Approved February 17, 1984
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./~~XXX~~ on Wednesday, February 15, 1984 in room 123-S of the Capitol.

All members were present except:
Senator Paul Hess

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

Conferees appearing before the committee:
Jerry Pickerill, MAPCO Inc.

Senator Gordon moved that the minutes of the February 10, 1984 meeting be approved. Senator Werts seconded the motion, and the motion carried.

Chairman Angell told the Committee that the recent Attorney General decision regarding resolutions rejecting rules and regulations promulgated by agencies would affect S.B. 510 (pertaining to the State Water Plan). The Revisor advised he met with the Attorney General's office, and they had decided a better procedure would be to incorporate by reference by law rather than adopting a concurrent resolution because resolutions do not have the force and effect of law. Senator Werts moved that the Committee introduce a bill that will incorporate by reference the minimum streamflow element of the State Water Plan. Senator Rehorn seconded the motion, and the motion carried.

Jerry Pickerill discussed the complexity of the natural gas problem. He pointed out that anything done just in Kansas will be relatively ineffective because it is a national problem. He said there is both a gas glut and a gas shortage. Mr. Pickerill stated that at a given price, MAPCO can market all of the gas they can produce. They believe prices are ridiculously low in the Hugoton Field. The gas production market has been a regulated industry for over 45 years. He related that drilling has been done where the best price might be obtained rather than where the lowest price might be available.

Mr. Pickerill said MAPCO takes a position for total deregulation so that the free enterprise system can have a chance to work. They believe there will be adequate gas supplies at a price that is reflective of market price when this commodity is able to compete on the same level with other energy sources. Mr. Pickerill said there is an opposing view that decontrol will create a chaotic situation. He remarked that everyone agrees that there is a problem, the choice is whether to try to find a solution or to do nothing. He stated that information presented to the interim committee by the Kansas Geological Survey indicated that no one can say for sure what is going to happen under deregulation. Mr. Pickerill cited the decontrol of gasoline as being an indication of what would happen with decontrol of natural gas. He said that most informed sources believe that the present gas glut is a temporary situation and that within three to five years there will be a gas shortage. Mr. Pickerill said he has heard that the known gas reserves are equal to only 10 years of the country's needs. He said that the immediate effect of decontrol will be decreasing prices because gas contracts contain renegotiation clauses in the event of decontrol. This would mean that not only would Hugoton prices rise, but high-price contracts would go down. Mr. Pickerill said he is confident this would happen because his company has not waited on decontrol to have this effect; and he explained the workings of economic out provisions and minimum take provisions in gas contracts. They have voluntarily reduced their price to increase the take. Mr. Pickerill said that gas contracts are for a long period of time, such as 20 years, and it is expensive to build the facilities to produce that gas. Take-or-pay provisions allow a company to be sure they will recover a profit. Mr. Pickerill said they welcome the opportunity to compete in the marketplace.

Senator Rehorn asked questions about regulated monopolies. Mr. Pickerill replied that there are economic situations where a particular service is so crucial to the system that it must be controlled to avoid unfairness. Senator Rehorn asked what happens to the competitive picture if the control is by a very few companies. Mr. Pickerill pointed out that not only is the producer of the natural gas involved but also the transporter and the marketer. He agreed that MAPCO does have a vested interest in advocating deregulation but

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.

CONTINUATION SHEET

MINUTES OF THE Senate COMMITTEE ON Energy and Natural Resources,

room 123-S, Statehouse, at 8:00 a.m./XXXX on Wednesday, February 15, 1984

said they feel it would be good for the industry, Kansas and the nation. He said with decreased prices, their total production would be greater, allowing a greater profit. Mr. Pickerill said deregulation would also allow them to make a financial commitment because they would be able to plan 20, 30 or 40 years in the future. He noted that with the present situation, they are not certain whether they want to drill for gas or not.

Senator Feleciano asked questions about take-or-pay provisions. Mr. Pickerill said the cost for any gas paid for but not taken goes into the rate base at the time it's paid for, but when the gas is eventually taken and delivered, a year later or whenever, there is no charge to the consumer for that gas.

Mr. Pickerill discussed the recent Kansas Supreme Court decision that provides that royalty owners must be paid on the basis of the fair market value of the gas without regard to vintaging. He said in some cases this can mean that the price paid to royalty owners exceeds the price the producers receive. The case has been appealed to the U.S. Supreme Court but it has not been determined whether they will hear the matter.

The meeting was adjourned at 8:56 a.m. by the Chairman. The next meeting of the Committee will be at 8:00 a.m. on February 16, 1984.

Senate Energy & Natural Resources
Feb. 15, 1984

Name		Organization
Joe Hodges	Tulsa	Cities Service Oil & Gas Corp
Lon Stanton	Topeka	Northern Natural Gas Co.
Richard D. Kready	Topeka	KPL / Gas Service Co.
Richard C Byrd	Ottawa	Interstate Oil Compact Comm
Jim Collins	Tulsa	Cities Service O&G Corp
Dan Donahue	Plains	City of Plains
Brock Apfel	Tulsa	MAPCO
Paul E. Thornbrugh	Tulsa	Mapco
George A Sims	Hugoton	moki
Robert C. Anderson	Ottawa	[illegible]
D. S. Black	Topeka	KPL/Gas Service
Chip Wheelen	Topeka	KLPG
Jim Young	Oakbrook, Ill.	Waste Mgmt, Inc.
Melanie Cromwell	Lawrence	KU Energy Research
Walter Dunn	Topeka	EKOGA
Penny Plyjmann	"	KIOGA
Don Schnacke	"	"
Jerry L. Pickerill	Tulsa	MAPCO
Bill Perdue	Topeka	KPL/Gas Service
Glenn Cogswell	Topeka	North West Central Pipeline
Becky Crenshaw	"	Committee of Farm Orgs.
~~[illegible]~~ Martin	Topeka	KPC

Presentation by MAPCO Inc.
to the Kansas Legislative
Special Committee on Energy and Natural Resources

September 8, 1983

MAPCO is an integrated energy company with interests in Kansas which are, to us, substantial. We explore for, produce, market and transport oil and gas in Kansas. Particularly, we operate 45 wells in the Hugoton Field and own other production in that reservoir for a total annual production of approximately one billion cubic feet of gas per year. We own and operate other gas wells in Kansas and purchase gas produced by others. We are a common carrier for anhydrous ammonia and natural gas liquids, and are a gas pipeline carrier as well. We transport gas from Harrington to our fractionator at Conway, and from Southwest Kansas to Tyrone, Oklahoma. Our liquid pipelines run from El Dorado to Coffeyville, and we have main trunk lines running from Kansas to Nebraska and Missouri.

MAPCO appreciates the opportunity to appear before this Special Committee and present its views on the announced interest items of:

1. Increasing the taking and use of natural gas produced in Kansas; and,

2. Minimizing importation of expensive gas to Kansas consumers by limiting take or pay, favored nations, indefinite escalators and similar gas contract provisions.

While MAPCO fully concurs in and supports the statements made by Amoco and KIOGA, we believe it important to accept your invitation and speak out on what we consider to be very vital issues. You will, of course, be able to anticipate exactly what our position is on these matters.

It has been especially impressive to attend the Committee's efforts to become knowledgeable as to the intricacies of gas production, marketing and transportation. The expert testimony presented by the staff in yesterday's session was not only comprehensive, but pointed out what a complex matter we are dealing with. It seems clear that Kansas is not in a vacuum, and that any regulatory or legislative action may not have the response intended. It is apparent that much of the gas problem lies within federal jurisdiction and is beyond control of this Committee. It is important that we identify where we are, why we are here, and what can be done about it. Obviously, this Committee must focus on the latter point, but the evidence available so far indicates a total lack of unanimity on any of those issues.

As to where we are, we hear there is a gas glut in some areas of our state and our country, and yet we hear there is a gas shortage in other areas. We hear prices of gas are too low, as they obviously are in the Hugoton Field, and we hear gas prices are too high to the consumers in Kansas.

As to why we are where we are, some argue, as MAPCO does, that it is the inability of free enterprise to work, in that gas production, marketing and transportation have been regulated by state and federal government for over 45 years, creating artificial prices and artificial supplies. Others take the position that the situation results from failing to control producers, transporters or distributors so that contract terms may come into being which affect the end consumer adversely.

As to what should be done, some see the solution, as MAPCO does, in total deregulation. The removal of controlled pricing will allow the supply/demand curve to function so that our country will have adequate gas supplies when it needs them, at prices reflective of the market value. Deregulation will result in lower future prices. The alternative view is that decontrol of gas will create a chaotic situation, will release the cheaper old gas market and will not relieve the perceived monopoly of the pipelines. Deregulation will result in higher future prices.

While there are arguments to be made on either side of these issues, it is true that Kansas has cheap gas available at Hugoton, and that its consumers are paying relatively high prices. But what is the problem? The low prices being received at Hugoton, or high prices being paid in Kansas City? Would we be meeting today if the Hugoton prices were in line with the average national price? Probably not. It is this artificial disparity that creates an appearance of relative inequity.

Deregulation of old gas in Hugoton must be accomplished at the federal level, of course, so there is nothing the Kansas legislature can do to increase the price of that gas. But it is at least interesting to speculate what results would follow if total deregulation occurred so that this legislature can consider whether it should attempt its own regulation.

MAPCO firmly believes that total deregulation is necessary, of old and new gas, as quickly as possible to allow gas to seek market level conditions. As was evident from the economic testimony presented by the Kansas Geologic Survey, no one can with certainty say exactly what results will follow or how long it will take for the effects of 45 years of control to dissipate. We do have a very good example, however, in the decontrol of oil prices. There were serious forecasts of economic disaster including gasoline shortages and cold winters for our citizens if oil prices were allowed to meet market demand. We now know this was the wisest action our country could take; crude oil prices and all of the products made from crude oil have fallen, including gasoline. This has been the single greatest factor in removing the hands of the OPEC nations from our energy throat.

MAPCO believes decontrol of gas will have equally beneficial results. Whatever the present situation is as to gas surpluses, most informed sources know that the condition is temporary. We are in transition and within two or three years the need for gas supplies will re-occur and deregulation will allow producers to develop reserves for real markets, not markets created by an Act of Congress. While decontrol may not affect some gas sales contracts, our experience is that most contracts contain clauses providing for renegotiation of the gas price in the event of deregulation. This sword cuts both ways, giving gas purchasers an opportunity to reduce high prices and, therefore, their take-or-pay commitments, and allowing producers who have been prohibited from receiving market value for their product to do so. We believe the end result will not be an increase in the average price of gas, but a decrease. We also believe the effect will be rather immediate due to the renegotiation clause.

You should be aware that industry has not waited on deregulation to let the market place work. MAPCO's experience is that gas purchasers have been able in many cases to handily deal with obtaining lower prices, even in the face of take-or-pay provisions. It must be remembered that a gas contract is a voluminous document containing numerous provisions as to gas quality, quantity, price, deliverability, minimum takes, and economic out or market out clauses as well as take-or-pay provisions. As an aside, it would be a very rare contract submitted by a gas purchaser today which contained an enforceable take-or-pay provision. MAPCO, as other companies, must maintain an adequate cash flow and must sell its gas, not leave it in the ground. Gas purchasers have two formidable weapons to negotiate with, one being the economic out clause, the other being the minimum takes. A producer's market is a limited one by the nature of our business, and it is usually effective for the purchaser to give two equally undesirable alternatives: Either reduce the price or the contract will be deemed unecomic. If the contract is not declared uneconomic, then the minimum take provisions are enforced. No minimum take provision equals the deliverability or the capacity of a gas well to produce its allowable. The results have been a strong downward pressure on gas prices which will continue under deregulation.

Take-or-pay provisions have been criticized and, in fact, blamed for higher gas prices. This is invalid. In the first place, gas paid for but not taken is there, in the ground, waiting to be produced in a later period at no cost. The price paid by the purchaser is not a higher price but is the exact price agreed to in the contract. Take-or-pay provisions do not affect the overall price paid by the consumer. Any prepayment increments are returned as reductions when the gas is taken. On the other hand, a producer is expected to enter into a long-term sales agreement, committing the gas reserves for the entire life of the field to a single purchaser. It is not unreasonable for that producer to require a minimum sale for his product, in the same fashion that public utilities require minimum bills for consumers.

All the risk of finding and producing the gas reserves is on the producer, who cannot include the cost of the dry holes drilled in the price of the gas that may otherwise be discovered. Similarly, the expense of drilling the producing wells must be recovered by the producer, and take-or-pay provisions make the development of these energy assets feasible. We come back to free enterprise and the reasonable expectation of a profit from capital investment in the market place.

These are effects of artificially high gas prices which go beyond the gas prices paid by consumers for heating and light:

1. Studies tell us that the basic alternative fuel in lieu of gas is fuel oil, a product made from crude oil. The high price gas encourages movement to this alternative fuel and disadvantages our country as to oil imports. It is reported that for every trillion cubic feet of gas used, we displace one-half million barrels of oil which we would not have to import.

2. We not only have competing gas imports from Canada and Mexico, including Canadian gas with a statutory minimum price at the border in the neighborhood of $4.50, but cheaper products of gas including ammonia utilized in fertilizer production. This import of a gas product utilizing cheap foreign gas has severely affected our fertilizer manufacturing industry as well as the gas producers who supply the feed stock for that product.

3. Locally, in the Hugoton Field, the disparity of gas prices has had an adverse effect on certain producers because of a recent Kansas Supreme Court decision in the Metzen case. For those producers having a market value royalty clause in the lease, the court has held the royalties must be calculated on the highest price paid for gas in the field. This is true regardless of the price received

by the producer and regardless of the vintaging price restriction imposed by FERC under the NGPA. A producer may not legally charge a higher price, but is required by the Kansas Court to calculate royalties as if he could. There is not much incentive for a producer to seek greater production from the Hugoton Field when the net received is only a fraction of a cent after royalties.

In summary, MAPCO believes total decontrol of gas would increase gas takes and gas usage in Kansas. That belief is qualified to the extent that unfavorable taxes or restrictive production regulation make searching for gas in Kansas less opportune than other producing states.

MAPCO believes that decontrol will minimize the import into Kansas of expensive gas, because there will be effected a leveling of the national gas price and greater competition in the free market. MAPCO may not be Exxon, Amoco or Texaco, but we are willing to compete in the marketplace on equal terms. We only ask for the opportunity to do so.

Thank you for giving us this opportunity to address this important topic.

Jerry L. Pickerill
Assistant General Counsel
MAPCO Inc.

JLP:bab

cc: P. E. Thornbrugh
D. Grounds