Approved March 25, 1983
Date

MINUTES OF THE Senate COMMITTEE ON Energy and Natural Resources.

The meeting was called to order by Senator Charlie L. Angell at
Chairperson

8:00 a.m./~~p.m.~~ on Thursday, March 24, 1983 in room 123-S of the Capitol.

All members were present except:
Senator Tom Rehorn

Committee staff present:
Ramon Powers, Research Department
Don Hayward, Revisor's Office
LaVonne Mumert, Secretary to the Committee

Conferees appearing before the committee:
Representative Keith Farrar
Steve Holsteen, Governor's Office
Ed Peterson, Kansas Corporation Commission

The minutes of the March 23, 1983 meeting were approved.

H.B. 2208 - Oil and gas leases; covenants of reasonable exploration

Chairman Angell presented an amendment agreed to by all parties -- the gas industry, the royalty owners association and Douglas Energy. Senator Feleciano moved that the following amendment be added to the bill: "If the court determines that the lessee has failed to comply with such covenant, the court may grant the lessee a reasonable time in which to comply; or the court may issue an order terminating the lessee's right to such subsurface part or parts as are the subject of such action; and the court may enter such other orders as the interests of the parties and equity may require." Senator Kerr seconded the motion, and the motion carried. Senator Feleciano moved that line 45 of the bill be amended to read: "preponderance of all relevant evidence that the lessee has fully complied". Senator Kerr seconded the motion, and the motion carried. Senator Feleciano moved that the bill be reported favorably, as amended, for passage. Senator Gordon seconded the motion, and the motion carried 9-0.

H.C.R. 5004 - Memorializing Congress to nullify certain clauses in natural gas purchase contracts

Representative Farrar provided written testimony (Attachment 1). He said the House had amended the resolution to include a provision recommending freezing the price of natural gas which he does not support. There was testimony before the House Energy Committee in favor of the resolution from the Attorney General's office and the Governor's office, but no one requested that there be a freeze on the price of natural gas. Representative Farrar recommended that the Committee remove this part of the resolution. He also suggested that the Committee may wish to consider including a request that Congress repeal the Power Plant and Industrial Fuels Act. Answering a question from Senator Roitz, Representative Farrar said the way the freeze recommendation is worded, it would prevent prices from dropping below the frozen price.

Senator Feleciano and Chairman Angell asked George Sims, of Mobil, questions concerning take-or-pay clauses. Most contracts include a take-or-pay provision, a market-out provision and an economical factor provision. Mr. Sims was asked what the impact actually is by removing these take-or-pay clauses and if this doesn't in fact give the pipelines the right to hold all of this gas without penalty or without having to release it to the free market. Mr. Sims said it is necessary to have a certain volume of gas so that the costs can be charged off. He said there are times when no other market for the can be had unless another pipeline is built into the area.

Representative Farrar pointed out that if take-or-pay clauses are completely eliminated, the gas companies can hold those reserves. He said it is preferable to lower the percentage in the take-or-pay clauses. He also mentioned the problem of indefinite price escalator clauses.

S.B. 209 - Kansas natural gas price control act

Steve Holsteen summarized his written testimony (Attachment 2). He said they basically

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

support the amendments made by the Subcommittee on S.B. 209. They would prefer a somewhat later sunset date on the bill. He told the Committee that the earlier sunset date would reduce the expected savings by about 42 million dollars.

Ed Peterson reviewed his calculations for reaching the estimated savings to consumers (Attachment 3). He said he would guess that the assumption of stable production is likely to hold true over the next 12 months. The figures represent a savings of a 6% inflation rate at today's prices. If the inflation rate is lower, this would have an effect, but it is not a dollar-for-dollar change.

Senator Kerr explained that the Subcommittee's proposal concerning the sunset was recommended by the Kansas Corporation Commission so that the sunset would coincide with the sunset of the original price act. The impression was that the date was sometime in 1985, but it actually turned out to be December 31, 1984. Senator Kerr said it was also recommended by the Corporation Commission that the date be changed from January 20 to the effective date of the act. Mr. Peterson agreed that both of these statements are true.

Answering a question from Senator Roitz, Steve Holsteen said the residential customers of KPL and, to some extent, the electrical customers of KG&E would benefit most from S.B. 209.

Chairman Angell said he had done some research that indicates a number of wells very close to existing intrastate lines which have never been hooked up to the pipelines. He said this raises a serious questions as to whether artifically lowering the price of natural gas by state law has the cause and effect of forcing intrastate pipelines to interstate sources of natural gas, leaving Kansas producing wells in a nonproductive state.

Addressing H.C.R. 5004, Mr. Holsteen said they support the resolution. He pointed out that although instances such as Northwest Central Pipeline's filing its PGA are positive steps, they do have severe consequences and Congress needs to address the whole problem of take-or-pay clauses. Mr. Holsteen suggested that the Committee may wish to consider a provision in the resolution addressing automatic pass-throughs. They have some concern about the freeze language possibly precluding prices from dropping below the set price. He suggested that the word "moratorium" be used in place of the word "freeze". Mr. Holsteen discussed the decontrol of "old" gas and said this could cause the price of gas paid on the KPL system to double.

The meeting was adjourned at 9:04 a.m. by the Chairman. The next meeting of the Committee will be at 8:00 a.m. on March 25, 1983.

Senate Energy & Natural Resources
Mar. 24, 1983

Name	Organization
KEITH FARRAR	Dist 124
Robert A. Anderson	Mid Cont Oil & G
[illegible]	Mobil
Bob Clawson	Energy Office
BILL PERDUE	KPL
LON STANTON	KPL
Don Schnacke	KIOGA
David W Nickel	KCC
Ed Peterson	KCC
Steve Holsteen	Gov. Off.
Ken Klaus	Gov. Office
Ed Reinert	KS League Women Voter

STATEMENT BY REP. KEITH FARRAR

BEFORE THE HOUSE ENERGY AND NATURAL RESOURCES COMMITTEE

WEDNESDAY, JANUARY 27

ON HCR 5004

Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you today in support of HCR 5004.

As you are aware, one of the major items appearing in the news over the last few months, and especially now during the winter season, is the increasing cost to the consumer for natural gas. Included in the proposed Resolution are many of the reasons we are faced today with higher prices for a product that is presently in an over supply situation, yet we in Kansas and the United States are not able to benefit from the availability of cheaper reserves of natural gas that are being left in the ground. Something needs to be done. In a more normal supply and demand situation, the cost of natural gas would hold steady or decline because of less demand. As a farmer, I would like to see my income go up as I produce more, however we all know that agriculture is in financial trouble because of interference in the market place such as federal grain embargoes, or the threat of embargoes. No matter how good the intentions for protecting the consumer, we are again seeing the results of government interference in the market place.

To me, our present problems in pricing of natural gas can be traced back to the decision made many years ago by Congress and the Supreme Court to hold down the price of natural gas in relation to the price of other fossil fuels. The result was a reduction in exploration for natural gas and therefore a predictable shortage of natural gas developed for interstate markets. Again, Congress came to the rescue and passed the NGPA (Natural Gas Pricing Act) of 1978. Instead of complete deregulation of the natural gas industry, Congress created more than 20 separate categories for pricing natural gas and allowing prices to escalate monthly until January 1, 1985 when they cease to exist, however, so-called old gas will not be completely deregulated.

Now back to the proposed Resolution. I will briefly try to explain my understanding of the "take-or-pay" clauses in many of the contracts negotiated by pipeline companies and natural gas producers in recent years.

The "take-or-pay" provisions require the purchaser to pay for all the gas contracted for (or a percentage of that amount) within a specified period of time whether or not the gas is taken. The contracts usually contain a provision for a make-up period during which the gas must be taken. As you can see, there are two parts to this provision. I would think the producers want the take provision to be sure of producing the well which results in creating the cash flow needed to continue developing oil and gas reserves.

The pay portion enables a pipeline company to know that they will have gas reserves for future sale. The actual effect of this clause in a contract during a decline in the market demand is the pipeline companies are faced with large payments associated with those take-or-pay provisions and may not be able to meet their make-up deadlines. In many instances, especially in the Hugoton field, pipeline companies are refusing to take from their normal supply of old, cheaper gas, thus creating higher prices to the consumer without letting the normal supply and demand forces affect the market place.

I am concerned, and satisfied in my own mind that some of the contracts the pipeline companies claim they cannot cancel because they contain these "take-or-pay" provisions actually contain "market out" provisions or "unprofitability" provisions which allow the buyer to terminate the contract by notice to the seller. For instance, I will quote from a copy of a portion of a current pipeline contract - "Right to Terminate. It is specifically understood and agreed that if at any time in Buyer's sole opinion, the taking of gas hereunder from any well or wells become unprofitable, Buyer may terminate this Contract as to such well or wells upon sixty (60) days notice in writing to Seller."

Now as to the reason of including in the proposed Resolution a request to nullify the indefinite price escalator clauses explained on page 2 starting on line 0063. "WHEREAS, The indefinite price escalator clauses in natural gas purchase contracts have caused the price of gas under those contracts to automatically become the ceiling price, thereby preventing the marketplace from determining the price of natural gas." Again, I will quote from a portion of a current natural gas contract - "Price - For all gas delivered to Buyer, Buyer shall pay Seller the ceiling prices, including all adjustments and escalations, applicable to the gas covered by this Agreement, as established by the Federal Energy Regulatory Commission or other federal or state governmental authority having jurisdiction, including but not limited to Acts of Congress. The price shall change to conform to all such adjustments and escalations on the date they become effective as to the gas covered hereby."

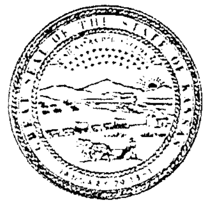
As you can see, I believe both the "take-or-pay" concept as well as the indefinite price escalator clauses are at the heart of increased prices for natural gas consumers. Additionally, they have caused reduced gas purchases in the Hugoton field which has a depressing effect on the Kansas economy in lost income as well as contributing to more unemployment for Kansas citizens. I think it would be of benefit to point out the approximate underages in the takes of natural gas from the Hugoton field by some of the major companies since 1978 and what that means in dollar value of natural gas left in the ground. The total cumulative underages from the Hugoton field by December 1982 totaled 223.5 billion cubic feet of natural gas. Using an average well head price of 50 cents a thousand cubic feet, you come up with approximately one hundred twelve million dollars value at the well head. Conservatively the value to the consumer would be at least three times that amount. 1982 figures for the average well head price was 1.20 and 5.20 to 5.25 to the consumer.

Realistically I don't know if Congress will nullify these provisions, however if enough pressure is applied, the percentage of takes from high priced natural gas could be reduced from approximately 90% to approximately 45% thus allowing the pipelines to increase their purchases from lower priced sources, such as the Hugoton field, and still provide needed cash flow for the producers. As the committee looks at this Resolution, you may want to consider including within the Resolution a request of Congress to repeal the Power Plant and Industrial Fuels Act. To me, these restraints on use of natural gas prevent the best energy supply mix for industrial use, this restriction placed on the use of natural gas because it was thought we would not have enough natural gas for domestic consumption is no longer valid.

I will try to respond to questions. .

Attachment 2

STATE OF KANSAS



OFFICE OF THE GOVERNOR
State Capitol
Topeka 66612

John Carlin *Governor*

Testimony To
Senate Energy and Natural Resources Committee
By
Stephen E. Holsteen
March 24, 1983

Mr. Chairman and Members of the Committee:

It is a pleasure to appear before you today in support of Senate Bill No. 209 and House Concurrent Resolution 5004. Both the Senate Bill and the House Concurrent Resolution deal with natural gas pricing and that is an issue which has vitally concerned the Governor.

First I would like to comment on SB 209. SB 209 would create the Kansas Natural Gas Price Control Act of 1983. The bill would freeze the price of intrastate natural gas at the price on the introduction date of this Act and would impose a moratorium of at least one year on any future price increases for natural gas.

I have already presented testimony on this bill to the Committee so I will not go into great detail. I would, however, like to make a couple of comments on the amendments made by the Subcommittee to the bill. First let me say that we support the amendments made by the Subcommittee. The Subcommittee amendments were designed to prevent a situation developing under which Kansas gas would not be marketable and that certainly is a situation which should be avoided.

Additionally, we support the inclusion of a sunset date in SB 209. I would like to call to the Committee's attention the actual date used. The savings of nearly $100 million estimated under this bill assumed that the bill would be effective through the end of 1985. The sunset date in the bill is December 31, 1984. Consequently, a year of savings, or nearly $42 million would be lost from our estimate.

The many bills which have been introduced in the Kansas Legislature during this Session to try to control the impact of natural gas prices is just one indication of the seriousness of the problem which we are all trying to combat.

Although SB 209 will not affect every Kansas energy consumer, it is a start. In fact, it is one of the most substantial steps that you, as Kansas Legislators, can take to help alleviate the impact of rising gas prices. I urge the Committee's adoption of this bill.

Atch. 2

The Governor also urges your favorable consideration of HCR 5004. It has become quite clear that Congress must intervene to grant any type of substantial relief to Kansas consumers served by interstate pipelines.

In this regard, the Kansas experience is by no means unique. It is, however, probably the best example of the need for Congressional action to remedy the pricing problems in the natural gas markets.

The Northwest Central Pipeline Company (NWC) provides an instructive example of the onerous impact that current contractual and regulatory practices can have upon the price paid by consumers for natural gas. The NWC system supplies over half the gas consumed in Kansas; NWC purchases its gas in Kansas, Oklahoma, Texas, Wyoming, and Colorado. Last year, NWC raised the price of gas three times: in April the PGA was increased by 38¢ and in October the PGA again was increased by 82.16¢/mcf. These increases, although they represented over a 50 percent increase in purchased gas costs, were passed through to consumers automatically without any question as to whether they were reasonable. The State of Kansas challenged the October PGA filing as excessive, and in response NWC explained that take-or-pay contracts dictated that the company purchase the more expensive gas while it was shutting-in relatively low-cost gas wells in the Kansas Hugoton Field. In short the pipeline had two options: it could take gas from expensive sources and minimize potential take-or-pay penalties or it could buy from less expensive sources and incur the risk of very heavy take-or-pay obligations.

Initially, Northwest chose to follow the first option. The result was a burner-tip gas cost that was about $1.00 per unit above the price of competitive fuel oil. At this price level the pipeline experienced about a 25 BCF or 10 percent decrease in its anticipated demand as the result of industrial fuel switching. It is currently in danger of losing another 11 BCF. If this scenario continues, the impact will be yet another round of price increases as the fixed costs which those industrial customers had borne are shifted to the remaining consumers. It is a vicious cycle in which higher prices generate even higher prices despite a gas surplus.

The second option is to buy gas from less expensive sources and reduce the current cost of gas but substantially increase the risk of paying for gas not taken under take-or-pay requirements. This is the course which Northwest chose Tuesday in filing its PGA -- to increase production of cheap supplies in the Kansas Hugoton Field while incurring take-or-pay penalties under contracts for more expensive sources. This choice represents a mixed blessing, at best. The average price will be reduced by $1.00/mcf. Take-or-pay "prepayments", however, will increase dramatically. The Company has estimated the levels to be:

1983	$100 million
1984	$224 million
1985	$348 million

To put these numbers in perspective, the total current rate base is approximately $350 million, or roughly equal to one year's take-or-pay penalty under the revised purchase pattern. With such massive obligations and a shrinking or stable demand, it is highly unlikely that NWC's customers will ever be able to reclaim the "prepaid" gas under take-or-pay.

The bottom line is that take-or-pay presents a choice to pipelines and their consumers which is no choice at all -- pay excessive costs for gas now or pay for gas they will not receive tomorrow.

In summary, we support HCR 5004 because we believe it addresses the most pressing problem before us: the excessive increase in natural gas prices that have been caused by faulty contract provisions.

State of Kansas

JOHN CARLIN — Governor
RICHARD C. (PETE) LOUX — Chairman
JANE T. ROY — Commissioner
PHILLIP R. DICK — Commissioner
CAROL J. LARSON — Executive Secretary
BRIAN J. MOLINE — General Counsel

State Corporation Commission

Fourth Floor, State Office Bldg.
Ph. 913/296-3355
TOPEKA, KANSAS 66612-1571

March 17, 1983

Senator Charlie Angell
Statehouse
Topeka, KS 66612

Dear Senator Angell:

Enclosed are the calculation and assumptions used to estimate the potential savings to result from passage of SB209. You were correct when you stated that the $100 million estimated savings applied to extension of the act through 1985. The result of sunseting SB209 on December 31, 1984, is to reduce the savings estimated here by approximately 44% from roughly $92 million to $50 million.

If you have further questions, please contact me.

Sincerely,

C. Edward Peterson

C. Edward Peterson
Assistant General Counsel

CEP:ec
Encl.

Atch. 3

Aggregate estimates based on:

-- 5 largest purchasers of intrastate gas -- KPL, Ks Gas Supply, People's Division, Anadarko, Getty = approx. 90% of total intrastate volum

-- price freeze from January 1983 to December 1985

-- stable production/purchase levels

-- 6 percent inflation, projected from actual purchase prices in 1981 & 1982

Estimates by community and class of service:

-- savings equal to proportionate share of each community / class of service to total sales, as reported by company in annual report to KCC

-- KGE estimates based on annual report of Kansas Gas Supply, which lists volume sales to KGE; and, annual report of KGE which lists sales to communities and customer classes

Estimated Effects of Placing a Moratorium on Price Increases of Intrastate Gas in Kansas, (January 1983-December 1985)

Kansas Gas Supply

1979	$1.17 MCF		
1980	1.32		25 BCF
1981	1.86		
1982	2.05 (est)		
1983	2.17	(+.12)	3.06 million
1984	2.31	(+.26)	6.50
1985	2.45	(+.40)	10.00
			$19.56 million

Anadarko

1979	$1.43 MCF		
1980	1.74		10 BCF
1981	2.08		
1982	2.29		
1983	2.43	(+.14)	1.40 million
1984	2.58	(+.29)	2.90
1985	2.73	(+.44)	4.40
			$8.7 million

Getty

1979	$1.75 MCF		
1980	2.10		4.5 BCF
1981	2.47		
1982	2.72 (est)		
1983	2.88	(+.16)	.72 million
1984	3.05	(+.33)	1.49
1985	3.23	(+.51)	2.30
			$4.51 million

People's Division

1979	$1.67 MCF		
1980	1.90		
1981	2.15		13 BCF
1982	2.45		
1983	2.60	(+.15)	1.95 million
1984	2.76	(+.31)	4.03
1985	2.93	(+.48)	6.24
			$12.22 million

KPL

1979	$1.07 MCF		
1980	1.27		55 BCF
1981	1.60		
1982	1.90		
1983	2.01	(+.11)	$6.05 million
1984	2.13	(+.23)	12.65
1985	2.26	(+.36)	19.80
			$38.50 million

Total savings for the five companies for the three year period = $83.49 million

Notes

1. Average wellhead prices are actual for 1979-1981.
2. Purchase volumes are based on the most recent actual data published for each company -- in most cases, either 1981 or 1982.
3. Price escalation is assumed to be 6 percent per year.
4. The companies listed represent an estimated 90 percent of total intrastate sales, thus yielding a statewide savings estimate of $92.77 million.