Approved March 29, 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.XXXX on Friday, March 25, 1983 in room 123-S of the Capitol.

All members were present except:
Senator Paul Hess
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:
Don Schnacke, Kansas Independent Oil and Gas Association

The minutes of the March 24, 1983 meeting were approved as amended.

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

Don Schnacke read his written testimony (Attachment 1). They oppose the bill because they feel it will result in continued shortages of Kansas produced natural gas, causing higher prices for consumers of Kansas. Mr. Schnacke cited figures of continuing declines in drilling activity. Answering a question from Senator Kerr, Mr. Schnacke said everything is being pushed towards the interstate market and there is very little activity in gas right now.

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

Mr. Schnacke read his written testimony in opposition to H.C.R. 5004 (Attachment 2). He said take-or-pay clauses are put into contracts to assure a flow of capital to risk takers who drill wells and assure the production of gas. Mr. Schnacke emphasized that the pipeline buys the gas whether it takes the gas now or later. He said price escalator clauses are for the purpose of keeping wellhead prices at market prices. Mr. Schnacke said that the Federal Industrial Fuel Use Act should be repealed. Senator Werts asked if there is such a thing as price de-escalator clauses. Mr. Schnacke answered he is not aware of any. He said price escalator clauses benefit the interest of all parties -- producers, pipelines, utilities and consumers. He said price freezing tends to stop renegotiation of contracts. Senator Werts asked about future unknown reserves. Mr. Schnacke said only about 2% of the total known area in this country has been explored. He said the development of the oil and gas industry in America is just beginning. He answered that there is enough technical expertise to avoid wide swings in the market and avoid vagaries of international cartel marketing but there is no control of the politics affecting this. Answering questions from Senator Chaney about take-or-pay clauses, Mr. Schnacke said these are between the pipelines and producers. He discussed the heavy commitments that are made. Mr. Schnacke discussed situations when the producer isn't able to supply the gas contracted and paid for and the contracts are renegotiated.

Chairman Angell cited figures from Kansas Power and Light Company Statement in Answer to KCC Data Request on February 9, 1983. The answers of Kansas Power and Light Company indicate a decrease in gas from 72,539 mmcf in 1978 to 57 mmcf in 1983. At the same time the system-wide average of gas prices increased from the 1978 figure of $1.134 to $2.20 in 1983. Chairman Angell asked Mr. Bill Perdue, of KPL, if these figures are an example of what happens in demand elasticities -- reduction in quantity results in an increase of price and that becomes a never-ending cycle of increasing costs, causing even further reductions in volume of gas sold. Mr. Perdue indicated that is true. Chairman Angell asked why Kansas Power and Light Company's average system price has doubled since 1978. Mr. Perdue answered the reason is the increased cost of gas to their customers from increases in old contracts and high new contracts. Senator Kerr asked what Kansas Power and Light Company's position is on S.B. 209. Mr. Perdue answered they feel that the bill has been improved by the Subcommittee's amendments. They favor anything that will hold down the price of gas to their customers yet at the same time they are apprehensive about anything that might hinder them from buying Kansas gas and this legislation could have that effect.

CONTINUATION SHEET

MINUTES OF THE Senate COMMITTEE ON Energy and Natural Resources,

room 123-S, Statehouse, at 8:00 a.m./~~p.m.~~ on Friday, March 25, 1983

S.C.R. 1622 - Directing studies of minimum streamflow requirements of certain watercourses

Senator Kerr moved that the bill be reported favorably for passage. Senator Werts seconded the motion, and the motion carried 8-0.

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 29, 1983.

Senate Energy & Natural Resources
Mar. 25, 1983

Name	Organization
Ed Reinert	KS Sierra Club
Patti Hackney	Public Assistance Coalition
Robert E. Anderson	Mid Cont Oil & Gas
George A. Sims	Mobil
Bob Clawson	KS Energy Office
Dale Satterthwaite	The Gas Service Co
Tom Sloan	GRMC
Bill Perdue	KPL
Lon Stanton	KPL
Don Schnacke	KIOGA

Attachment 1

KIOGA

KANSAS INDEPENDENT OIL & GAS ASSOCIATION

500 BROADWAY PLAZA • WICHITA, KANSAS 67202 • (316) 263-7297

March 25, 1983

TO:Senate Energy & Natural Resources Committee

Re: SB 209 - Maximum Price of Natural Gas

SB 209 is an attempt to extend the Kansas Natural Gas Price Protection Act (KNGPPA). We think in the long run, that Act and the policy proposed in SB 209, will result in continued shortages of Kansas produced natural gas and a continued increase dependence on out of state higher priced natural gas. The result is and will be higher prices for consumers of Kansas.

On March 24th we appeared before your Sub-Committee opposing this bill. The Sub-Committee did recommend new language for Section 2. to replace the four sub-sections (lines 24-35) of which we did not agree with at all.

Section 4 is the heart of the bill. It would freeze prices within contracts for natural gas. The Sub-Committee recommended it become effective on date of enactment instead of January 20, 1983.

In 1980, we ran a survey of Kansas natural gas producers to reflect their attitudes and concerns arising from the passage of the KNGPPA in 1979. Seventy producers responded. The results of the survey reflected hostility, frustration and a desire to divert what has normally been considered intra-state gas to inter-state markets when possible. There are Kansas producers today who have company policies not to drill where they would have to sell to an intra-state pipeline because of the passage of the KNGPPA and the threat of what the Legislature might do further, like the passage of legislation proposed in SB 209.

Senator Angell recited yesterday about wells that were capped on nearby lines and a statement from one producer who refuses to sell into the intra-state market. This is a serious problem.

The trends in Kansas are disturbing to us and should be to this committee. Intent to drill filings dropped considerably in 1982 from 20,551 (1981) to 14,524 (1982). Gas production continues in a sharp decline in Kansas. Our rotary drilling rig count has dropped from 224 to 108 or 52% off. In Southeast Kansas the truck mounted rigs are largely idle-reportedly one in ten are operating.

We believe the issue presented by SB 209 is very serious and much is at stake for the Kansas economy. The interference of government in the market place; restricting contract obligations, freezing prices, favoring one class of consumers over another, is an will continue to have serious consequences for our state.

In the meantime, we oppose SB 209 and urge you to not report it favorably.

Donald P. Schnacke

Atch. 1

Attachment 2

KANSAS INDEPENDENT OIL & GAS ASSOCIATION
500 BROADWAY PLAZA • WICHITA, KANSAS 67202 • (316) 263-7297

March 25, 1983

TO: House Energy and Natural Resources Committee

RE: HCR 5004

It is correct in assuming the issue of contracting relating to natural gas pricing is a matter that primarily confronts the Congress. However, natural gas contracts have, are, and will be entered into in Kansas in the future, between producers, pipelines and consumers that may or may not contain escalator clauses or take-or-pay clauses.

We find there is much misunderstanding about "take-or-pay" and "indefinite price escalator" clauses. Many do not understand them.

If instead of "take-or-pay", if we referred to these clauses as "minimum production sales", or "natural gas shortage charges", we wonder if the public would be as much offended.

These clauses are put into contracts to assure a normal flow of capital to service debt of risk takers who drill wells and assure the production and deliverability of the gas. In Kansas, I doubt if many of these contract provisions are activitated. The more expensive wells found in Oklahoma and Wyoming where the cost of the drilling of a well is extensive, dictate these provisions. We seriously doubt Congress will nullify the concept of take-or-pay as provided in line 89-91 in HCR 5004.

The important thing for you to consider is that the pipeline buys the gas, whether it takes it currently or at a later date through make-up provisions contained in the take-or-pay clauses.

Indefinite price escalator clauses in contracts are placed in natural gas contracts in an attempt to keep wellhead prices of gas at or close to market prices. Normally, these contracts are for many years or for the life of the well and these clauses attempt to avoid short-term contracts that, in today's market, might otherwise have to be renegotiated on a year to year basis.

Use of indefinite price escalator clauses are limited by existing law in Kansas. To nullify them completely would further distort market value versus prices received for natural gas.

We see a conflict with the Governor's office testimony yesterday. They don't support a price freeze as contained in HCR 5004 but support a price freeze as contained in SB209.

Atch. 2

If the intent of HCR 5004 were finally adopted, we would predict a curtailment of drilling and shortages would once again occur. Nullifying these contract provisions will result in premature abandonment of Kansas wells resulting in shortages and increased prices in the long run to consumers. Without strong incentive prices and assurances of a steady cash flow, producers will not take the risk to drill the wells. People that advance money for building pipelines to hook up these wells want to be assured of a steady flow of money.

The solution to the problem is not addressed in HCR 5004. The problem of today's price imbalance and conflicts in deliverability of natural gas still points at the Congress.

The NGPA of 1978 sets prices at a ceiling that have no relationship to the marketplace. Old gas, much of which is in Kansas is locked in at low prices indefinitely. We have gas below 20¢/mcf in Kansas when the national average for this type of gas is $1.35/mcf.

Additionally the Federal Industrial Fuel Use Act enacted in 1978 continues to severely restrict the use of natural gas in America. IOCC addressed this subject in New Orleans, with Governor Carlin present. We agree.

Most experts believe a general overhaul of the NGPA of 1978, the Fuel Use Act and decontrol of prices of natural gas would solve much if not all of the problems facing this industry, the consumer and issues contemplated in the future.

We ask you to not pass HCR 5004.

Donald P. Schnacke

Enclosures

RESOLUTION ON SURPLUS DELIVERABILITY OF NATURAL GAS

WHEREAS, the United States continues to import foreign fuels at high levels; and

WHEREAS, these imports are largely composed of oil which is being used in the nation's industrial sector because of the prohibition in the Fuel Use Act against the use of natural gas as industrial fuel; and

WHEREAS, there now exists a substantial surplus of deliverable domestic natural gas; and

WHEREAS, the Fuel Use Act's said prohibition is contributing significantly to this domestic gas deliverability surplus; and

WHEREAS, such surplus has caused both severe curtailment of production from existing wells and the inability of some new wells to obtain any market at all; and

WHEREAS, this situation threatens to cause premature abandonment of gas wells and their reserves, thereby resulting in physical waste, and it restrains the exploration for and development of new reserves; and

WHEREAS, use of natural gas for industrial purposes in lieu of other fuels has a positive advantage in terms of preserving environmental quality.

NOW, THEREFORE, BE IT RESOLVED by the IOCC that the Fuel Use Act should be amended to allow use of natural gas as an industrial fuel.

STAR BUSINESS

It's time to totally decontrol natural gas

Jerry Heaster
The Star's business & financial editor

Despite overwhelming opinion to the contrary, the time has come to completely decontrol the natural gas market. In fact, the time has never been better and logic and reason fairly cry for such a move.

This winter has been milder than anticipated so far and most consumers have had lower heating bills than were expected. The combination of warmer-than-usual weather and higher gas prices also has kept demand moderated and supplies plentiful.

With usage down and supplies up, these factors would serve to mitigate any sudden price jump created by total decontrol of prices. Moreover, deregulation in the last half of this heating season would allow the market plenty of time to adjust to the temporary shock of decontrol between now and the advent of the 1983-84 heating season.

Anyone who is skepitcal of this line of reasoning should try one last argument on for size: Regulation simply is not doing the job it was intended to do, which is to keep prices down.

Despite all efforts by Congress to protect consumers from price increases, natural gas lives an inflationary life all its own during a time of otherwise dramatic disinflation.

On the face of it, this alone makes a strong case for freeing the market.

A thorough review of the history of natural gas controls doesn't weaken the argument, either.

Natural gas has been regulated since 1938, when rates were fixed for those transporting and selling gas in interstate markets. In 1954, regulation of interstate business was extended to producers at the wellhead. The end result of legislating prices that were lower than the product's value was the disaster that befell consumers during the winter of 1976-77, when states dependent on the interstate market suffered two months of dangerous shortages that on occasion created potential life-threatening situations for residential consumers.

In an effort to encourage production, Congress went through an exercise in pseudo-deregulation that for all practical purposes made the problem worse by enlarging what was already a crazy-quilt price structure.

All this regulation has brought America from a situation where gas was cheap but increasingly hard to get to a situation where it's plentiful but difficult to afford. The next step, given regulation's result to date and political pressure for added controls, is gas that will be both expensive and in short supply—or the worst of all possible worlds.

Looked at another way, natural gas remains the only commodity under government controls and, wonder of wonders, it is the most confused and inefficient market in the American economy today.

All of which seems to argue persuasively for decontrol because as it stands now the U.S. marketplace hasn't the slightest idea of what the supply and demand factors are or what the true market clearing price is.

Until consumers, suppliers and producers know these factors with some degree of certainty, nobody can make any rational decisions as to whether being part of the natural gas market makes good sense as either a buyer or seller.

Most, however, seem to reject deregulation proposals because they are absolutely convinced that it will mean even higher prices.

But this seems a rather irrational view, considering what has happened when other markets have been deregulated—the most recent best example being the oil market. Since oil was deregulated two years ago, the price trend for all petroleum products has been a steadily downward one.

This has been the case even though oil price deregulation was opposed for years on the belief that decontrol would send prices through the roof.

The popular counter to that case in point, though, is to say the gas business is a much different animal than the oil business and thus more insulated from free market forces.

Well, of course it is. But that's not the same thing as saying natural gas is totally exempt from the law of supply and demand once everyone knows what the clearing price is and what the traffic will bear.

But a simple truth is fairly plain at this point: While consumers may not know what will happen to gas prices in the wake of decontrol, they do know the consequences of what happens with controls.

Working out from the knowledge of what control has wrought in the real world seems to acknowledge that controls aren't serving the consumer very well and haven't for more 45 years.

If reasonable minds accept such realities for what they are, it seems overwhelmingly logical to accept the notion that another approach to the natural gas market is at least worth a try.

This leaves only a totally free market because it's about the only thing that hasn't been tried yet. And the timing couldn't be better for such an experiment.