gas and that the two companies had a right under the rule of capture to produce any gas that had migrated from the Cunningham Storage Field.

The state court determined the issue of the case was whether under KSA 55-1210(c)(1), a storage field operator retains title to storage gas that migrates beyond “adjoining” property. The state court found that since none of the wells identified by Northern were in a section of land touching a section containing the Cunningham Storage Field, as determined by its FERC-certified boundaries, none of the wells could be considered to be located on property “adjoining” the Cunningham Storage Field. Thus, KSA 55-1210(c)(1) protects a storage field operator’s title to previously injected storage gas that migrates horizontally, beyond the boundaries of the storage field, only if that gas migrates to “adjoining property,” and not if it migrates further, to property that is too far from the storage field to qualify as “adjoining property.” This case currently is in the appeals process and likely will not be decided until later in 2011.

Federal Regulation of the Interstate Distribution of Natural Gas

Staff from the Office of the Revisor of Statutes provided information on federal regulation of the interstate distribution of natural gas. Two federal statutes govern the interstate distribution of natural gas: the Natural Gas Act (NGA) and the Natural Gas and Hazardous Materials Pipeline Safety Act (PSA). The NGA is a regulatory scheme concerning the interstate transportation and sale of natural gas for distribution to the public. The PSA regulates the safety of natural gas pipelines.

Federal Energy Regulatory Commission (FERC) Order Concerning Northern

The FERC order concerning Northern was reviewed for the committee by staff from the Office of the Revisor of Statutes. Northern filed an application pursuant to section 717f of the NGA for a certificate of public convenience and necessity to expand the certificated protective boundary around the Cunningham Storage Field. The FERC found the proposed extent of the expansion of the Cunningham Storage Field and protective boundaries was not reasonable as submitted by Northern, but authorized an expansion of 12,320 acres instead of the proposed 14,240. In addition, the FERC refused to authorize the proposed management plan that was submitted by Northern and instead required Northern to file a comprehensive and specific management plan to slow and reverse the flow of gas out of the field. On July 23, 2010, Northern filed a management plan with FERC as required by the order.

Colorado Interstate Gas (CIG) v. Thomas E. Wright (KCC)

The *CIG v. KCC* case was reviewed for the committee. The CIG, an operator of an underground natural gas storage facility, alleged that the Kansas gas storage statutes and regulations were preempted by the NGA and the PSA, violated the US Constitution's Supremacy Clause, and had no force or effect on the CIG. The court's decision addressed two aspects of the Kansas regulations: permitting and safety. According to the court, the FERC has exclusive jurisdiction of the rates and facilities of interstate natural gas companies. The jurisdiction includes all aspects of operations, including economic matters and safety.

The court determined that the Kansas regulations are focused upon regulating a field exclusively occupied by FERC's permitting authority and that the NGA preempts Kansas regulations. The PSA includes a provision that

explicitly forbids any state safety regulation over pipeline transportation or pipeline facilities. The court found that the PSA expressly preempts all state safety standards imposed for the purpose of addressing risks to life and property posed by pipeline transportation and pipeline facilities, including Kansas regulations. Thus, the court ruled that the Kansas gas storage statutes and regulations have no force or effect on CIG's interstate natural gas pipeline, storage facilities, and transportation at CIG's Boehm Underground Gas Storage Field.

Agency Presentation of Information on Natural Gas Storage Issues in Kansas

The Kansas Corporation Commission (KCC) presented information to the Special Committee on the issues surrounding natural gas storage in Kansas. A representative of the agency noted that there is currently an absence of regulation of natural gas pipelines by the US Department of Transportation, which leaves an opening for the KCC to have some authority over the natural gas pipelines. The KCC reported that this arrangement is acceptable to the FERC. Members of the Special Committee expressed their concern that the state must have some authority to ensure that natural gas pipelines and natural gas storage fields are safe.

A KCC representative presented information regarding the Southern Star Storage Field expansion and recent FERC rulings. It was noted that Southern Star lost a large amount of funding in its investment at the South Welda Storage Field, mostly due to gas migration. The FERC determined that due to the gas migration, Southern Star should be authorized to buy all the mineral rights within the certificated boundary of the South Welda Storage Field.

The agency provided a map showing the location of active natural gas porosity storage fields in the state. The agency also discussed specific regulations for natural gas storage facilities, which are divided into groups by permitting

requirements, operational requirements, and abandonment requirements. In addition, the Special Committee heard testimony on current draft resolutions that are currently before the FERC.

A member of the Special Committee stated the only time that production increases in a natural gas well is when there is injection of natural gas into the ground. The standard curve of production for a natural gas well is always on a declining curve from the moment of production.

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