Approved: 3-18-96
Date

MINUTES OF THE SENATE COMMITTEE ON ENERGY & NATURAL RESOURCES.

The meeting was called to order by Chairperson Don Sallee at 7:30 a.m. on March 14, 1996 in Room 254-E- of the Capitol.

All members were present:

Committee staff present: Raney Gilliland, Legislative Research Department
Dennis Hodgins, Legislative Research Department
Ardan Ensley, Revisor of Statutes
Clarene Wilms, Committee Secretary

Conferees appearing before the committee:
William J. Wix, Assistant General Counsel, Kansas Corporation Commission, Conservation Division
Montgomery S. Escue, Vice President, First National Oil Co., Inc.
Jack Glaves, Panenergy Corp.
Joe Staskal, Williams Field Services
Don Schnacke, KIOGA
Ron Hein, MESA Gas Company
David Pierce, Professor, Energy Law, Washburn University, representing Allied Small Producers and Consumers
Anne Spiess, representing Gary Post, Seward County Appraiser
Gene Smith, Liberal

Others attending: See attached list

SUB 2613--concerning disposition of moneys recovered by the state in certain litigation; establishing the interstate water litigation fund and the water conservation projects fund

The Chairperson reminded committee members that a motion by Senator Vancrum, seconded by Senator Emert was before them when the March 13, 1996 meeting adjourned. The motion would amend page 3, lines 28-30 that the balance of funds remaining after mandated reimbursements are made go entirely to the state water litigation fund.

Discussion expressed concern that people and groups who had given money toward the litigation be reimbursed for their expenses prior to anything else taking effect. Several members voiced support for the amendment noting the attitude of Nebraska appeared to reinforce the thought that the state could be in litigation concerning the Republican River Basin.
Senator Emert made a substitute motion to pay the Association of Ditches first, then the State General Fund for Attorney fees and then pay litigation expenses. Senator Tillotson seconded the motion.

A member commented that this amendment would strip the bill since all it deals with are litigation expenses. The question arose as to why such a bill was being dealt with since settlement had been determined and there were no moneys to receive. A comment was made that going 75/25 would establish the perception that the funds would be returned to the damaged area for use.

Discussion included an effort to clearly set forth just what the bill does and how the funds would be handled. It was stated that the first step would be to use the money to pay back the Association of Ditches that helped the state financially. Secondly the money would go into a litigation fund to be available to the Attorney General's office in the event there is need for future water litigation issues. At the end of five years the remaining money would go back to the State General Fund. Thirdly, part 2, section 3, number 2 page 3 will take effect which states that 50 percent will be credited to the State Water Plan Fund and 50 percent shall be credited to the State Water Conservation Fund. This third area would be the one from which to put money back into the general fund. It was noted that if the concept of the money being diverted, that is 25 percent of recovered litigation costs going to water conservation projects funds was not favored, a vote should be made against the bill. The way the bill came from very of litigation costs.

The substitute motion failed.

The original motion failed.

Senator Morris moved to amend **SUB HB 2613** with 75 percent of the remaining funds going to water conservation projects and 25 percent to the general fund. Senator Hardenburger seconded the motion. With the agreement by the second Senator Morris changed the amendment to send 25 percent to the State Water Plan. The motion carried.

Senator Lee moved to report **SUB HB 2613** favorable as amended. Senator Hardenburger seconded the motion and the motion carried.

HB 2477--Relating to boating; prohibiting certain acts and providing penalties for violation

The Chairperson stated this bill had been amended into another bill late in the 1995 session and was no longer needed.

Senator Lee made a motion to kill **HB 2477**. Senator Tillotson seconded the motion and the motion carried.

SB 667--Relating to big game permits

Senator Wisdom stated this bill would allow land owners to request two permits from the Department of Wildlife and Parks which could be assigned to anyone he wants as long as said person has drawn a tag from the regular drawing. This would allow the land owner to have control of deer on his land.

Senator Wisdom, with a second from Senator Emert, moved passage of **SB 667**. The motion carried.

HB 2041--Concerning oil and gas; relating to natural gas gathering systems and underground storage facilities; providing for licensure and regulation of certain entities

Montgomery K. Escue, Vice President, First National Oil, Inc. appeared in opposition to **HB 2041** stating there are claims made that there is competition in gas gathering but that is not correct (Attachment 1) Mr. Escue stated that Commissioner McKee, in an August meeting, had stated Kansas is a mature state as far as gas fields are concerned and that the incentive for producers to develop more wells is limited due to economic inefficiency. He stated that irrigators or royalty farmers do not have the money to hire an attorney to represent them before the KCC to fight major pipelines. The conferee stated that there are abuses going on in the field, some of which are listed in Attachment 1. Mr. Escue stated a need to curb short cut-off notices along with numerous other problems with **HB 2041**. He expressed the opinion that this issue should first be examined to determine what we have before changing the law.

William J. Wix, Assistant General Counsel, Conservation Division, KCC, presented testimony in support of **HB 2041** (Attachment 2). In testimony Mr. Wix provided a history of the Federal Energy Regulatory Commission over a number of years noting a move toward deregulation of the natural gas industry in 1985 which has continued up to the present time. Mr. Wix stated the primary purpose of **HB 2041** was to expand the definition of "operator" to include "operators of gathering systems as well as defining gas gathering services". Additions were also added to the definition of "contractor". This bill would specifically exempt gas gathering systems from the definition of "public utility" insuring that such systems would not be regulated in the same manner as other public utilities.

Mr. Wix told the Committee that a generic docket was opened to hear testimony with public hearings held in Wichita, Liberal and Chanute and subsequently a report was furnished to the Legislature on March 1. A summary of the generic docket is included in Mr. Wix's testimony. This bill would prohibit any person performing gas gathering service for hire from charging any fee or engage in any practice which is unjustly or unlawfully discriminatory. Also, any person seeking gas gathering service who is aggrieved by an unjust or unlawful fee or practice would be able to file a complaint with the KCC. Mr. Wix stated the KCC believed the proposal to be middle ground. A bill balloon was also presented and is shown as Attachment 3.

Jack Glaves, PanEnergy, appeared concerning **HB 2041** stating support with some reservations (Attachment 4). Mr. Glaves expressed concern lest an open-ended, undefined, regulatory regime be substituted for the "light-handed" complaint type regulation originally envisioned by the original **HB 2041**. Attention was called to amendatory language for **HB 2041** found in Mr. Glaves' written testimony, also where it would be placed in the balloon bill.

In discussing the balloon bill presented by the KCC Mr. Glaves commented that it must be established that the

system could accommodate the gas that is desired to be transported and gathering is not required to extend or expand facilities in order to provide a service. This condition is spelled out in the Oklahoma statute.

Joe Staskal, Williams Field Services Company, appeared concerning **HB 2041** stating Williams Field Services Company supports a case by case complaint mechanism for the purpose of gathering regulation (Attachment 5). He noted his company would like protection for existing contracts added to the Commission proposal to be consistent with their stated intent. Mr. Staskal stated the belief that the legislature could solve potential problems by limiting the Commission's authority over existing contractual relations.

Donald P. Schnacke, KIOGA, appeared in support of **HB 2041** stating it appeared adequate material has been presented allowing passage of meaningful legislation to protect the independent gas producers when dealing with gas gathering entities (Attachment 6). Mr. Schnacke's testimony made other suggested changes to the bill.

Ron Hein, MESA, appeared in support of **HB 2041** reiterated concern previously expressed at hearings, namely, that if the KCC has the ability to set rates, even on a complaint basis, that after contracts have expired, there will be an encouragement for producers to take the issue to the KCC to seek the rate which has been approved as reasonable under similar factual circumstances under earlier complaints before the KCC (Attachment 7).

Mr. Hein proposed the KCC language be modified to provide that any gas gatherer whose gas gathering pipeline is used more than two-thirds for the gas gathering of their own gas would be exempt from the Commission's jurisdiction.

David E. Pierce, Professor, Washburn Law School, appeared on behalf of Allied Small Producers and Consumers ("Allied") presented testimony in opposition to **HB 2041** (Attachment 8). Allied opposes the approach to the gas gathering regulation recommended by the KCC. Allied supports the Legislature taking no action on this matter at this time supports relying upon existing law.

Mr. Pierce asked the Committee to give the industry and the KCC a chance to operate under the same monopoly-regulating regime that has been effectively used in Kansas since 1911, that is a case-by-case application of existing authority.

Anne Spiess appeared representing Gary Post, Seward County Appraiser, and presented testimony expressing concerns of Seward County concerning the regulation of gas gathering systems as proposed in the KCC report to the Committee (Attachment 9). Mr. Post expressed concern that gas gathering charges will adversely impact the ad valorem tax value of gas in Seward and surrounding counties. Attachment 9 includes a report by Ron Cook, a Petroleum Engineer made for Seward and Morton Counties and presented to the KCC on January 10, 1996.

Gene Smith, Liberal, appeared concerning **HB 2041** stating that Kansas has statutes on the books which provide for regulation of all pipelines, all that is needed is a willing KCC to enforce the laws. This bill would restrict the KCC in fulfilling their duties. Historically these issues were handled by just and reasonable approach as does present law. Mr. Smith urged the Committee not to pass **HB 2041** in its present form.

The Chairperson appointed Senator Morris to chair a Sub-Committee to put together a commission to further study **HB 2041** with Senator Hardenburger and Senator Lee to serve on that committee. This Sub-committee will attempt to report to the Committee by Tuesday, March 19, 1996.

The meeting adjourned at 9 a.m.

The next meeting is scheduled for March 15, 1996.

SENATE ENERGY & NATURAL RESOURCES COMMITTEE GUEST LIST

DATE: March 14, 1996

NAME	REPRESENTING
Karl Landis	Western Resources
Dave Hitchens	Western Resources
Whitney Damron	Anadarko Petroleum Corporation
Jack Glaves	Pan Energy Corp.
Anne Spiess	Ks. Assoc of Counties
Joe Staskal	Williams Field Services
DAVID B SCHLOSSER	PETE McGILL & ASSOC.
Ron Hein	MESA
KEVIN HOWERTSON	ENRON CORP.
Lee Ralph	DWR - KDA
MIKE HEIM	WESTERN RESOURCES
DAN STEVENS	TEXACO INC
DAVID PIERCE	ALLIED SMALL PRODUCERS AND CONSUMERS
Ron Hammerschmidt	KDHE
Nancy Heinz	KCC
Bill Wix	KCC
TOM DAY	KCC
MONTGOMERY ESCUE	FIRST NATIONAL OIL
John Campbell	AG

SENATE ENERGY & NATURAL RESOURCES
COMMITTEE GUEST LIST

DATE: March 14, 1996

NAME	REPRESENTING
Don Schmaltz	ICIOGA
TERRY HOUDEK	
Jack Dale	
Kent Brosnahan	

BEFORE THE KANSAS CORPORATION
HEARINGS ON NATURAL GAS GATHERING
DOCKET NO. 193,135-C (C-27,760)

TESTIMONY OF MONTGOMERY A. ESCUE, VICE PRESIDENT
FIRST NATIONAL OIL, INC.

Commissioners:

My name is Montgomery Escue, and I am Vice President of First National Oil, Inc., a small family-owned oil and gas exploration company. My father, Nelson B. Escue, started the company more than thirty years ago here in Liberal, Kansas. We currently own and operate approximately 75 wells in Southwestern Kansas.

I am here to testify today as to a few of the problems and frustrations my company, along with other independent producers, have experienced in our pursuit to obtain a fair and equitable transportation (gathering rate) rate from pipelines. I am raising these issues and problems in the hope that this Commission will realize that while the pipelines are requesting a light-handed approach to regulation, they are utilizing heavy-handed policies and tactics to control and manipulate huge profits from their monopoly position. All of this is being implemented at the expense of my company, other independent producers, family farmers (irrigators), royalty owners and the Kansas tax payers.

Pipelines Monopolize Volumes of Gas on Their System Through Corporate Affiliations and Mergers

In the spring of 1994, First National Oil was contacted by Centana Gathering Company, a division of Centana Energy Corporation, which is owned by Panhandle Eastern Corporation. Centana Gathering Company, aware of the spin-down of the gathering systems from the FERC, represented that they were to be the new owners of the gathering system that was to be spun-down by Panhandle Eastern Pipeline Company upon final FERC approval. At this time, Centana was only interested in purchasing our gas under a percent of proceeds contract, not in providing transportation services.

When we inquired as to a straight, fixed gathering fee for transportation of gas, Centana declined to offer such service. After further investigation, we found that Panhandle Field Services, another affiliate of Panhandle Eastern Corporation, was to be the true owner of the gathering systems.

When First National Oil refused to execute such a gas purchase agreement, Centana Gathering Company advised us that if we did not sign up, we would be subject to whatever gathering rate they felt the cost of service warranted once they had final approval from the FERC to spin-down. During this time, Panhandle Field Services remained silent and did not provide a gathering rate for shippers or producers.

Senate Energy & Natural Res.
March 14, 1996
Attachment 1

While Centana Gathering Company was out securing supplies, all other purchasers and shippers were not able to compete with Centana Gathering Company for volumes of gas because they did not know what it was going to cost them to gather gas. So during the waiting period for the FERC to give final approval of the spin-down, Centana Gathering Company was out securing long-term contracts from producers by threatening sharp increases in gathering rates and disruption of service, while no one else could offer competition.

During this time, First National Oil was unable to get direct and forthright answers to our questions regarding the actions of Panhandle Field Services, Centana Gathering Company, Centana Energy Company, Panhandle Eastern Pipeline and National Helium, again all belonging to Panhandle Eastern Corporation.

In frustration to the evasiveness of our questions and the heavy-handed tactics used by this pipeline, for the first time in its history, First National Oil turned to the Federal Energy Regulatory Commission (FERC) for help. First National Oil intervened in the Panhandle Eastern Pipeline's spin-down proceedings raising many concerns. A few of them are as follows:

1. **Affiliate relationship and abuse of that relationship to eliminate competition.** (referenced above)

2. **There is no competitive alternative for gathering.**

   One would want to be cautious when hearing pipelines testify that there is competition in gathering. Enron (Northern Natural) testified before the Special Committee on Energy and Natural Resources that there was competition in gas gathering and provided three examples of competition for 3 different volumes of gas. I have had the opportunity to visit with the representatives for each one of the companies used in their examples. It turns out that the volume of gas used in each example was approximately 1 million cubic feet of gas per day with good, if not excellent, processing value. Two of the companies' representatives made the statement that they wished there was competition for their other wells.

3. **Discrimination against low BTU gas wells.**

   The pipelines state that low BTU gas has a limited value and it is my understanding some pipelines are talking about a conditioning charge for this low BTU gas so that it meets pipeline quality standards. Please note that Mr. Eugene Smith had a BTU map of the Hugoton Field that he presented with his testimony before the Special Committee on Energy and Natural Resources. This map shows that approximately 30% of the wells in the Hugoton Field have low BTU gas. This could be as many as 1400 wells. My point being is that this gas has been flowing through pipelines since before the 1950s and there has never been a problem.

4. **Discrimination against low volume wells.**

Gathering rates are higher on low volume wells. Pipelines argue that high volume of gas should have discounts. Natural gas should be like apples. The price for the apples should be based on the quality of the apple you sell. Transportation should be equitable.

We brought forth all of these issues before the FERC and were consistently directed to the state for remedy. This Commission has testified before the FERC and expressed that it is explicitly interested that gas gathering services are not abusive. I have been told by the KCC staff that they do not have authority to regulate gas gathering, and therefore has proposed H.B. 2041.

However, this Commission has had two experts in energy and regulatory law give very compelling testimony that this Commission has the authority and the duty to regulate natural gas gathering.

House Bill 2041 has a host of problems that have been pointed out by me and others during earlier hearings, but I would like to address the most burdensome problem of H.B. 2041.

THE COMPLAINT PROCESS

The complaint process is economically discriminatory to the people it is intended to serve. It is simply out of the financial reach of independent producers, irrigators and royalty owners. I am still wondering how the county would be a complainant if it is losing tax dollars due to excessive gathering rates charged by the pipelines.

In closing, I would like to propose the following:

1. KCC ENFORCE CURRENT LAW BY REQUIRING COMMON CARRIER GAS PIPELINES TO OBTAIN CERTIFICATES AND FILE A SCHEDULE OF JUST AND REASONABLE TRANSPORTATION RATES.

2. CONDUCT EXTENSIVE FACT FINDING STUDIES CONCERNING NATURAL GAS TRANSPORTATION.

3. PROVIDE FOR GENUINE NON-DISCRIMINATORY OPEN ACCESS TO TRANSPORTATION SERVICES AT UNIFORM, FAIR, JUST AND REASONABLE RATES.

I truly the time and effort you have put forth to have these hearings here in Liberal.

Respectfully submitted,

Montgomery A. Escue

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BEFORE THE SPECIAL COMMIITTEE ON ENERGY AND NATURAL RESOURCES
AUGUST 23, 1995
TIMOTHY E. McKEE

Mr. Chairman, Members of the Committee:

First, I would like to thank you for the opportunity to appear before you. My name is Tim McKee, I was recently appointed by Governor Graves to the Kansas Corporation Commission. I have practiced law in Wichita for approximately 25 years with an emphasis on energy and natural resources issues for approximately 20 years.

I am appearing today with respect to the Kansas Corporation Commission's position with regard to gas gathering issues including House Bills 2041 and 2097 and to attempt to answer any questions you might have.

As you may recall my predecessor, Rachel Lipman appeared before you on January 23, 1995 and generally supported what I understand to be H.B. 2041 (hereinafter H.B. 2041) or its predecessor.

As the representative of the Commission on this issue we want the Committee to understand that the general philosophy of the Commission is not to regulate every aspect of the gas gathering. Generally we believe that if a producer and a gas gatherer are able to reach an agreement on a contractual basis which is working, we should not be involved in regulating their relationship.

We do believe that it would be beneficial for the Commission and the State of Kansas to have technical information about all the gathering systems in the state such as the their size, location and other data. However, beyond the registration and the listing of the gathering entities and their systems, we believe that if parties are operating on a consensual basis with regard to

gas gathering, the Commission should not lay the heavy hand of regulation on them.

With that said, however, we do believe that there will be instances where the Commission will be called upon to and should have the power to regulate in the gas gathering arena. As you were told by Ms. Lipman in January of 1995, Federal Energy Regulatory Commission ("FERC") indicated in May, 1994 that the states were free to regulate gas gathering. FERC also required that gas gathers have a FERC approved contract form in place to cover a 2 year period. This was a part of the general deregulation of the natural gas industry and including natural gas transportation divided or broken down into its component services. The decision of FERC to vacate the arena of gas gathering regulation is on appeal in U.S. Ct. of App. DC Circuit; Case No. 94-1724.

There is little if any question that the states have the authority to regulate gas gathering under Section 1(b) of the Natural Gas Act which specifically provided in pertinent part that the Act ..."shall not apply... to the production or gathering of natural gas." 15 USC S. 717(b)(1988).

The case law on this particular issue is also clear in providing that the states have authority over gathering as it relates to their traditional role of conservation and protection of correlative rights. See Colorado Interstate Gas Co. v. FPF, 324 U.S. 581(1945), and FPC v. Panhandle Eastern Pipeline CO. 337 U.S. 498(1949).

We are still in a transitory time period where certain gathering systems that were formally owned by interstate natural

gas pipelines are being spun down into subsidiary corporations or other affiliates of the interstate systems and others are being sold to third parties.

Thus, I believe that we will find ourselves presented with a mixed bag of cases where parties are unable to enter into contractual arrangements for various reasons and/or their current contractual arrangements, which may have been approved by FERC during this transition period, expire and the parties are unable to enter into new agreements.

Due to the nature of the production of natural gas, unlike oil, which cannot be produced to the surface and transported away from a lease in a truck, an entire system of gathering lines, dehydration, compression and main-line transmission is necessary to bring the natural gas to the surface and then ultimately to market. There could be many instances where there is little if any discretion on the part of the producer in selecting a gathering system to transport the gas to market.

In Kansas, we are generally in a mature state of natural gas industry. For example, the Hugoton Field is approximately 2/3 of the way through its productive life and the gathering systems are fairly well established.

There are not many new significant reservoirs being discovered is this state and thus the gathering systems that are in place are generally of some vintage with little producer discretion in selecting among or between gathering systems. Also because of the mature state of our reservoirs, there is often little incentive for gatherers to construct new systems which might provide alternatives for gathering. Simply stated, if the reservoirs are not large or are well into their productive life there is not sufficient economic incentive for a new gathering

system to be constructed. On the other hand, if a producer were fortunate to find a new reservoir that would justify the construction of a gathering system, once that system is in place there is very little discretion in switching to another system because no other gatherer will go to the trouble and expense of constructing to a well or series of wells once a system has already been constructed.

It is my view that the Corporation Commission should not regulate the daily activity of gatherers and producers as long as they have entered into a contract and are able to maintain that contractual relationship. However, I believe that the Commission should be granted sufficiently broad authority to be exercised upon the filing of a complaint, such that the Commission can thoroughly investigate and will have the power to remediate those situations where there is an unlawful, unreasonable or unconscionable fee or service.

Under a recent decision of Tucker v. Hugoton Energy, 253 KAN. 373, 855 P.2d 929 (1993) our Kansas Supreme Court has directed that when a producer has any market, whether or not he likes the market, he is required to produce his gas rather than shut-in his well. Thus, caught between no choice as between gatherers and the requirement of the production of gas to satisfy the oil and gas lease, the producer can be in a very untenable situation.

This leads us to the consideration of House Bills 2097 and 2041. As you know Article 66 of the Kansas Statutes Annotated has historically contained a broad grant of authority to the Corporation Commission for purposes of regulating public utilities including ratemaking powers. Under Article 55 the Commission is granted broad authority under the Conservation Act to protect correlative rights and prevent waste of economic and natural resources in the production of oil and gas. I believe that the

Legislature is on the right track in creating a statute such as H.B. 2041 granting the Commission regulatory authority over gas gathering under Article 55. I believe that is the correct procedure because gas gathering should be tied to the conservation powers of the Commission as is contemplated under the exception of Section 1(b) of the NGA as it relates to "to the production or gathering of natural gas."

However, I believe there are several technical problems with H.B. 2097 and H.B. 2041, which I will cover in a moment, but, more importantly I believe that there is a potential problem with the source or location of the authority granted to the Commission.

My concern is that under H.B. 2041 gas gathering services are proposed to be regulated by the Kansas Corporation Commission in those instances where the Commission receives a complaint, and after appropriate notice and hearing determines that there is an unjust or unlawfully discriminatory fee or practice. The Commission has authority under this bill to order remediation in those circumstances. The problem however is that with this grant of authority under the Conservation Art. 55, a reasonable argument can be made that the Commission lacks the authority to investigate and, more importantly, to enter an order concerning the fee or the rate charged for gathering. The question is whether the Commission has the appropriate grant of authority to set rates or set fees for gathering under Article 55 that it would have if it were granted such authority under Article 66.

The second problem I observe with H.B. 2041 is the standard of finding the service or the fee unlawfully or unjustly "discriminatory." It appears to me that one can find a service or a fee to be unlawful or unreasonable or unjust and not have any discrimination involved. For example, a gathering company could offer to render gathering services to all of the producers on its

system on the same terms but those terms could be confiscatory or unjust or unreasonable. There would not be any discrimination here. Simply because, as I have noted, there may not be any discretion in seeking another gathering system, the producers then are faced with the decision to either not produce their gas or produce it and paying an unreasonably high gathering fee.

Also, there is a technical or structural problem as between H.B. 2041 and H.B. 2097. If you will examine H.B. 2041 and H.B. 2097 you will observe that 2097 excepts from the public utility definition "gas gathering pipelines" and then defines gas gathering pipeline under Section 1(b). However, H.B. 2041 defines gas gathering system and the definition of a gas gathering system is not the same as a gas gathering pipeline under 2097. Also House Bill 2041 defines gas gathering services without any apparent references to a gas gathering system or pipeline. Attached to my testimony is Exhibit "A" which is a comparison between the definitions of a gas gathering system and pipeline as found in 2097 and 2041. My point simply is that there should be a common definition as between these two statutes.

In my opinion the Corporation Commission should have a rather broad grant of authority to regulate gas gathering systems or pipelines in those instances where the producer and the gatherer are unable to enter into a contractual arrangement. The powers of the Commission should be broad enough to include the ability to thoroughly investigate and resolve all complaints (whether discrimination is present or not) and should include such powers as are necessary to establish a rate or a fee for a gas gathering service that is just and is reasonable. I do not believe that Legislature should automatically designate every gas gathering

system in the state a public utility or that they should all be required to file tariffs. Generally, I would think that as long as the parties have entered into a contract the Commissions should not regulate them. If they have a dispute with respect to their contract they can seek resolution of that through the Courts of general jurisdiction.

Because gas gathering is an integral part of the entire conservation business of the Commission and an essential link in providing reliable and reasonably cost energy services to the citizens of this state and the nation, the Legislature should not leave the Commission handcuffed with respect to its regulatory power. There is no question that gas gathering has an essential role in the production process and therefore an impact on correlative rights and possible waste of natural and economic resources.

Thank you for allowing me to address the Committee today, if there are any questions, Mr. Chairman, I will be pleased to respond.

(d) "Gas gathering system"*(pipeline)* means a ~~pipeline that transports natural gas from a central metering point for natural gas produced by one or more wells to the point of compression or entry into a sales or transmission point~~ natural gas pipeline system used primarily for transporting natural gas from a wellhead *(well-head)*, or a *(central)* metering point for natural gas produced by one or more wells, to a point of *(compression)* or entry into a main transmission line.

* Words in brackets and italics --language use in Bill 2097
Remainder language taken from Bill 2041

Kansas Corporation Commission

Bill Graves, Governor Susan M. Seltsam, Chair F.S. Jack Alexander, Commissioner Timothy E. McKee, Commissioner
Judith McConnell, Executive Director David J. Heinemann, General Counsel

MEMORANDUM

TO: Pat Saville, Secretary of the Senate
Janet E. Jones, Chief Clerk of the House of Representatives
Chairperson Don Sallee/Senate Committee on Energy and Natural Resources
Chairperson Carl D. Holmes/House Committee on Energy and Natural Resources
Janis Lee, Ranking Minority Member/Senate Committee
Robert Krehbiel, Ranking Minority Member/House Committee

FROM: Chair Susan M. Seltsam
Commissioner F.S. Jack Alexander
Commissioner Timothy E. McKee

DATE: February 29, 1996

RE: Gas Gathering Report

Pursuant to Senate Concurrent Resolution No. 1613, this memorandum shall serve as the report regarding possible regulation of natural gas gathering systems within the State of Kansas.

Historically, with minor exceptions not important here, the Federal Energy Regulatory Commission ("FERC") has dominated the field of regulatory jurisdiction over natural gas. Under this regulation, most interstate pipelines were considered wholesale merchants of natural gas. As merchants, the pipelines could sell "bundled services" that included both the commodity (gas) and the transportation of that commodity. In 1985 FERC initiated the move toward deregulation of the natural gas industry by the issuance of Order No. 436. In that Order FERC began to change the concept of operators of interstate natural gas pipelines as merchants and made them transporters of natural gas. The result was that large industrial customers and local distribution customers were permitted to acquire their own supplies of gas and to arrange for the transportation of those supplies on interstate pipelines.

FERC proceeded to further deregulate the natural gas industry by issuing Order No. 451 which had a significant impact on the natural gas fields in Kansas. The Hugoton Field is the largest known gas field in North America. Order No. 451 allowed producers that were tied to specific pipelines under long term contracts to obtain a release from the pipeline and sell directly to large users.

In 1992 FERC issued Order No. 636 which was designed to mandate total unbundling of the transportation of natural gas from the wellhead to the city gate or town border station. Under that Order, pipelines were required to divide their services into parts such as gathering, storage, and transportation. Once gas gathering became a separate service many pipeline companies began to spin off their gathering systems into separate subsidiaries or to sell them to third parties. Previously, gas gathering was considered to be an integral part of interstate pipelines and therefore was regulated at the federal level by the Federal Power Commission and later the FERC.

In May of 1994, FERC issued a series of decisions which held that if a pipeline spun off its gathering facilities to a subsidiary and if the subsidiary was truly operated as an arm's length affiliate of the interstate pipeline, then FERC would no longer exert jurisdiction over gathering rates. Similar treatment was given to systems which were sold to unrelated parties by the pipelines. FERC also indicated that states were free to exercise jurisdiction if they so desired. FERC provided for a two year time period which would enable states to make the necessary legislative changes to begin state regulation of gathering systems. Recent comments from the Commissioners of FERC indicate that they are somewhat dismayed that the states have not been more aggressive in drafting such legislation.[1] Specifically, Oklahoma is the only state to date which has adopted legislation to deal with the regulation of gathering systems.

During the 1995 Kansas legislative session H.B. 2041 was introduced and amended by the House of Energy and Natural Resources Committee. This Bill was introduced at the request of the Commission. The Bill was passed by the House of Representatives, subsequently referred to the Senate Committee on Transportation and Utilities and finally referred to the Senate Committee on Energy and Natural Resources. H.B. 2041 remains in that Committee.

[1] In the December 4, 1995 issue of Inside FERC it states: If and when producer-shippers believe that gathering companies are taking advantage of monopoly positions to deny access or to charge unreasonable rates, their sole source of regulatory relief will emanate from state capitols, commissioners asserted last week in making clear that FERC has washed its hands of the matter and fearful that states have not adequately prepared for their new role, Commissioners James Hoecker and Donald Santa, Jr. urged them to gear up. (See also February 26, 1996 Inside FERC, attached)

In its present form H.B. 2041 would amend several provisions of existing law with regard to the regulation of gas gathering systems, operators of those systems and operators of underground natural gas storage operations. H.B. 2041 defines a "gas gathering system" in K.S.A. §55-150 to mean a natural gas pipeline system used primarily for transporting natural gas from a wellhead or a metering point for natural gas production by one or more wells to a point of entry into a transmission line. The primary purpose of H.B. 2041 was to expand the definition of operator found in K.S.A. §55-150 to include operators of gathering systems. Also "gas gathering services" was defined to include the gathering, compression, or dehydration for natural gas transportation or distribution.

Pursuant to Senate Concurrent Resolution No. 1613, the Commission's General Counsel, David J. Heinemann, provided a legal opinion to the legislature stating that authority for regulation of gas gathering systems could either be found under Chapter 55 (Conservation) or Chapter 66 (Public Utilities) of the Kansas Statutes Annotated. (copy attached)

Senate Concurrent Resolution No. 1613 also directed the Commission to hold public hearings investigating the necessity and extent of such regulation. Public hearings were held in Wichita on January 4, 1996, Chanute on January 9, 1996, and Liberal on January 10, 1996. Approximately 36 witnesses appeared and 107 people attended the hearings. The witnesses gave testimony ranging from recommending no or extremely light-handed regulation to the creation of a very comprehensive cost of service utility approach by the Commission.

The public hearings demonstrated that vast differences exist throughout the state in terms of the nature of gas production and gathering facilities. Obviously Western Kansas produces the majority of gas in the State of Kansas. As such, Western Kansas has large sophisticated gathering systems. Those gathering systems located in Southeastern Kansas quite often are under ten miles in length and do not possess the technical sophistication that is found in Western Kansas.

This report is also being supplied to the members of the Senate and House Committees on Energy and Natural Resources. The following is a summary of the different positions taken by the parties who offered testimony at the public hearings. Those who were designated to receive this report are also receiving a complete notebook which includes the transcripts of the three hearings. We have prepared a specific summary of each individual witness's testimony which is included.

kdd

Summary of Public Testimony and Written Comments

Small Eastern Kansas Operators

Small Eastern Kansas producers presented a unified front in their opposition to extensive or stringent regulation. The wells, reserves, volumes and conditions in Eastern Kansas are so different from Western Kansas that a two tier structure of regulation was preferred.

Typically, the gas wells in Eastern Kansas produce from 3 mcf to 50 mcf per day, often with associated water. These wells are low volume and require more compression. This situation makes them marginally economic. The gathering systems themselves are six to fifteen miles long and most are owned by the operator of the gas wells. The reserves will not attract construction of large gathering systems. Most owners of these gathering systems have no more than two or three employees thus regulation that would require more employees would have an extremely negative impact upon the operators of these systems.

It was suggested that limited regulation consisting of licensing by the KCC, filing maps depicting pipeline size, location, proper identification and marking be adopted. It was also suggested that in the absence of contracts between the producer and gathering system operator, the KCC's Conservation Division should be the forum for handling complaints under Chapter 55.

Local Governmental Units

Stevens and Morton Counties testified as to potential erosion of the tax base and loss of income to Western Kansas communities.

If these hearings result in "light handed" regulation under Chapter 55 (Conservation) as opposed to regulation in Chapter 66 (Utility Division) there is a concern that the gathering systems would be re-classified as industrial and commercial as opposed to public utility thereby causing a drop from 33% to 25% of assessed value with a potential loss of $1,000,000 per year in tax revenue to Seward county. If the transportation costs are transferred back to the operator or well head, these costs would be shared by the county through the loss of county ad valorem taxes and by the state through a loss in severance taxes.

Regulation of the gathering systems should allow the KCC to know prevailing rates, charges, terms, and conditions for gathering fees and services. The regulations should be an extension of Chapter 66 because some gathering systems have been paid for

through the utility rate base in the past, and the systems function as a monopoly and regulation is needed from the well head to the mainline, including all steps in between. Gathering systems and pipelines should charge just and reasonable rates. Any regulations or legislation should not adversely affect economic returns to the Southwest Kansas area.

Large Gas Gatherers and Producers

Testimony from this group came from representatives of two large gathering systems and two large producers who favored a "light-handed" approach under Chapter 55 of the Conservation Statutes. Where truly free market conditions do not exist, a case by case complaint forum should be established to determine individual gathering rates. This group supports H.B. 2041 which grants the Commission authority to regulate gas gathering systems. They also favor the complaint forum as enacted in Oklahoma.

One major producer/gatherer testified that in order for gathering systems to expand they must be receptive to the producers needs and would not survive if perceived, to be abusive and monopolistic.

Two of the producers testified that their gathering systems were private and should be exempt from compelled access.

Mid-Sized Producers Favoring Chapter 66 Regulation

Four witnesses testified on behalf of this group. Their testimony stated that they represented small to medium producers and irrigators. Their position is that FERC Order No. 636 opened the door for a flood of monopolistic abuses. This group believes that the KCC should step into the void left by FERC and assert similar regulatory authority. Examples of alleged abuses cited were improper relationships between affiliate companies, no competitive alternative for gathering, and discrimination against low BTU gas and low volume wells. This group favors the filing of tariffs, full open access to any gathering system and public disclosure of rates being charged.

Independent Producers

This group believes that H.B. 2041 in its present form is inadequate to prevent the abuse that is inherent with a monopoly. As a whole this group favored regulation under Chapter 55. They do not believe sufficient competition exists in the gas gathering business to warrant a non-regulatory policy. This group would favor more expansive regulations such as those used in Oklahoma but stopping short of Chapter 66 regulation. They fear that a utility approach would be too expensive.

Irrigators and Agricultural Interests

Irrigators use approximately four to five percent of the total production from the Hugoton field for irrigation purposes. This group believes that: (1) any legislation should require equal access for the use of gathering and/or main pipelines; (2) the KCC should monitor good faith negotiations between carriers and irrigation users; (3) charges for pipeline transportation should be based on sound and fair economics; (4) rates should be made public by way of filings with the KCC; and, (5) that any regulation adopted should not adversely affect Southwest Kansas. This group favors open access to permit anyone to tap into the gathering lines and purchase irrigation gas. They believe that deregulation has already resulted in escalating costs of natural gas with respect to the operation of irrigation wells. They are greatly concerned about the dwindling pressures and the life expectancy of the Hugoton field and further believe that deregulation of transportation without government oversight would create monopolies and thereby deny equal and fair access to the pipelines.

Gas Storage

Only one large gas storage operator testified and took the position that gathering systems within a storage field should be exempt from any regulation.

Conclusion and Recommendations

The Commission believes that Kansas is possessed of one of the more valuable natural gas reserves in the Continental United States if not in the world. This asset is too valuable to the citizens of this state and the nation to allow the forces of the market place alone to dictate its future. The Legislature has already recognized these facts by virtue of its enjoinder to the Commission to protect correlative rights and to prevent waste of the natural gas resources of this state. (Kansas Statutes Annotated §§55-701 et seq.) The Commission is therefore of the view that a regulatory structure for the gathering of natural gas is appropriate.

It is the Commission's view that this regulatory authority would be in addition to the statutory amendments proposed in H.B. 2041. That legislation provides for licensing of gas gatherers and gas storage operators. The legislative changes suggested in Appendix "A" set forth the scope and nature of the complaint based regulatory oversight. Some changes to H.B. 2041 will have to be made to harmonize it with the proposed legislation in Appendix "A".

The Commission heard from many diverse interests in its public hearings over a period of two years and believes that it has sufficient factual basis upon which to fashion the regulatory structure to protect the interests of the citizens of this state with a "light handed" approach to the regulation of natural gas gathering.

The Commission requests that the Legislature grant sufficiently broad statutory authority to the Commission to complement and augment the authority already existing in K.S.A. §§55-701 through 713 by the addition of three statutory sections shown in Appendix "A" attached. Also H.B. 2041 will have to be modified to be certain it is consistant with Appendix "A".

Appendix "A" was drafted by the Commission after consideration of the evidence offered by mineral and royalty owners, lessees, producers (regardless of size), gathering interests, farmer/irrigators, and the public hearing participants.

By way of explanation the Commission is attempting to accomplish the following with its draft of proposed legislation in Appendix "A" which would give the Commission the authority to:

1) Hear complaints between persons who are unable to reach an arm's length agreement with respect to gas gathering services and the fees therefore. It is the intention of the Commission not to involve itself in contractual disputes or in cases where the parties have an existing contract governing gathering

services and fees. The resolution of disputes covered by existing contracts is clearly a matter for the judiciary and not the Commission.

2) Hold hearings and to take such evidence as it deems appropriate to fashion an order governing the gathering of natural gas in any particular case through and including the setting of fees for gathering services to the end that a fair and nondiscriminatory system of gas gathering is established.

3) The Commission believes that except for safety, registration, licensing and informational purposes, the following should be exempt from the complaint based regulation of the Commission:

   a) Gathering systems utilized exclusively for the gathering of natural gas produced by the owner of the gathering system.

   b) Lead lines owned by the producer which connect the well to the gathering system.

   c) Gathering injection lines used exclusively for gas storage purposes.

The Commission believes that a complaint based system, not unlike that system adopted in Oklahoma, is the least intrusive mechanism available while still providing a knowledgeable governmental entity with authority to protect the interests of all parties with respect to the production and gathering the natural gas resources of Kansas.

Respectfully submitted,

The Kansas Corporation Commission

APPENDIX "A"

PROPOSED LEGISLATION

55-702. Definitions. The term "waste", in addition to its ordinary meaning, shall include economic waste, underground waste and surface waste. Economic waste shall mean the use of natural gas in any manner or process except for efficient light, fuel, carbon black manufacturing and repressuring, or for chemical or other process by which such gas is efficiently converted into a solid or a liquid substance. The term waste shall not include the use or flaring of natural gas if permitted pursuant to an order issued or rule and regulation adopted under the provisions of subsection (b) of K.S.A. 55-102, and amendments thereto. **The term "common source of supply" shall mean any underground accumulation of natural gas which constitutes a single natural pressure system whereby production of natural gas from one portion thereof will affect the pressure in other portions thereof. Common source of supply shall include those natural gas reservoirs which contain one or more wells for production of the accumulated natural gas. Further** the term "common source of supply" shall include that portion lying within this state of any gas reservoir lying partly within and partly without this state. The term "commission" shall mean the state corporation commission of the state of Kansas, its successors, or such other commission or board as may hereafter be vested with jurisdiction over the subject matter of this act.

55-7 (a) No person offering services for the gathering of natural gas for a fee or other consideration shall engage in any unduly discriminatory services or offer gathering services for a fee which is or otherwise anti-competitive.

(b) Upon the filing of a complaint by any aggrieved person, the corporation commission shall, after due notice and hearing, be authorized to issue an order directing the remediation of any unduly discriminatory fee or unduly discriminatory service for the gathering of natural gas.

55-7 Any aggrieved party as referred to in this act shall be required to allege and prove to the satisfaction of the corporation commission that the operator of the natural gas gathering systems which is offering services for a fee or other consideration has sufficient facilities to accommodate the producer's natural gas, that there is no other natural gas gathering system conveniently located to gather the complainant's gas and willing to do so; that the quality of complainants's natural gas will not have an adverse affect of the gatherer's facilities or the safety thereof and is of a quality and content consistent with gas being gathered by the gathering entity.

55-7 (a) Upon proof satisfactory to the commission, the commission shall have authority to require any gas gathering entity to provide open access and non-discriminatory gas gathering and to establish a fee for such gathering services.

(b) In determining the fee to be charged for gathering services, the commission shall consider among such other evidence as it shall determine is proper, the following:

1) The historic fee or consideration for gathering services for gas of like kind and quality in relevant geographic area as the gas which is the subject of the proceeding, given all the facts and circumstances.

2) The fee that would fairly compensate the gatherer for the gathering services, the fees the gatherer charges and receives from other producers, the capital, operating and maintenance costs of the operation of the gathering system and such other factors as the commission deems relevant.

55-7 (a) This act shall not apply to: (1) the gathering of natural gas produced from wells owned and operated by the gatherer and where the gathering system is used exclusively for its own private purposes (2) to lead lines from the wellhead to the connection with the gathering system which are owned by the producing entity and (3) to gathering systems used exclusively for injection and withdrawal from natural gas storage fields.

(b) The corporation commission shall have authority to promulgate rules and regulations for the administration of its authority over natural gas gathering as authorized herein.

HOECKER, OTHERS PONDER NEW REGULATORY ENVIRONMENT FOR GATHERING

It is difficult to know whether gathering service is being offered competitively in Texas, or in other states for that matter, Commissioner James Hoecker said at the Texas Railroad Commission's Gas Forum in Houston last Thursday. As the nature of gathering regulation and organization has changed in recent years, Hoecker has been among those asserting that states must move faster to fill the gap created by Ferc's withdrawal from the field (*IF*, 19 Feb, 1).

"If you look at gathering across the state [of Texas], you see that there are lots of different gathering companies and what seems to be good competition. If you look on a [TRC] district-by-district basis, you see less competition. And if you look at it on a county-by-county basis, there is even less competition," Hoecker said. "But I really don't know if anticompetitive behavior is a problem in this state, or in others."

According to TRC statistics filed at Ferc in 1994, about 20% of the producers in Texas are in areas where gatherers exhibit market power and have little competition. But even if gathering is not being offered competitively, there is little Ferc can do, Hoecker said. Since May 1994, when Ferc loosened its policy on regulating gathering facilities, the commission's role has been limited. Now, it regulates only about 22% of gathering facilities nationwide, he said.

Gathering "may be anticompetitive in some regions, and the TRC [information filed with Ferc] tends to show this," Hoecker said. "But the burden is on the states, not on Ferc," to deal with the matter.

Katherine Edwards, a Washington attorney who represents producers in gathering cases, said Ferc "really blew it on gathering. Ferc had an obligation and [it] stepped away from that obligation." She said she is convinced that gathering in many areas of the country is provided in an anticompetitive environment.

"There may be some pockets of competition, but that is the exception, not the rule," Edwards maintained, adding that statistics on gathering can be deceiving. "You have to look at things on a case-by-case, a wellhead-to-wellhead basis," to determine whether gathering service is competitive.

Edwards' firm, Travis & Gooch, represents major producers in gathering cases, "and you would think that being major producers, they would have clout." But that is not the case, she said. Even majors are having difficulty finding reasonably priced and competitive gathering services.

Since the proliferation of spindowns/spinoffs of gathering facilities, gathering rates have skyrocketed, said Taylor Yoakam, a gas consultant representing independent producers. "With higher gathering fees and lower prices, there is no incentive for the independent producer to drill," Yoakam said. "We would like to see the TRC get involved in this."

But M.J. Panatier, president of GPM Gas Corp., said the criticism of gathering companies is unwarranted. During the spinoff/spindown process, the gathering industry has gone from a subsidized to an unsubsidized industry, he said.

He explained that when interstate pipelines commonly owned and operated gathering systems, they could subsidize gathering services, or offer them for free, because they were making money by attaching gas to their interstate system. But as gathering companies were spun down or spun off, it became obvious that gathering services could not be offered for free if a gathering company was to stay in business, he said.

"Gathering costs money," Panatier said. "I sympathize with producers who had subsidized rates before and now they don't. But I didn't create the situation, and just like the producers, I have to deal with it." Responding to criticism that GPM and other gathering companies use their market power to charge exorbitant prices for gathering services, Panatier replied, "If I can't compete, I go out of business. If I provide a service, and I can't compete doing it, I have to sell out. Someone else will come in and provide the same service, but rates will go up because there are fewer competitors." He added that GPM does not take advantage of any market clout (see related story on page 7). "We have a reputation to protect because our success as a gatherer is based on repeat business," Panatier said.

Since the spindown/spinoff process, about 40% of GPM's gathering customers aren't under contracts "because they didn't want the default contract," he related. About 20% still are negotiating new gathering contracts and 40% are operating under existing contracts, he said. — *Cathy Landry, Houston*

FIRST
NATIONAL
OIL, INC.

Nelson B. Escue
President

October 12, 1995

Ms. Laura L. McClure
202 South 4th Street
Osborne, Kansas 67473

Re: Natural Gas Gathering Regulations

Dear Mrs. McClure:

First of all I would like to thank you very much for your time on the phone the other day. I will try and make this letter as brief as possible.

At the last hearing that your committee held on this issue one of the attorneys mentioned to Senator Gooch that this was not a consumer issue. This was a false statement.

- Irrigators that use gas to produce crops "are consumers". They are deeply effected by gathering issues.

- If the pipelines are able to control the volume of gas that goes through the gathering lines that take the gas to the main lines. They, therefore, can dictate what the city consumers will have to pay for that gas. **Eliminating completion.** Again, it is a consumer issue. Many small and intermediate cities do not have more than one pipeline supplying gas to the city utility.

Several of the pipelines have mentioned that the common carrier statutes that Mr. Eugene Smith made us aware of at the last hearing are old and no longer used.

My grandmother is probably as old as this law. I can assure you that her ability to cook, clean, garden and lecture her grandson, are in full force. In other words, she functions very well. Please note that oil is transported under common carrier statutes.

KN Energy presented at the last hearing as to how nice a company they were.

Please find enclosed a letter to Reserve Pipeline dated August 16th, 1995. Please notice that the letter was sent August 16th, 1995 and the abandonment was to take place August 21, 1995.

Reserve Pipeline had 4 days warning, **(two business days, due to the weekend)**, to deal with the fact that their gas was going to be shut-in. Take note that they had no authority from the K.C.C. to abandoned transportation services.

It will cost Reserve Pipeline in excess of $100,000 to re-connect these 3 wells to the system that they refer to. It won't happen. These wells will be abandoned.

The effect will be:

A. No more money to Reserve Pipeline.
B. No more money to the land owner.
C. No more money to the county schools, hospitals, public protection and other county services.

Tax revenues from gas:

1. Both ad valorem and severance taxes are based on the well head price of gas.
2. The higher the gathering rate - the **lower the well head price.**
3. The lower the well head price, the lower the amount of money received by the county schools, police departments and county services to its citizens.
4. The counties that depend on gas revenue are very concerned about where they are going to get the money.

Irrigators, royalty owners, small producers and consumers do not have the resources to fight these major companies. They simply cannot afford an attorney specialized in these issues to file and fight a complaint case before the Kansas Corporation Commission as provided for in House Bill #2041. We do need regulation of the pipelines and set rates that will be fair to all concerned.

The KN letter is just one example of callousness of the pipelines. As I stated in my testimony I can show several cases of unfair practices. However, I am still trying to keep this letter as short as possible.

I sincerely appreciate your time and your consideration. If you have any questions please feel free to call.

Very truly yours,

Montgomery Adam Escue

MAE\zb

C:\WP51\LETTER\MCCLURE.GAT

KN INTERSTATE GAS TRANSMISSION CO.

A subsidiary of KN Energy

August 16, 1995

Reserve Pipeline, Inc.
Eugene Smith
400 N. Washington
Liberal, KS 67901

In Re: Petro #1 Sec. 1, Twp. 20, Rg 33W, Scott County, Ks.
Petro #1-2 Receipt Pt. Sec. 2, Twp. 20, Rg 33W, Scott County, Ks.
Barnhardt #1-2 Sec. 2, Twp. 20, Rg 33W, Scott County, Ks.

Mr. Smith:

We regret to inform you that we can no longer take transportation volumes from your wells into our gathering system. Due to the needs of our retail customers in this area, we are forced to convert this system to retail sales, supplied by our Scott City Compressor Station. This gas will be 950 BTU and a constant supply pressure. Due to safety obstacles we cannot blend high and low BTU gas in this system and therefore find it necessary to discontinue gathering and transportation of your gas effective 8:00A.M. August 21, 1995.

If you wish to install the pipeline facilities required to deliver this gas to our gathering system in Sec. 24, Twp. 20, Rg 33W Scott County Ks., we would be willing to discuss this option.

If you have questions about this change, please contact Steven B. Steele, Group Leader, Lakin Field Office, at (316) 355-7122 Lakin, Ks.

Sincerely,

Steven B Steele

Steven B. Steele
Group Leader
RR 2, Box 16
Lakin, KS 67860
(316) 355-7122

cc: Gary Sanchez - Lakewood
Rita Dutsch - Lakewood
Mary Kirby - Lakewood
Bob Bergman - Lakewood
Bob Muirhead - Scott City
Don Almond - Scott City
File

TESTIMONY BEFORE THE KCC

HEARINGS ON NATURAL GAS GATHERING
CHANUTE, KANSAS
JANUARY 9, 1996

My name is Charles B. Wilson, I am a vice president with BEREXCO INC. in Wichita. BEREXCO is an oil and gas operator with extensive properties throughout Kansas.

I am here today to refute a certain notion conveyed by Mr. Eric Reigle, a representative of Northern Natural Gas Company, in his testimony presented to the Special Committee on Energy and Natural Resources on September 25, 1995. His notion was that sufficient competition already exists in the gas gathering business.

We agree with Mr. Reigle's testimony in which he states (and I quote) "Any regulation which addresses gathering should be structured to give both parties incentive to participate in fair negotiations before going before the Commission." But the point that we disagree with and what we want to make clear with the Commission is that it is easy for the producer and the gathering companies to negotiate when wells have significant capabilities. When gas wells are not significant or most of the reserves have already been produced, negotiations become very one-sided in favor of the gatherer.

Mr. Reigle stated (and again I quote) "Northern has entered into various fixed term, negotiated gathering agreements with many of the producers presently flowing into Northern's gathering systems. These negotiations have taken place with active competition from other parties, and with results mutually agreeable to all parties involved." Mr. Reigle attached three examples of this active competition to his testimony, one of which addressed a recent negotiation with our company, BEREXCO. It stated: "The BEREXCO Stonestreet 1-30, Bixler 1-25, and Hatfield 1-31 were connected to Northern Natural Gas in September 1994. The wells had been previously connected to another pipeline. Competitive pricing net back to the producer, was the incentive for connection to Northern."

I want to provide some facts regarding our wells which were not addressed in the testimony. These three wells were right next to each other and connected to William's pipeline, and subject to a gathering rate of $.24/mmBTU. At the time, Williams was going through a reorganization and was not allowed to negotiate a lower rate if competition was available. Northern had a FERC posted gathering rate of $.12/mmBTU. We approached Northern and they agreed to lay their line and connect to our wells, but we had to agree to produce 825,000 mmBTU into their pipeline over the next 5 years or pay a penalty of $.12 for every mmBTU not produced if the aggregate over 5 years was less than 825,000 mmBTU. This is commonly referred to as a throughput agreement. Fortunately, these were exceptional wells capable of producing over 3000 mmBTU a day with expected reserves sufficient to honor the commitment to Northern. Active competition did occur because these are unusually significant wells for Kansas.

When you have significant wells as these, the producer is in a bargaining position with the gathering companies and active competition may occur. But just to contrast for you how exceptional these wells are, again they were capable in aggregate of over 3000 mmBTU a day, BEREXCO's other 40 wells connected to Northern produce an average daily volume of only 78 mmBTU per day for each well. BEREXCO is not in any bargaining position with these other wells to negotiate similarly with any other pipelines. And I am sure our situation does not vary greatly from other Kansas gas producers.

To reiterate my point, if pipelines are free to establish gathering rates subject only to competitive market forces, producers and wells with less than significant reserves will be disadvantaged in negotiations with the gatherers. Only newer wells or wells with significant reserves will command the ability to negotiate with any presence.

As the professor from Washburn implied last week in his testimony before you, the nature of gas wells and their dependence on gathering systems does not lend itself to an environment without regulation.

To conclude, as a producer we are concerned that without the benefit of a watch dog agency, pipelines will be in a position to unjustly and unfairly take advantage of producers when their gas wells are past their prime, which will result in premature abandonment of remaining reserves and economic waste.

ENERGY AND NATURAL RESOURCES COMMITTEE

Hearing on Proposal No. 26 -natural gas gathering systems, including removing them from regulation as a public utility.

MY NAME IS DENNIS MCLAUGHLIN, I AM THE PRESIDENT AND FOUNDER OF AURORA NATURAL GAS. MY COMPANY IS IN THE BUSINESS OF AGGREGATING AND PURCHASING NATURAL GAS PRODUCTION FROM SMALL INDEPENDENT PRODUCERS. WE THEN SELL THE VOLUMES IN SUFFICIENT QUANTITIES FOR INDUSTRY AND UTILITY COMPANIES. CURRENTLY WE REPRESENT IN EXCESS OF EIGHTY PRODUCERS AND SELL APPROXIMATELY 250,000 MMBTUS, OR MCF PER DAY.

I APPRECIATE THE OPPORTUNITY TO ADDRESS THE COMMITTEE ON THE TOPIC OF NATURAL GAS GATHERING DEREGULATION. AS YOU KNOW, THE FERC HAS TAKEN THE POSITION THAT IT SHOULD NOT REGULATE NATURAL GAS GATHERING FACILITIES. IN 1993, THE FERC ISSUED AND BEGAN IMPLEMENTING ORDER 636, THIS ORDER WAS DESIGNED TO IMPLEMENT THE FINAL PHASE OF NATURAL GAS DEREGULATION. AMONG OTHER THINGS, THE ORDER CALLED FOR THE UNBUNDLING OF GATHERING, TRANSMISSION, AND STORAGE. IN PARTICULAR, BY SEPARATING GATHERING FROM LONG HAUL TRANSMISSION LINES, TWO ENTITIES AND TWO FEES WILL BE CREATED. AS A RESULT, THE PIPELINES BEGAN TO SEE TREMENDOUS OPPORTUNITY BY CREATING UNREGULATED GATHERING ENTITIES USING THE FACILITIES THAT WERE CONSTRUCTED IN THE JURISDICTIONAL, REGULATED ERA. TO MEET THE GATHERING CRITERIA, THE PIPELINE COMPANIES ARE EITHER SELLING THESE GATHERING SYSTEMS TO OTHER COMPANIES, OR ARE CREATING WHOLLY OWNED SUBSIDIARIES TO HOLD THESE FACILITIES. THIS IS KNOWN AS THE "SPINDOWN PROCESS."

THE FERC HAS IMPOSED A TWO YEAR TRANSITION PERIOD ON THE SPINDOWNS. AS A RESULT, THE NEW GATHERING ENTITIES HAVE TO OFFER THEIR EXISTING REGULATED RATE FOR THE NEXT TWO YEARS. FURTHER, THE FERC REQUIRED THE PIPELINES TO DEMONSTRATE THAT IT HAD NEGOTIATED AGREEMENTS WITH ALL EXISTING CUSTOMERS, OR HAD OFFERED A FERC APPROVED DEFAULT AGREEMENT.

THIS WAS ESTABLISHED PRIMARILY SO THAT THE STATES WOULD HAVE THE OPPORTUNITY TO RESPOND TO THIS NEW INDUSTRY STRUCTURE. KEEP IN MIND HOWEVER, ITS ONLY TWO YEARS, AND AFTER THAT, ANYTHING GOES.

ALTHOUGH MANY HAVE COMPLAINED TO THE FERC THAT THIS COURSE OF ACTION WILL BRING HARDSHIP TO PRODUCERS AND OTHER PARTIES THROUGH THE CREATION OF UNREGULATED MONOPOLIES, THEY HAVE MAINTAINED THEIR POSITION: IF ANYONE HAS AUTHORITY TO REGULATE GATHERING, ITS NOT THE FERC, ITS THE STATES.

THE FACT IS PRODUCERS HAVE FOUGHT THE SPINDOWNS TOOTH AND NAIL. THE FTC HAS BEEN INVOLVED AS A RESULT OF PRODUCER OUTCRIES. THE FERC CONTINUES TO RECEIVE COMPLAINTS OF ABUSE, OR IMPENDING ABUSE. ONE OF THE CONTRADICTIVE COMPONENTS OF THE WHOLE THING IS THAT INDEPENDENT PRODUCERS GENERALLY LIKE THE IDEA OF DEREGULATION, AS DO MOST BUSINESS PEOPLE. THE IDEA OF MARKETS DETERMINING PRICES IS SOMETHING THAT WE BELIEVE IN THIS COUNTY. IN FACT, THE FERC'S ENTIRE INTENT WAS AFTER ALL, TO CREATE COMPETITION FROM THE WELLHEAD TO THE BURNERTIP. BUT, HEREIN LIES THE ECONOMIC CONTRADICTION; THESE NEW ENTITIES ARE, OR WILL BECOME MONOPOLIES.

MONOPOLIES DO NOT PROMOTE COMPETITION, THAT'S WHY THEY ARE REGULATED. THESE COMPANIES WILL ARGUE THAT SUFFICIENT COMPETITION EXISTS. IF YOU LOOK AT A CONTINENTAL PIPELINE MAP YOU MIGHT COME TO THE SAME CONCLUSION. HOWEVER, LOOK AT THE MAP A LITTLE CLOSER YOU WILL SEE ITS NOT AS EASY AS DROPPING A NEW LINE TO CONNECT A WELL TO ANOTHER GATHERING LINE, AS I WILL DEMONSTRATE IN A MOMENT. THIS SIMPLE FACT CONTRADICTS ONE OF THE BASIC REASONS THESE ENTITIES ARE ASKING NOT TO BE REGULATED. THEY CONTEND THEY ARE NOT MONOPOLIES, BUT ASK ANY PRODUCER, OR ANY ONE WHO HAS BASIC KNOWLEDGE OF THE PRODUCING FIELDS IN KANSAS, OKLAHOMA AND TEXAS. THESE NEW COMPANIES ARE MONOPOLIES. THEY DO, OR WILL HAVE THE ABILITY TO

EXERCISE MONOPOLY POWER OVER PRODUCERS AND THIRD PARTY SHIPPERS.
IF YOU ARE STILL NOT CONVINCED THEY ARE MONOPOLIES, JUST ASK A PRODUCER WHO HAS A WELL CONNECTED TO ONE THEIR SYSTEMS AND HAS NO OTHER CHOICE BUT TO DEAL WITH THEM ON THEIR TERMS. AT THIS TIME, I WOULD LIKE TO DEMONSTRATE GATHERING AND HOW IT LOOKS AT THE NATIONAL, REGIONAL, AND LOCAL LEVEL. I WOULD FURTHER LIKE TO DEMONSTRATE EXAMPLES OF INTERSTATE GATHERERS WHO HAVE MONOPOLISTIC POWER.

PIPELINE AND PRODUCTION EXAMPLE

THESE NEW GATHERING ENTITIES WANT TO TAKE A MASSIVE NATURAL GAS GATHERING INFRASTRUCTURE THAT WAS CREATED UNDER REGULATION AND TREAT IT LIKE ITS A LEMONADE STAND. THEY WANT YOU TO BELIEVE THAT THEY ARE NOT MONOPOLIES AND IF THEY WERE, THEY WOULD NOT TAKE ADVANTAGE OF IT. IMAGINE IF THE CITY AND COUNTY DECIDED TO SELL THE ROADS THAT LEAD FROM YOUR HOME TO THE INTERSTATE HIGHWAYS. IMAGINE IF THIS NEW COMPANY WAS PERMITTED TO CHARGE YOU WHATEVER TOLL IT DESIRED. AND FURTHER IMAGINE THE COUNTY TOLD YOU THAT YOU DON'T HAVE TO USE THE ROADS, YOU COULD BUILD YOUR OWN, OR GET SOMEONE ELSE TO IF YOU DON'T LIKE IT. YOUR FIRST THOUGHT IS THAT YOU HAVE ALREADY PAID THE TAXES TO BUILD THE ROAD AND THE RULES HAVE BEEN CHANGED ON YOU. YOU ARE NOW DEALING WITH A COMPANY ON TERMS YOU COULD HAVE NEVER IMAGINED.
TO ACCENTUATE THIS FACT, THESE WERE INSTALLED BY INTERSTATE PIPELINES WHO HAD JURISDICTIONAL STATUS, THAT IS, THEY WERE PERMITTED TO PUT IN LINES WITHOUT THE WORRY OF COMPETITION. THE LINES WERE PAID FOR BY THE RATE BASE FROM THE TRANSMISSION LINES. THE CONCEPT OF A NATURAL MONOPOLY RESTS ON THE PREMISE THAT THE DUPLICATION OF EXPENSIVE FACILITIES IS NOT IN THE PUBLIC INTEREST. THEREFORE, ONE COMPANY IS GRANTED AN EXCLUSIVE RIGHT TO BUILD AND OPERATE FACILITIES, MUCH LIKE ANY MODERN UTILITY. THIS IS WHERE THE COST OF SERVICE RATE METHODOLOGY COMES FROM.

THE SYSTEMS THAT ARE TO BE SPUN DOWN WERE CREATED UNDER THAT STRUCTURE, HOW COULD THEY NOT BE MONOPOLIES. AS YOU MAY KNOW, THERE ARE A NUMBER OF INDEPENDENT GATHERING COMPANIES. GATHERING, IN AND OF ITS SELF DOES NOT CREATE A MEANINGFUL MONOPOLY. THE DIFFERENCE OF COURSE LIES IN HOW THE COMPANIES ARE CREATED.

AN INDEPENDENT GATHERER, A COMPANY NOT AFFILIATED WITH AN INTRA, OR INTERSTATE PIPELINE, GENERALLY MAKES A DEAL WITH A PRODUCER TO GATHER, AND/OR PURCHASE THEIR GAS WHEN A FIELD IS DISCOVERED, OR ENOUGH NEW PRODUCTION IS BROUGHT ON TO JUSTIFY A NEW FACILITY. LIKE ANY OTHER SERVICE, HIS RATES MUST BE COMPETITIVE, BECAUSE THERE ARE ANY NUMBER OF COMPANIES WILLING TO MAKE A SIMILAR DEAL. THE GATHERER HAS NO WAY TO ASSURE HIMSELF OF A PROFIT, OTHER THAN HIS ABILITY TO OPERATE EFFICIENTLY AND AGREE TO TERMS THAT ARE REASONABLE FOR BOTH PARTIES.

NATURAL GAS WELLS ARE NATURALLY PRODUCING RESERVOIRS. THEY DECLINE AS THEY AGE. A GAS RESERVOIR IS LIKE A BALLOON. WHEN YOU FIRST PUNCTURE IT, THE CONTENTS RUSH OUT. HOWEVER, AS THE CONTENTS DEPART, THEY CONTINUOUSLY DEPART SLOWER AND IN LESS QUANTITIES.

USING MY ANALOGY, THE AVERAGE FIELD IN THE THREE STATE AREA THAT IS GATHERED BY THE INTERSTATE GATHERING SYSTEMS IS ABOUT THREE FOURTHS DEPLETED. WHEN THE FIELDS WERE NEW, IF COMPETITION HAD BEEN THE STANDARD, THERE WOULD BE GATHERING LINES EVERY WHERE AND A PRODUCER WOULD HAVE A MULTITUDE OF CHOICES. HOWEVER, THE REALITY IS THOSE CHOICES ARE LIMITED BY THE AGE OF THE PRODUCTIVE RESERVOIR HE IS DEALING WITH. FURTHER, AS THE FIELDS ARE PRODUCED, THESE FACTORS WILL BE MORE PRONOUNCED. IT JUST DOES NOT MAKE SENSE TO BUILD A LINE THAT COSTS $100,000 TO RECONNECT A WELL THAT HAS $150,000 WORTH OF RESERVES LEFT. THEREFORE, WITHOUT OVERSIGHT, THERE IS NO DOUBT IN MY MIND THAT GIVEN THE GREEN LIGHT, THESE NEW GATHERING COMPANIES

WILL CHARGE THE HIGHEST GATHERING RATE POSSIBLE. FURTHER, THEY WILL MAKE IT IMPOSSIBLE FOR COMPANIES SUCH AS MINE WHO COMPETE TO PURCHASE SUPPLIES FROM PRODUCERS AT THE WELLHEAD TO SHIP ON THEIR SYSTEMS. I BELIEVE THESE GATHERING ENTITIES WILL BASE THEIR GATHERING CHARGE, NOT ON WHAT WILL MAKE DECENT PROFIT, BUT RATHER, WHATEVER RATE THEY CAN EXACT THAT WILL FORCE THE PRICE RECEIVED BY THE PRODUCER RIGHT DOWN TO THE MARGINAL COST OF PRODUCTION, THAT IS, WHATEVER THE PRODUCER CAN BARE TO RECEIVE, SHORT OF GOING OUT OF BUSINESS.

MOST OF THE PIPELINES WHO HAVE RESPONDED TO THE IDEA OF REGULATION ON A STATE LEVEL WANT TO REMOVE THE COST OF SERVICE RATE METHODOLOGY AND THE KANSAS CORPORATION COMMISSION AS A MEANS OF REGULATION AND REPLACE IT WITH AN ARBITRATION BOARD. THEY ARE ASKING YOU TO COMPLETELY DISCARD ANY FACTUAL BASIS FOR THEIR RATES. RATHER THAN USING A DEFINABLE STANDARD, THEY WANT TO DEFER COMPLAINTS TO A 'BOARD' THAT WILL ARBITRATE BASED ON DISCRIMINATION, UNJUST, UNLAWFUL, AND UNREASONABLE. IF THERE IS NO FACTUAL BASIS, HOW DO YOU DETERMINE WHAT IS UNLAWFUL? WITHOUT AN OBJECTIVE STANDARD, HOW DO YOU DETERMINE WHAT IS UNREASONABLE? AND IF ALL PRODUCERS GET A BAD DEAL, THEN CAN'T ONE PRODUCERS BE INJURED BY A GATHERER WITHOUT DISCRIMINATING AGAINST?

IN MANY CASES THESE COMPANIES HAVE MADE MISLEADING STATEMENTS ABOUT WHAT A PRODUCER CAN AND CANNOT DO WITH RESPECT TO SELLING AND TRANSPORTING THEIR GAS. THEY HAVE MADE MISLEADING STATEMENTS ABOUT WHO ACTUALLY OWNS THE GATHERING LINES. THE STANDARD IMPLICATION HAS BEEN, SELL US YOUR GAS NOW ON OUR TERMS, BECAUSE THE TERMS THAT WILL BE OFFERED IN THE FUTURE ARE NOT GOING TO BE AS GOOD. IN MY OPINION, THIS PRACTICE HAS BEEN USED PRIMARILY TO COMPEL PRODUCERS TO AGREE TO LONG TERM CONTRACTS SO THAT THE NEW GATHERING ENTITY COULD MISLEAD THE FERC INTO

BELIEVING THAT THE TERMS OF THE SPINDOWNS WERE ACCEPTABLE TO THE PRODUCERS AND OTHER PARTIES INVOLVED.

IN CENTANA'S RESPONSE TO HOUSE BILL 2041, THEY SUGGEST THAT THE KCC SHOULD NOT BE USED AS "VEHICLE TO ENHANCE A PARTIES' NEGOTIATING POSITION", OR, BE USED AS A DEVICE TO "RESOLVE PRICING DISPUTES BETWEEN PRODUCERS AND GATHERERS". I POSE THE QUESTION, HOW ELSE WOULD A PRODUCER NEGOTIATE?

OUR POSITION IS THIS: THE CREATION OF NON REGULATED MONOPOLIES SHOULD NOT BE PERMITTED. IF THE FEDERAL GOVERNMENT IS NOT GOING TO OVERSEE THESE ENTITIES, THE STATES SHOULD. THESE NEW ENTITIES HAVE ASSUMED THAT THEY WILL NOT BE REGULATED WHICH HAS BEEN DEMONSTRATED BY THE CAVALIER MANOR THEY HAVE TAKEN WHEN APPROACHING PRODUCERS ABOUT ENTERING INTO AGREEMENTS.

I WOULD BE REMISS IF I ACCUSED ALL PIPELINES WHO HAVE GATHERING SYSTEMS OF ABUSIVE BEHAVIOR. SEVERAL OF THEM HAVE GONE OUT OF THEIR WAY TO BE EQUITABLE, CIG, ANR, AND WILLIAMS ARE GOOD EXAMPLES OF THIS. FURTHER, NONE OF THEM HAVE MONOPOLY POWER IN EVERY INSTANCE. I BELIEVE THERE IS A BETTER WAY TO REGULATE GATHERING THAN USING A COST OF SERVICE BASIS. HOWEVER, THE COMPLETE REMOVAL OF OBJECTIVE OVERSIGHT IS NOT THE ANSWER. THE PRIMARY INTENT MUST BE TO RETAIN COMPETITION AT THE WELLHEAD, INSURE THAT PRODUCERS ARE NOT SUBJECTED TO UNHARNESSED MONOPOLY POWER AND THAT OTHER RESTRAINTS OF TRADE ARE NOT PERPETRATED. IN ORDER TO ACHIEVE THESE GOALS, THE FOLLOWING MUST OCCUR:

1. A BOARD SHOULD BE ESTABLISHED THAT HAS WEIGHTED REPRESENTATION. THIS BOARD SHOULD HAVE THE AUTHORITY TO DETERMINE WHEN A GATHERER HAS MONOPOLY POWER OVER PRODUCERS AND THIRD PARTY SHIPPERS.
2. OPEN ACCESS TO ANY SHIPPER AND/OR PURCHASER MUST BE A STANDARD.

3. AN OBJECTIVE RATE DESIGN MUST BE ESTABLISHED, THAT CREATES A MAXIMUM RATE A MONOPOLISTIC GATHERER CAN CHARGE.

4. PRODUCERS AND OTHER PARTIES MUST HAVE THE RIGHT TO FILE THEIR COMPLAINTS WITH THE KCC.

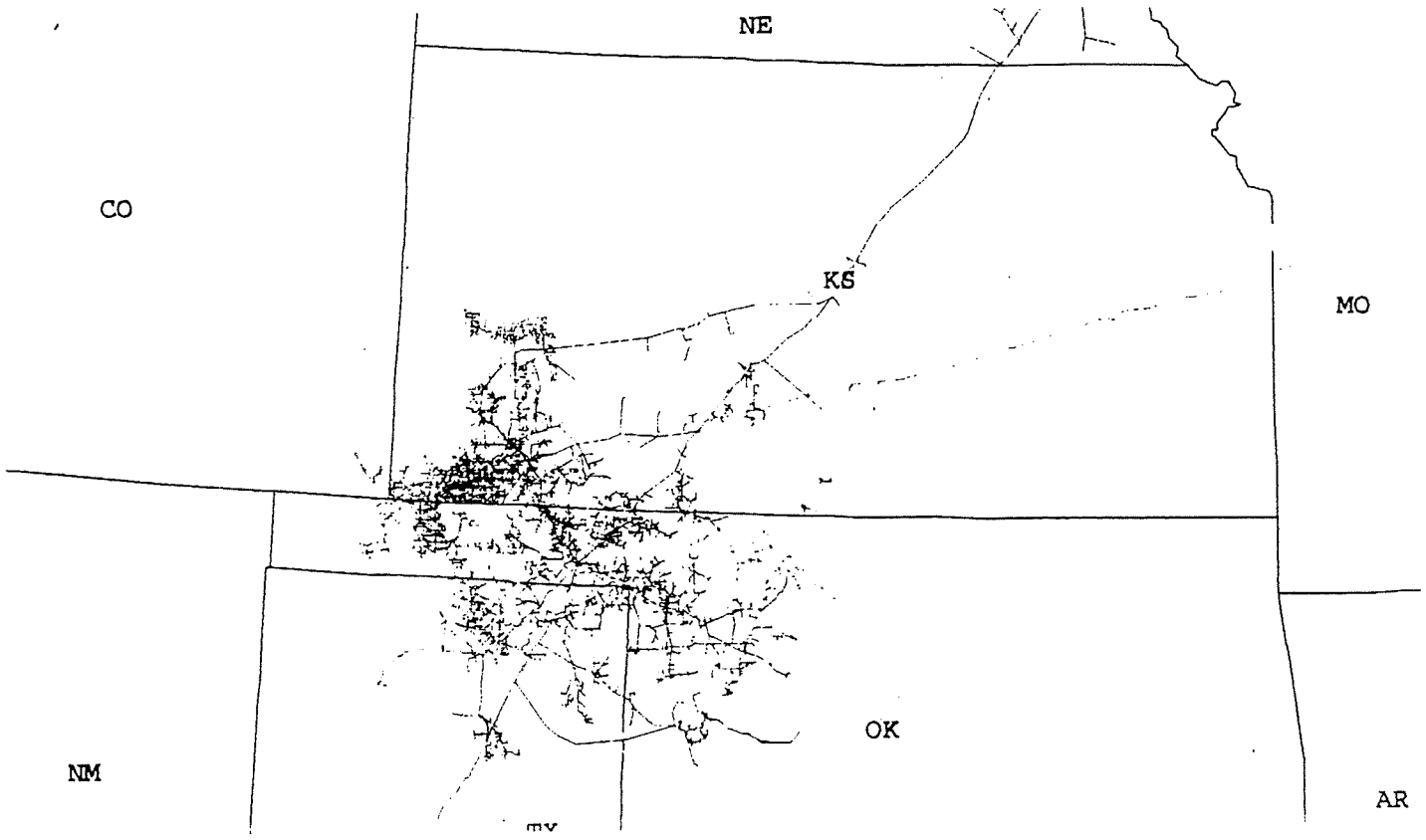
5. RATES AND OTHER PERTINENT INFORMATION SHOULD BE OF PUBLIC RECORD.

KAN ELLS

WELL NAME	PATTERSON #1	ATWELL #1	BARTH #1
OPERATOR	WILSON COS.	AMERICAN WARRIOR	AMERICAN WARRIOR
LOCATION	SW 25-28S-37W	NW SE 9-33S-31W	C NW/4 10-35S-22W
CURRENT RATE	825 MCF/D	112 MCF/D	109 MCF/D
REMAINING RESERVES	.5BCF	49 MMCF	144 MMCF
DECLINE	5%	5%	5%
LINE PRESSURE	21-28	60 #	90#
LOE PER MONTH	$1,000	$826	$1,384
CURRENT CONNECTION	PEPL	PEPL	NNG
CURRENT GATHERING RATE	0.1659	0.1659	0.0731
FUEL	0.25%	0.25%	
WELLHEAD PRICE			
NEW GATHERING COMPANY	ANADARKO	ANADARKO	GPM
NEW GATHERING RATE	0.2218	0.2218	0.2218
FUEL	0.25%	0.25%	0.25%
DISTANCE TO NEAREST	6730'	13980'	5000'
ALTERNATE LINE	CIG 6" LINE	CENTANA	TWPL
ALTERNATE RATE	0.159	0.22	0.1
FUEL	0	1%	1%
COST TO LAY NEW LINE AND INSTALL TAP (TAP = $20,000) (LINE IS $4/FT FOR 500 MCF/DAY OR LESS) (LINE IS $6/FT FOR MORE THAN 500 MCF/DAY)	$60,380	$75,920	$40,000
	AVERAGE PRICES 10/94-9/95		INDEX
ASSUMPTIONS:		PEPL	1.383
1/8TH ROYALTY		NNG	1.323
__5__% KS PROD TAX		CIG	1.138
MAINLINE PRICE		TW	1.32
NO ESCALATION			
NO DISCOUNT			
Daily production	825	112	109
Decline	0.95	0.95	0.95
year 1	297,000	40,320	39,240
year 2	282,150	38,304	37,278
year 3	268,043	36,389	34,296
	848,018	115,126	110,814
Gathering Cost per MCF for 3 years	**$0.0712**	**$0.6595**	**$0.3810**
CURRENT RATE	**$0.1659**	**$0.1659**	**$0.0731**
RATE TO NEW FACILITY	**$0.2302**	**$0.8795**	**$0.4610**
CURRENT PRICE	**$1.2141**	**$1.1583**	**$1.2499**
PRICE TO ALTERNATIVE	**$0.9078**	**$0.5035**	**$0.8590**
Operating cost	$0.0425	$0.2583	$0.4496
Royalty	$0.1598	$0.0863	$0.1236
Profit before prod taxes	$1.0765	$0.3459	$0.4158
Tax	$0.0559	$0.0302	$0.0433
Net before overhead, taxes et al	$1.0205	$0.3157	$0.3725

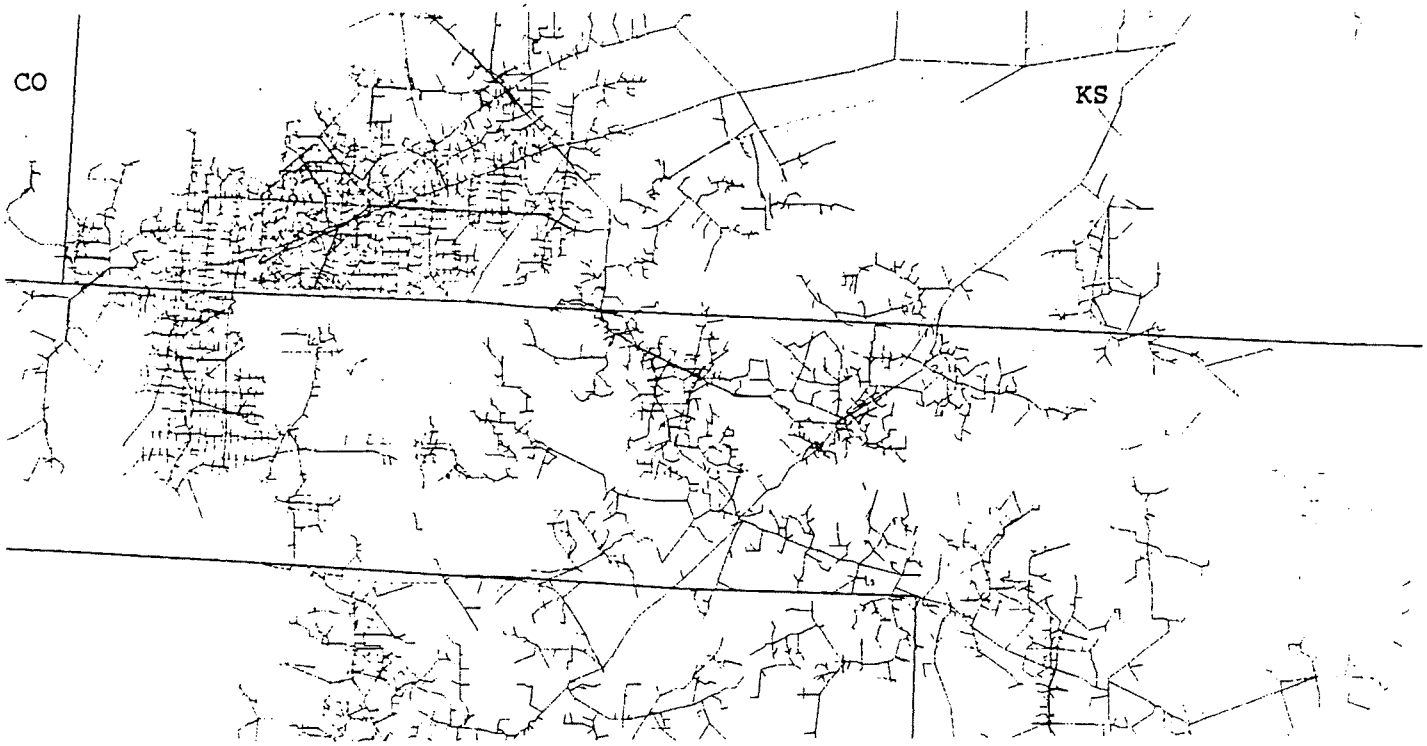
Northern Natural Gas Company

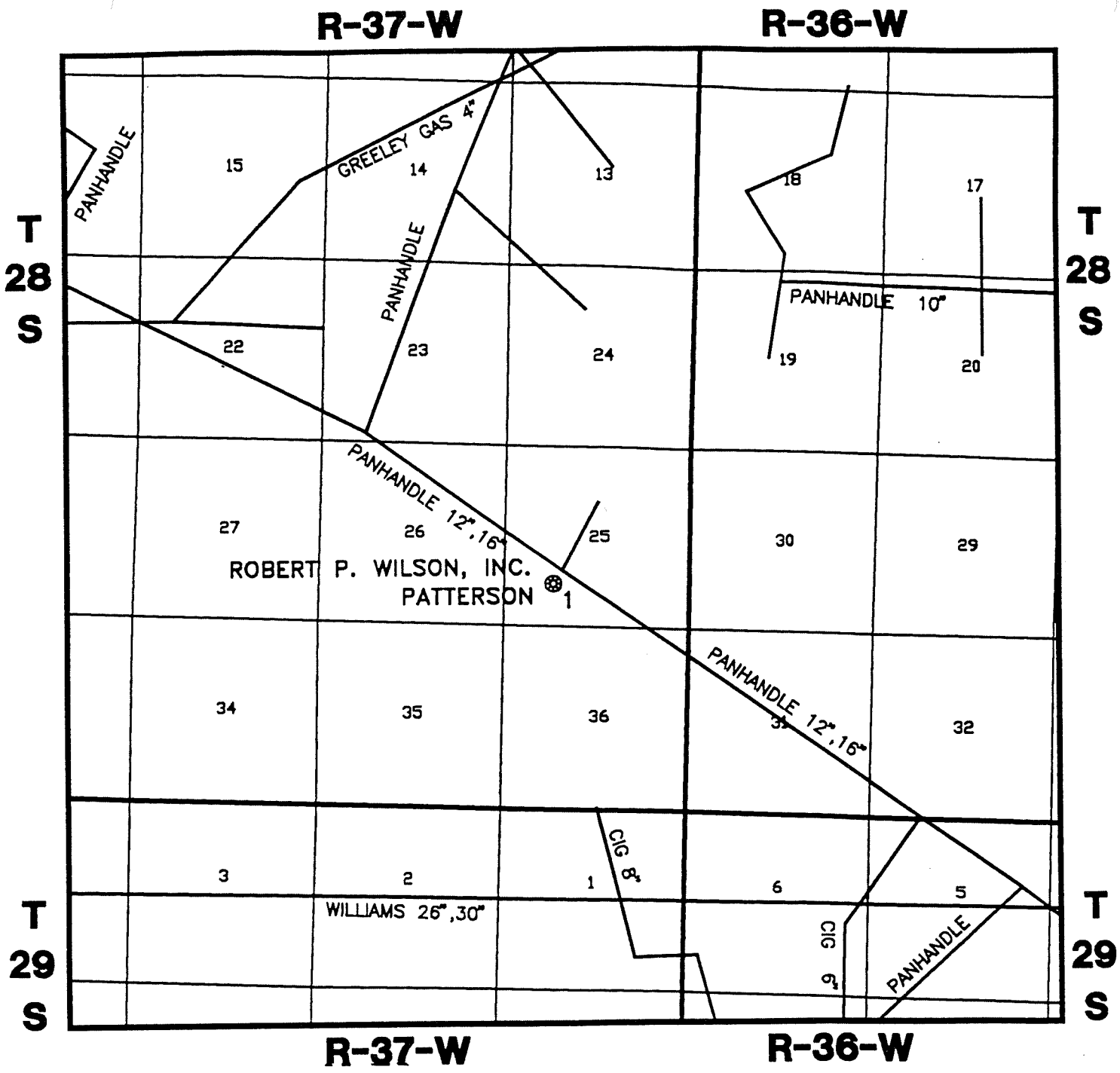
Panhandle Eastern Pipe Line Co
Panhandle Field Services Compa



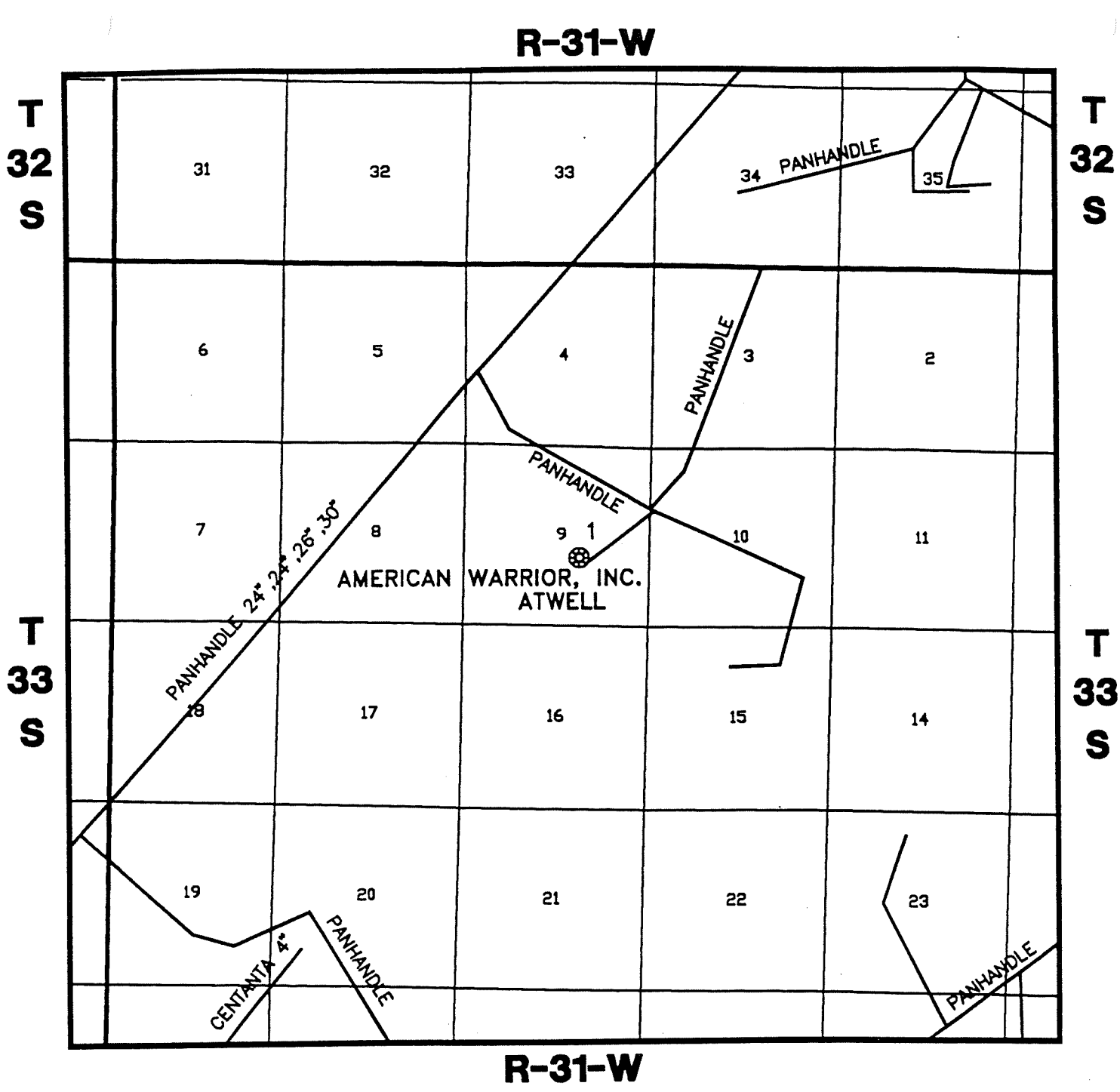
Northern Natural Gas Company

Panhandle Eastern Pipe Line
Panhandle Field Services Compa





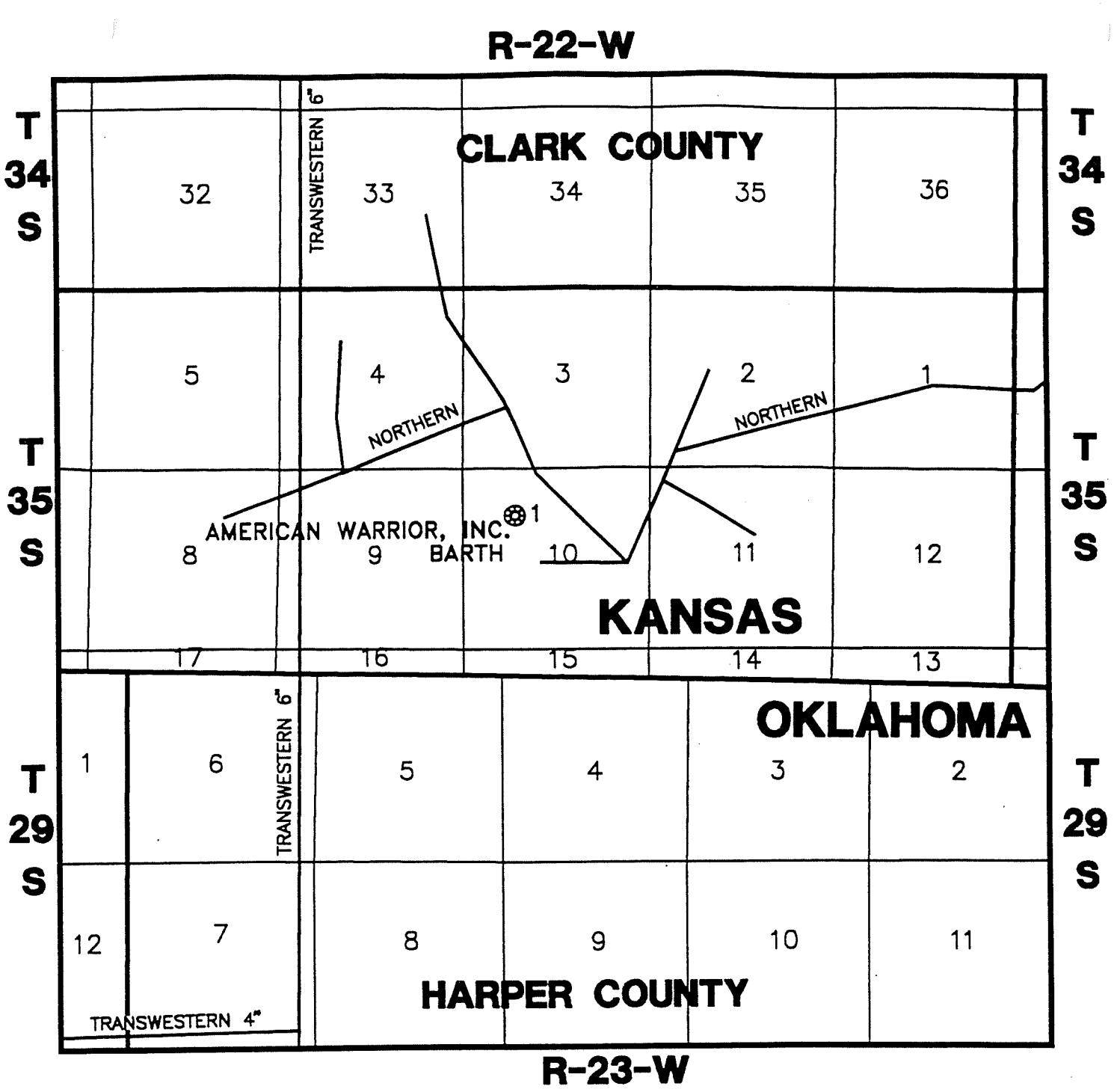
LOCATION PLAT
FOR THE
ROBERT P. WILSON, INC. - PATTERSON #1 WELL
GRANT COUNTY, KANSAS



LOCATION PLAT
FOR THE
AMERICAN WARRIOR, INC.- ATWELL # 1 WELL
SEWARD COUNTY, KANSAS

0 5,000 10,000 15,000 20,000

SCALE IN FEET



LOCATION PLAT
FOR THE
AMERICAN WARRIOR, INC - BARTH #1 WELL
CLARK COUNTY, KANSAS
HARPER COUNTY, OKLAHOMA

0 5,000 10,000 15,000 20,000

SCALE IN FEET

BEFORE THE KANSAS CORPORATION COMMISSION HEARING
AT LIBERAL, KANSAS
January 10, 1996
Testimony of Paul Hoag

Re: Docket No. 193,135-C (C-27,760)
General Investigation to Determine the Need and Extent of Regulation of
Gas Gathering Systems

My name is Paul Hoag, and my address is 2140 Zinnia Lane, Liberal, Kansas. I am a royalty owner, a public policy economist by training, and a former Seward County commissioner, as well as the former Seward County Clerk. I thank the Commission for permitting my appearance here today.

Affirmative Regulation:

My purpose is to suggest briefly that there are social and economic reasons for believing that the KCC ought to adopt a more affirmative regulatory stance for gas gathering than has been suggested by some pipeline spokesmen, or is contemplated by such measures as House Bill 2041 (at least the version that I have seen).

The economic situation is that an oligopolistic, and in some instances monopolistic, industry that has been regulated to prevent unfair or discriminatory tactics will now be unregulated (in practice) unless the KCC adopts an affirmative regulatory stance.

Until May 1994, gas gathering was part of a regulated transmission business that moved natural gas from the well to the final user. Affirmative regulation was desirable because of two special features of the business.

First, natural gas is a critical component of our regional and national economies, a strategic asset for the nation, and its extraction and consumption represents the one-time harvest of a precious resource. Therefore orderly, optimized production to assure best use and best conservation was deemed an important public purpose requiring affirmative regulation.

Second, it is usually not efficient to build multiple pipelines to carry gas over any one particular route. The need for large product volumes to achieve economic efficiency in transmission creates a "natural monopoly." The existence of the monopoly is in the public interest, but the public interest would suffer if the natural monopoly behaved like a monopoly by engaging in unfair, unjust and discriminatory practices. So the public interest requires affirmative regulation of the natural monopoly. The monopoly is tolerated but affirmatively regulated.

These two special features of the natural gas business have been the prime rationale for affirmative regulation. The industry has been permitted to develop a strategic, prime resource in an efficient manner without predatory and economically distorting monopolistic practices.

Since the FERC decisions of May 1994, there will be no federal regulation of transmission from the wellhead to the main pipeline. The KCC must now decide whether and to what degree to regulate this "gas gathering" segment of the gas transmission business. With the most "light handed" approach advocated by pipeline companies, the gas gathering segment of the transmission business will be effectively unregulated.

The Illustrative Case of the Babylon Monopoly Pipeline Company:

Let us now reason together over a hypothetical case, just to see what is at issue. Let us assume that Babylon Monopoly Pipeline Company moves all the gas from Seward County to New York City and charges 10,000 buffalo skins a month for this service, a fee set by the federal regulators on a cost-of-service basis. But the federal regulators decide to henceforth only regulate from Kansas City to New York City, and set the rate from Kansas City to New York City at 9,000 buffalo skins because the cost-of-service calculations show that 9,000 buffalo skins are allocated to the Kansas City to New York City transmission and 1,000 buffalo skins are allocated to the Seward County to Kansas City segment. So the transmission rate from Seward County to New York City will now be 9,000 regulated buffalo skins plus whatever the unregulated price is for transmission from Seward County to Kansas City; what will that price be?

Will the price decrease? Why should it, since Babylon had no competition nor is any competition likely to develop. A new pipeline from Seward County to Kansas City would most likely be inefficient since the second pipeline would be a duplication and could not expect to have the same volume as Babylon's existing pipeline. Even if a new, second pipeline could compete operationally, the new pipeline would have the severe disadvantage of amortizing capital costs while competing against Babylon which long ago paid for its original installation costs. So barring a startling technological innovation, Babylon's transmission price will not be dropping in response to competition.

Will Babylon maintain the same price as before: 9,000 regulated buffalo skins plus 1,000 unregulated buffalo skins? Of course Babylon will attempt to increase revenues by raising prices. Remember that Babylon is a monopolist let loose from regulatory restraint in a business that has no competition to provide economic restraint. Monopoly is an advantage, and as a rational economic actor, Babylon will certainly exploit its advantage. The question now is by what method will Babylon reap its monopolistic harvest.

The most direct and obvious method would be to just raise the price to whatever level will secure the most profits for Babylon without killing the industry. Babylon's goal will be to increase its revenues, which represent increased costs and lower profits for other actors - the

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producers and consumers. So Babylon might raise its Seward County to Kansas City price to 1,500 buffalo skins. Notice that Babylon's increased revenue becomes a direct increase in profit because there is no increase in cost, just an increase in revenue.

But Babylon decides not to raise its price to 1,500 buffalo skins. Why? Because that would be too obvious and therefore politically imprudent. If Babylon creates an impression of greedily exploiting its monopoly power, it invites political pressure to reinstate affirmative regulation. So what is a poor monopolist to do? One tried-and-true method is to disguise the exercise of monopoly power by creating the impression that several economic actors - not a single monopolist - are at work. The goal is to create a captive cartel that appears to be competitive but is in fact the original monopoly at work.

At this point Babylon brings out its lawyers and publicists and announces the formation of four new companies: the Liberal Pipeline Company, the Greensburg Pipeline Company, the Wichita Pipeline Company, and the Emporia Pipeline Company. Babylon is distributing its Seward County to Kansas City transmission assets to these four newly created subsidiaries which will now collectively move gas from Seward County to Kansas City. The only difference is that instead of one bill for 1,0000 buffalo skins for moving gas from Seward County to New York City, there will now be five bills. There will be a bill for 9,000 buffalo skins to move gas from Kansas City to New York City and an additional four other bills to move gas from Seward County to Kansas City.

Will the four bills from Babylon's four new subsidiaries add up to 1,000 buffalo skins, which was the old, regulated price? Of course not, since the purpose of creating the four new subsidiaries was to disguise the exercise of monopoly power while using monopoly power to increase revenues and profits.

Let us assume that each of the four new companies received one-fourth of the Kansas pipeline. Since these new companies have made no new investment, presumably the correct cost-of-service rate under a regulated tariff would be one-fourth of the previously calculated Kansas segment rate of 1,000 buffalo skins - 250 buffalo skins for each "new" segment.

Since the whole point of creating new subsidiaries to re-group existing assets was to raise revenues, the four new transmission bills will be more than 250 buffalo skins per segment. Because the four new companies can, in a literal sense, correctly claim that they have no existing rate for comparison (since they did not exist before as a legal entity, there was no rate), they can just set a new rate for a new, unregulated business. And if the parent Babylon's goal is a fifty percent increase on existing Kansas assets, then the four new companies could each charge 375 skins, so the new Kansas total would be 1,500 buffalo skins.

But it would be far more clever to create an elaborate disguise, thus effectively neutering opposition and complaints by making direct comparisons difficult. So instead of each new subsidiary charging 375 skins for transmission, each charges only 275 skins for transmission, but

what constitutes transmission is now re-defined. The elements or components of transmission service are now broken out or fractured. So what used to be transmission is now redefined as a package of transmission plus compression plus metering plus excessive fuel use plus gathering charges plus faxing plus weather reports. A little bit here, a little bit there, and an extra 100 buffalo skins is added to the bill. The result: 375 buffalo skins worth of charges, but not labeled as a large increase in the transmission fee.

Now the lawyers for Babylon's four new billing and revenue centers go to work and really earn their money with an especially aggressive twist. The lawyers arrange to bill the four new pipelines' services under confidential, non-disclosure contracts. No one but Babylon knows exactly what is going on. It is the old divide-and-conquer ploy. No individual Babylon customer in Kansas can easily compare charges or calculate aggregate charges, because they are hemmed in by the confidentiality clause. Producers in Seward County realize their costs have increased, but producers do not know their neighbors' charges or even the neighborhood's average charges. There is discontent amongst the little people but no ready information on which to allege a pattern of monopoly practices in order to call for regulatory remedies to be reinstated.

Babylon and its lawyers have acted rationally to maximize revenues under monopoly conditions, but no small actor can efficiently prove abuses or afford to complain.

Net result of our hypothetical:

Big victory for Babylon Monopoly Pipeline Company;

Big loss for everyone else.

How Instructive is our Babylon Hypothetical? How Close to Reality?

There are at least the following points of similarity:

1. There is a potential, even a likelihood, that monopoly practices will be created and flourish in Kansas gas gathering systems, if the KCC does not adopt affirmative regulation.

2. The existing main pipeline entities have created or "spun-down" gas gathering into new corporate entities or asset groupings.

3. Non-disclosure, confidentiality clauses have appeared in gas gathering contracts that have been recently offered to producers.

4. Other witnesses have testified to abuses that are characteristic symptoms of unequal or monopolistic economic power.

5. Pipeline companies are urging a light handed approach to regulation.

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Considerations from Economic Science:

1. Monopolistic entities, by historical precedent, if not by definition, engage in practices that are unfair, unjust and discriminatory. As rational economic actors, monopolists and oligopolists exploit the advantage of large size and power.

2. When economic entities, especially large oligopolies or monopolies, fracture the pricing structure or spin down assets to smaller pricing units, the results are predictable:

(a) Breaking out or fracturing charges gives the oligopolist an opportunity to increase the oligopoly's profits by increasing the costs incurred by the oligopoly's customers and suppliers.

(b) The total, summary cost of all fractured elements will most likely exceed the cost of the original unfractured service; and

(c) Where the spun down or fractured assets are still owned by the original entity, then pricing is structured to transfer profits to the entity which enjoys tax, economic or political advantage.

3. Fully competitive, open access markets require that all market participants have market knowledge, of both prices and conditions.

4. In the case before us, the main pipeline companies have spun down or fractured or broken out gathering, measurement and other services and appear to be increasing their revenues on assets long ago amortized. The obvious result is that profits have been transferred from gas producers and royalty owners to the pipeline companies. To protect profit collection, the pipeline companies have sought secrecy and market obfuscation through strict confidentiality contract clauses.

Social and Economic Effects in Southwest Kansas:

The effects of monopoly practices in the Hugoton field area will be to:

decrease royalty income;
decrease ad valorem and severance tax revenues to local governments and schools;
decrease producer profits;
decrease irrigator income.

1. Decreasing income to royalty owners is an attack upon the economic status and livelihood of thousands of royalty owners; net personal worth, disposable income, and concomitant economic activity is reduced.

2. Decreasing tax revenues to local governments and schools is an attack upon the social fabric, economic structure, and quality-of-life in southwest Kansas. Mineral taxes are essential to

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local governments and to our school districts.

3. Decreasing producer profits is an attack upon the small, independent producers that have been an economic mainstay of our rural economy, bringing jobs and income into southwest Kansas. By making independent gas production more difficult (less profitable) it is inevitable that fewer wells will be developed or re-worked, and that some wells will be abandoned earlier than need be, thus inhibiting the fullest possible exploitation of the Hugoton Field.

4. Where irrigators depend on a natural gas supply, an increase in cost will decrease farm revenue and land values - again having an obvious adverse effect on southwest Kansas.

Public policy conclusion:

Gas production is a one-time harvest and the Hugoton Field is already approaching depletion. Affirmative regulation of gas gathering is a public necessity. Why? Because gas gathering is an oligopolistic or monopolistic industry that without affirmative regulation will certainly engage in anti-competitive practices which harm royalty owners, irrigators, independent producers, and tax districts. It would be reckless public policy for the KCC to permit monopoly practices in gas gathering, for the effects of such practices strike directly at the economic and social base of southwest Kansas. **Affirmative regulation is necessary for the public interest.**

Providing Remedies and Managing Monopoly by Affirmative Regulation:

1. Gas gathering market conditions should be transparent to all concerned. The KCC and the Kansas legislature should take the necessary steps to insure that the Commission and everyone else will know the prevailing rates and charges, as well as the terms and conditions for gas gathering services.

2. The KCC should be sensitive to and actively scan for symptoms of monopolistic distortions and abuse. The KCC can find such symptoms, as this series of hearings has demonstrated. The most egregious example I have heard is that a customer in New York City pays less for gas than an irrigation farmer a mile away from the wellhead.

3. The KCC should not depend solely upon a complaint procedure. Depending upon folks who cannot bear the expense of complaining to do the Commission's fact finding ensures there will be an absolute minimum of complaints. So far as KCC regulation depends upon complaints from those aggrieved, a scheme that makes complaints prohibitively expensive amounts to a scheme for no regulation - light-handed indeed.

4. The Kansas legislature and the KCC should adopt affirmative regulation to inhibit monopoly abuses and the concomitant harsh effects upon the economic base of southwest Kansas. The law should reflect reality - monopolies act like monopolies and can be expected to attempt anti-competitive practices; oligopolies act like oligopolies and can be expected to attempt anti-competitive practices.

-- end --

Southwest Kansas Irrigation Association
By Larry Kepley - Member

Irrigators in Southwest Kansas use about 4 to 5% of the total natural gas produced in the Hugoton Field each year to produce crops. Added natural gas from the field is used to operate feedlots, grain dryers, pork feeding operations and dairies located in the area because of the irrigated crop productions. In other words the basic economy of agriculture and natural gas are closely tied together in Southwest Kansas. Any KCC regulation, or state legislation the natural gas industry has an effect on irrigators potential profits.

For this reason the Southwest Kansas Irrigation Association board is offering the following resolution to its membership January 23 at the annual meeting in Ulysses. (copy of resolution)

If something similar to H.B. 2041 in statute or regulation form comes to pass we feel the the following is necessary.

1. Equal access should be available for use of gathering and/or main pipelines and be given on a fair and equatable basis.
2. Good faith negotiation between carriers and users be mandated and monitored by KCC.
3. Charges for pipeline use be based on sound and fair economics to all parties.

4. Charged rates will be posted and made available through the KCC to anyone seeking the information.
5. Any changes in pipeline regulation such as suggested in H.B. 2041 should not have the net effect of reducing economic returns to the Southwest Kansas area.

Thank you and we stand ready at any time to help develop policy on this matter.

Larry Kepley

H.B. 2041

WHEREAS, the Board of Directors of the Southwest Kansas Irrigation Association has carefully reviewed the provisions of the proposed legislation pending before the Kansas legislature, known as H.B. 2041, and having considered the potential impact the enactment of such bill into law would have upon the cost of fuel for rural users in Southwest Kansas, has determined that the enactment of said bill would not be in the best interests of the members of our organization, and

WHEREAS, it appears to the Board of Directors that the alternative legislation providing for OPEN ACCESS to fuel gas and transportation services could considerably reduce the costs of fuel to our members and other rural gas consumers, while at the same time, potentially enhancing wellhead prices of locally produced natural gas to the benefit of Kansas producers and royalty owners,

NOW THEREFORE, BE IT RESOLVED that the Southwest Kansas Irrigation Association opposes the enactment of H.B. 2041 and urges the Legislature of the State of Kansas not to enact the bill.

FURTHER RESOLVED that the Southwest Kansas Irrigation Association would, and does, support the enactment of legislation which would provide for OPEN ACCESS by rural users and consumers to local fuel gas supplies at market prices and OPEN ACCESS to gas transportation services through local pipelines at uniform just and reasonable rates or charges.

SOUTHWEST KANSAS IRRIGATION ASSOCIATION HISTORY

The name of our organization is the Southwest Kansas Irrigation Association incorporated January 18, 1956 as a non-profit and non-stock corporation under the laws of Kansas. Early leadership was provided by Herb Hobble, Jr. - Liberal, Dale Williams - Ulysses, Ray Trostle - Johnson, Bill Annis - Ulysses, Lloyd Lambert - Liberal, Raymond Boles - Liberal, and C. Bayne Foster.

The organizational meeting was held in Ulysses with about 75 persons present and it was the general consensus of opinion that an organization was needed to develope irrigation farming in Southwest Kansas, although the group knew that there was going to be problems, both in research and production, that they were not acquainted with at that time.

In the original group there were about eight or nine counties represented and it was agreed to elect a temporary set of officers and two representatives from each county until such time as a Constitution could be prepared and a Corporate Charter received from the State of Kansas. The matter of two members on the Board of Directors from each county was contained in the new Constitution.

After the Charter was issued and the Board began to obtain data on the subject of crops, cattle feeding, irrigation practices, water problems and legislation, it was determined that possibly tours to various areas would be beneficial to the individual making the tour in order that he could observe farming practices, including cattle feeding which would beneficially affect his operation. As a result of that decision, the organization took three tours to Colorado, one tour to Arizona and one tour to southern California. It was generally agreed that irrigation farming in Southwest Kansas and individual cattle feeding benefited from those tours. One year the organization was asked to send a delegation to Washington to present testimony before the Agricultural Committee of the House of Representatives on pending farm legislation and the group was complimented by the Congressmen on the practical and sensible testimony.

It was recognized in the early days of the organization that a water policy was going to be necessary because too much water was being wasted and it needed to be conserved. The Kansas Legislature for years did not think any legislation was necessary, even though the organization cooperated with the Kansas Water board and the Kansas Department of Agriculture in trying to get legislation through the State Legislature on the subject.

One of the beginning goals of the organization was the endeavor to develope vegetable production in this area by having test fields of field vegetables and melons showing

what was possible with irrigation. Dale Williams and Ray Trostle were the leading force in the passage of the Groundwater Management District act and have watched over irrigators interests in issues of water rights, gas supply, and availability and water conservation. Many activities have involved legislation and developed leadership in the directors. When water and natural gas issues became serious issues in the mid 70's the directors saw need to hire a full time executive secretary whose primary job was membership, lobbying for irrigation interests, and helping irrigators with presenting testimony for the many issues during the time of gas shortage and irrigations rapid development. Membership reached a peak of about 1000 during this time and since, due to the economic crunch on agriculture and declining development dropped off considerably. In 1981 the decision was made to maintain an office to be managed by a business manager rather than the executive secretary. A strength of the organization has always been the willingness of its directors to give of their time and talent to go where ever needed to speak for irrigation and protect irrigation interests.

The territory presently served by the association (1995) consists of Meade, Seward, Stevens, Morton, Stanton, Grant, Haskell, Gray, Ford, Finney, Kearny, Hamilton, Wichita, and Scott Counties. The directors and officers are: President - Anthony Stevenson, Vice-President - Jim McCune, Secretary - Harold Shore, Treasurer - Kenby Clawson, Randal Loder, Thomas Bogner, Dennis Leighty, Kevin Fox, Jay Garetson, Don Neff, Ralph Reimer, Merle Krause, J. J. Jenkinson, Jr., Ted Musgrove, Marvin Odgers, Rex Julian, Lloyd Crawford, and Milton Gillespie.

Services provided by the association are the promotion, fostering, and encouragement of intelligent and economical operation of irrigated land with the territory of the association, and to do all lawful things deemed necessary or proper to accomplish such purposes including but not limited to the following:

To initiate, sponsor, and promote research to determine the amount of water available for irrigation purposes, the source of underground water, the rate the same is replenished or recharged, and all other factors pertaining to the available supply of water for irrigation purposes.

To assist the members of the association in obtaining the most satisfactory fuel for irrigation power at reasonable rates.

To initiate, sponsor, and promote research to determine the most profitable crops which can be raised on irrigated land.

To sponsor the formulation of a general water policy which will be for the best interests and will promote the welfare of the majority of the members of the association.

To obtain and furnish such information and reports to the members of the association as are deemed helpful or of value to them in connection with irrigation.

To take such action as is deemed necessary or advisable to protect the rights and promote the welfare of the members of the association in all matters which are of mutual interest and benefit to a majority of the members in connection with irrigation.

To promote the general interest and activities of the members of the association in the improvement of irrigation practices for their mutual benefit and welfare and for the development of the most profitable and permanent system of irrigation that is possible.

To sponsor the study of legislation, tax matters, rules and regulations of any duly constituted authority which may affect the irrigated lands, equipment, power and water resources of the members of the association.

Recent efforts of the association include:

Achievement of a high priority, essential agricultural use classification which guarantees 100 per cent of actual needs for natural gas and special consideration on gas pricing.

Appropriation from the state for development of pilot recharge projects to extend the life of the Ogallala Aquifer.

Defeat of several state legislative bills which would have altered the state water law in a detrimental manner to irrigation agriculture.

Defeat of the Governor's efforts to reorganize state water agencies into a super agency of his office.

Monitoring and providing input into the rewriting of the State Water Plan so that irrigation interests are protected.

Monitoring of the developing federal water policy which also threatens to extend federal authority over water development decisions.

Providing members with a monitoring role on groundwater management district policies and operations.

TESTIMONY OF MERLE KRAUSE

I am Merle Krause of Meade County. Two of our irrigation wells are fueled by gas from the Northern Natural Gas Pipeline in Meade County and are on separate meters. Two of our irrigation wells are fueled by gas from one meter on Panhandle Eastern Pipeline near Plains.

We had purchased gas for $1.94 per thousand from Panhandle for a few years and that ended in 1992. Peoples Natural Gas took over marketing and transportation of that gas in 1993. Peoples added a monthly "customer charge" and raised the price of gas. By 1994, we were paying $2.86 per thousand plus we paid a customer charge of $240 in 1994. That consists of about a 50% increase in price between 1992 and 1994.

Then in 1995, Peoples offered to sell us gas for $1.75 plus 40¢ transportation charge and $40 per month customer charge most of the year. Competition in gas marketing had become a reality in 1995 and we purchased gas from Panoak Gas of Tulsa for $1.73. I believe marketing competition was a factor that allowed lower price in 1995.

However, the transportation contract was not competitive. Peoples has a measuring meter and maybe about 10 feet of pipe to transport gas from Panhandle-owned pipe to our farmer-owned pipeline. Kansas Corporation Commission authorized Peoples Gas to charge us 40¢ per thousand cubic feet of gas that short distance.

In one instance in 1995, we paid over $2300 transportation cost plus $420 annualized customer charge. I wish Peoples would have been more reasonable in their request for that transportation rate and KCC would have been more objective in their analysis of that rate request.

On our entire farm in 1995, we paid Peoples about $5000 transportation charge and customer charge to have gas transported a few feet and read meters at 3 locations in Meade County.

It is my hope that the age of reason will prevail soon and this outrageously high expense will become reasonable.

Thank you for this opportunity to testify at this Kansas Corporation Commission hearing.

Respectfully submitted,

Merle Krause

MERLE KRAUSE
BOX 619 105 GREENSBORO
PLAINS, KS 67869

Merle and David Krause

1995 IRRIG. GAS EXPENSE

LAND REFERENCE	GAS USED	PANOAK GAS COST 1.73/TH.	PEOPLES TRANS. 40.84¢/TH.	PEOPLES CUST. CHARGE (ANNUAL)	PEOPLES TOTAL CHARGE TRANSPORTATION AND CUSTOMER CHARGE	CALCULATED RATE PER TH.
						$2723 ÷ 5639
SEC. 33	5639 TH.	$9755	$2303	$420	$2723	48.3¢
						$1242 ÷ 2013
SEC 36	2013 TH	$1482	$825	$420	$1242	61.7¢
						$1017 ÷ 1462
SEC. 32	1462 TH	$2528	$597	$420	$1017	69.6¢
		$15,765			$4982 = 24% of total cost.	

TH. means one thousand cu. ft. of gas

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BEFORE THE KANSAS CORPORATION

HEARINGS ON THE NEED FOR GAS GATHERING LEGISLATION

DOCKET NO. 193,135-C (C-27,760)

LIBERAL, KANSAS - JANUARY 10, 1996

TESTIMONY OF EUGENE L. SMITH

INDEX

BEFORE THE KANSAS CORPORATION COMMISSION
HEARINGS ON THE NEED FOR GAS GATHERING LEGISLATION
DOCKET NO.193,135-C (C-27,760)
LIBERAL, KANSAS
January 10, 1996
Testimony of Eugene L. Smith

My name is Eugene L. Smith. I am a lawyer and practice in Liberal, Kansas. I am appearing in opposition to H.B. 2041, at least in its present form.

I want to thank you for the opportunity to appear in these hearings.

I

I have previously written my observations, objections and comments concerning H.B. 2041. Rather than take time to repeat them here, I will refer you to my testimony before the legislative SPECIAL COMMITTEE ON ENERGY AND NATURAL RESOURCES, as to which you have taken judicial notice. I note that some of the observations may be erroneous, but in the main I believe they are accurate and do address many problems which would be created by enacting H.B. 2041 into law.

II

I wish to commend the Commission for the suggested amendments to H.B. 2041 made by Commissioner Tim McKee in his testimony before the Special Committee on Energy and Natural Resources, and call your attention to his testimony. The Commission, through Commissioner McKee, has addressed several of the questions and issues which were of great concern to me and many others who will be affected by any legislation you may now ultimately recommend to the legislature. However, it is apparent that there are additional problems that should be addressed.

III
THE QUESTIONS

The questions presented to the Commission by the legislative Special Committee on Energy and Natural Resources can basically be stated as follows:

1. What changes <u>are</u> <u>required</u> in Kansas law as a result of the FERC restructuring of the natural gas business to enable the KCC to effectively regulate gathering transportation?

The simple answer is, <u>none</u> is actually required. The problem has previously been perceived and presented to the legislature as one requiring urgent action. There is certainly no urgency.

2. What changes in Kansas law are <u>desirable</u> to benefit the State of Kansas by providing a business and regulatory climate which would promote higher prices to producers and royalty owners and lower prices to Kansas consumers?

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It would be desirable for the legislature to express a public policy which favors and provides for the benefits of competitive open market selling and purchasing of natural gas coupled with uniform, just and reasonable, non-discriminatory pipeline transportation charges and potential for elimination of unnecessary middlemen charges, including unbundling of transportation and distribution services.

HISTORY OF DEREGULATION OF GAS WELLHEAD PRICES

Since passage of the Natural Gas Act (NGA) in 1938, until recently, Federal agencies (FPC, then FERC) have regulated:

The price of natural gas; and
The cost of transporting natural gas.

What has occurred is that as a result of Congressional action, the wellhead price of natural gas was deregulated in 1993. The FERC no longer has jurisdiction to regulate the wellhead price of natural gas. Neither has the KCC nor possibly the State of Kansas any authority to regulate the wellhead price of natural gas - at least if it is to be sold on the interstate market, and possibly not under any circumstance if the U.S. Congress has occupied the field as a matter of federal sovereignty. The issue is not important except that it be understood that the U.S. Congress has terminated the authority of the FERC to regulate, determine or fix the wellhead price of natural gas.

CONTINUED REGULATION OF INTERSTATE TRANSPORTATION CHARGES BY FERC

On the other hand, Congress left intact the provisions of the Natural Gas Act of 1938 (NGA), requiring the FERC to regulate the transportation of natural gas in interstate commerce. The FERC has responded by promulgating many new rules and regulations by which the transportation of natural gas in interstate commerce is made much more complex than ever before.

(a) Interstate pipelines have in effect become common carriers. They no longer buy or sell gas. They just transport gas for the public.
(b) Gas users in consuming areas are supposed to be assured of open access to transportation services on interstate pipelines.
(c) Producers of natural gas are likewise supposed to have open access to transportation services on interstate pipelines.
(d) Users of natural gas are supposed to be able to contract for the purchase of natural gas directly from the producer, and to transport it from the purchase point to the point of use - by paying the transportation charges - which are highly regulated rates fixed or approved by the FERC.
(e) Users and shippers of natural gas are supposed to be able to select from a menu of available transportation services and be required to pay for only those services which they select and utilize.

THE GATHERING EXEMPTION IN THE NGA LEAVES GATHERING PIPELINE REGULATION TO THE STATES

11-1-57

So what's the big deal? Well, a provision of the Natural Gas Act (heretofore almost totally ignored) provides that the Act does not apply to

"the production and gathering of natural gas".

The Act does not define the term "gathering of natural gas".

The FERC, in its effort to make the benefits of competition available in purchasing natural gas supplies, has allowed the interstate pipelines to define which of their pipeline facilities are

"gathering systems"

and allowed the pipelines to "spin down" these pipelines to an affiliated company or sell them outright to a third party. Once the FERC has classified pipelines as "gathering systems" it no longer has authority to regulate the owners of these pipelines nor their rates and charges for transportation service as "natural gas companies" under the provisions of the Natural Gas Act of 1938 as currently interpreted by the FERC.

Under the present FERC scheme, regulation of pipelines classified by the FERC as "gathering systems", if there is to be any regulation, is the responsibility of the states.

KANSAS LAW GOVERNING PIPELINES

H.B. 2041 is designed to incorporate the FERC language of art into the Kansas law. It is further designed to allow the owners of thousands of miles of Kansas pipelines to operate with little accountability for their actions or the effect their actions may have upon the public good of Kansas citizens and businesses. MAKE NO MISTAKE. "GATHERING SYSTEMS" are PIPELINES. Pipelines are already well defined in Kansas law and provision for oversight of their owners' activities are already extant in Kansas statutes. It is unnecessary and unwise to create confusion in Kansas law by attempting to define some pipelines as "gathering systems". If the legislature does nothing, the laws of Kansas adequately address the problems supposedly thrust upon the states by the FERC's action in relinquishing jurisdiction to regulate Kansas "gathering systems", which under Kansas law are classified as PIPELINE COMMON CARRIERS. Other states are not so fortunate - and may be under time restraints to enact legislation. Not so for Kansas. The only thing urgently required in Kansas is enforcement of existing Kansas law.

THE OKLAHOMA LEGISLATURE'S HURRIED RESPONSE TO THE "CRISES"

A good example of a hodge podge of provisions enacted under the hysteria of time restraints is the recently enacted Oklahoma statute. A cursory review of this statute will convince almost anyone that it will spawn a virtual uncountable number of lawsuits or in the alternative will deny uniform just and reasonable transportation rates to the detriment of small producers and their royalty owners who may be unable to bear the litigation burden and costs. The burden of proving oppression is shifted to the oppressed.

IV
KANSAS COMMON CARRIER STATUTES GOVERNING GAS TRANSPORTATION CHARGES

Under Kansas law, all pipeline companies operating such agencies for public use in the conveyance of property in the State of Kansas are common carriers. KSA 66-105. The KCC is given full power and authority to regulate common carriers. It is the obligation of common carriers to file and charge uniform just and reasonable rates. It is the duty of the KCC to see that they do so. (KSA 1,215, et.seq.) You will note that the Kansas statutes are comprehensive and detailed. Virtually all "spin down" gathering system owners are common carriers, but most have not obtained certificates nor filed uniform just and reasonable rates as required by Kansas law. There may be other gas pipeline common carriers which have not filed uniform just and reasonable rates.

FERC RECOGNITION OF MONOPOLY POWER OF COMMON CARRIERS AND REJECTION OF MARKET BASED TRANSPORTATION CHARGES

The proponents of H.B. 2041 assert that by a "light handed approach" to regulation of gathering pipeline systems, the benefits of competitive market forces will be brought to bear in the natural gas industry. More likely, the abuse of monopoly power will result in a "heavy handed approach" by pipelines toward selected small producers and users. You have already heard about some such abuses occurring even before the FERC has finalized the relinquishment of its authority over interstate pipeline "gathering systems". A similar argument has been urged upon the FERC with respect to interstate main transmission pipelines. Read what FERC Commissioner Donald Santa, Jr., had to say about the matter (quoting from the Oil and Gas Journal, April 21, 1995).

> "Pipeline tariffs. FERC still is considering whether to allow alternative rate making methods for pipeline tariffs. In February it asked for comments on whether it ought to consider market based and incentive based rate making approaches to the traditional cost of service methodology. (FERC Commissioner) Santa said 'FERC has no intention of implementing market based rates without first requiring the pipeline to show it does not wield undue market power.'
>
> "It appears unlikely to me - and to many others - that a traditional mainline interstate pipeline easily could make such a showing. I expect such cases to be few and far between . . ."

Note that the burden would be upon the pipeline to show it does not possess monopolistic power. I suggest that the same reasoning does and should apply, and be applied to state regulated upstream pipelines. However, H.B. 2041 shifts the burden of proving the exercise of monopoly power to the transportation user. Nevertheless, there is considerable sentiment and belief that a rate making methodology using an approach other than traditional cost of service studies would benefit the industry. I agree that less burdensome and less expensive methodologies could be advantageously utilized. However, the "don't interfere with private contract" approach proposed by H.B. 2041 would insure non-uniform, unjust and discriminatory rates rather than eliminate them as the law now requires.

POSSIBLE MONOPOLISTIC PRACTICES SUGGESTED BY RAPID INCREASES AND WIDE VARIANCE IN GATHERING RATES

The current wide diversity in wellhead to mainline gas transportation charges made by different companies suggest that market competitive pricing is not at work in mature producing areas of Kansas. Charges recently or currently being made for wellhead to mainline gas transportation for small producers range from 11¢ or 12¢ to well in excess of 35¢ per MCF or MMBTU. Compare the reported results of a nationwide study which indicated the nationwide average gathering charge reported by shippers and transporters to be approximately 8¢ per MMBTU. Why the difference? Only the KCC has the authority to find out. So far the KCC has failed to initiate hearings or studies to find out.

Likewise, the recent increases in wellhead to mainline gas transportation charges made by some companies suggest that benign regulatory oversight by Kansas regulatory authority may not have been effective to inhibit exercise of monopolistic power. Some examples are:

	1990	1994
Kansas Nebraska (Gathering Charge)	7.0¢	29.0¢
(Fuel)	1%	5.6%
Total cost at $1.50 spot price	8.5¢	37.4¢

ALTERNATIVES TO COST OF SERVICE RATE MAKING

The KCC does not want to make cost of service studies, citing lack of funding and personnel and the benefits of "light-handed regulation". The pipelines and wanna be gatherers do not want to be burdened with cost of service type of regulation. Some producers, shippers, users and consumers believe there might be a better, more cost and time effective rate making methodology. So far the only specific proposal is to drastically reduce and limit KCC authority to provide for uniform just and reasonable transportation rates (H.B. 2041).

My suggestion is to leave the current common carrier statutes in effect, except, if deemed necessary, to specifically authorize the KCC, in its discretion, and after adequate study and hearings, to devise efficient rate making procedures that do not involve cost of service studies, where the KCC determines cost of service studies would be inefficient and unnecessary to accomplish the legislative mandate of uniform just and reasonable rates.

The State of California, for instance (I am told, but have no certain knowledge) provides for a single state wide maximum gathering transportation rate of 22 cents with provision for justifiable exceptions.

The State of Kansas has a similar statute regulating rates for transportation of oil by pipeline (KSA 55-503 & 504 - enacted in 1905). A similar approach based upon gas pipeline mileage and compression ratios might provide the least burdensome of all regulatory approaches.

VI
OPEN ACCESS DENIED TO KANSAS CONSUMERS AND SHIPPERS

Gathering pipelines in Southwest Kansas serve as conduits to move gas from the well to a main transmission line providing access to a distant market, and the additional function of being rural distribution pipelines. These pipelines are owned by the gatherers. The "distributors" do not own these pipelines and have no investment therein.

Many of these pipelines are constructed in rights-of-way that provide for the pipeline to sell the landowner household fuel or gas to fuel irrigation pump motors, grain dryers, and other agricultural uses.

Other rural businesses such as cattle feedlots, swine production facilities, dairies and other industries located in rural areas use gas transported through these pipelines for their fuel requirements.

Both the FERC and the KCC have a shameful record in failing to protect these rural users. What has happened is that at least one (1) pipeline company, Panhandle Eastern, has sold its "taps" to Peoples Natural Gas Company, a division or subsidiary of Utilicorp United. In the Panhandle sale, there was no sale of a "tap". What was sold were those facilities downstream of the first above ground shut off valve - being in most cases a short piece of pipe, a regulator and meter and some miscellaneous fittings. The pipeline also sold its "contracts" to Peoples, thereby separating the right-of-way grant obligations from ownership and operation of the pipeline. Legislation designed to address this inequity may be appropriate and could possibly avoid much litigation.

These meter sales and related abandonment of service by the pipeline were authorized by the FERC. Peoples promptly applied to the KCC for authority to purchase and operate these facilities. The KCC granted Peoples the necessary authority out of an expressed fear that Panhandle would drastically increase its rates or that Peoples would withdraw its certificate application. I am at a loss to understand this reasoning.

The shame occurred when Peoples was permitted to charge the rural users its' existing KCC filed rates instead of using the rates previously charged by the pipeline. Indeed it is possible that Peoples may be paying the pipeline a transportation price more than double the usual "gathering rate" charged for transportation of gas from the wellhead to a point on the pipeline's main transmission system, and passing this cost on to the rural consumer. That is to say:

(a) The pipeline gets twice the price for transmitting the gas half the distance, while:
(b) Peoples adds on a hefty surcharge for handling some paperwork which many shippers or marketers would handle for a much lower price, and
(c) The rural consumer pays twice the price he was formerly charged for the same fuel and service, with no additional facilities required nor enhanced service given.

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Peoples does not own these distribution pipelines and has not invested a single dollar in them. Basically, the only facilities it owns are the regulators and meters. These could be paid for in many instances in less than a year (and some in less than a month) if farmers or shippers were permitted to replace them. The rural user owns his own pipeline downstream of the meters. Simply because the filed rates of Peoples was much higher than the filed rates of the pipeline, the rural user was required to pay a much higher price for the same gas supply.

Worse, when a shipper or producer requests transportation access and service across a portion of the pipeline's gathering system (that is from the wellhead to the rural user's metering point) he is told that he cannot obtain such service, that only the rural user is permitted to procure such services. When the rural user makes application for such service, he is told that he can have such service only if he agrees to pay Peoples a fee. (Currently the fee in parts of southwest Kansas is approximately 40 cents per MMBTU plus a $40.00 per month meter charge.) Peoples' current charges for gas sales to rural users, at least in some areas of southwest Kansas, are approximately $2.15 per MMBTU plus $40.00 per month meter charge. This is down considerably from the price initially charged immediately after the transfer of facilities, but is still, I am told, more than an industrial or large commercial user would pay for natural gas in Omaha or Detroit and points east, as far as New York City.

Legislative action, or KCC regulatory reform, insuring open access to gas transportation at uniform just and reasonable rates and competitive market pricing of natural gas to consumers taking gas from non-distributor owned pipelines would result in lower fuel prices to Kansas rural consumers and higher gas prices to Kansas producers and royalty owners. Consumers should not be required to pay for "mainline" or other transmission services not utilized.

VII

OPEN ACCESS MAY REQUIRE LEGISLATIVE ACTION ABSENT KCC REGULATORY POLICY REVISION

The FERC scheme of things was for everyone to have "open access" to all gas transportation services at reasonable and uniform rates and charges. In addition, everyone is supposed to be able to select from a "menu" of services and pay only for those services which are utilized. A Kansas producer does not have "open access" to transportation across a "gathering system" so he can sell gas to a rural Kansas consumer only a mile or two down the pipeline. A shipper or agent desiring to arrange a purchase and sale between a producer and rural gas user is denied access to transportation services unless a fee is paid to the distribution utility. A farmer cannot purchase irrigation gas from a producer at the wellhead, pay the usual "gathering" transportation fee and take delivery at his farm unless he pays an additional fee to the distribution utility. The fee charged by distribution utilities appears to include charges made for "mainline" transportation services which are not utilized.

Apparently Kansas law and KCC regulations and practices do not provide for the benefits of "open access" to bring competitive forces to impact favorable prices to Kansas producers and rural consumers. If the law is to be changed, this is certainly a situation which should be addressed and rectified. Consideration should be given to modifying or abolishing the concept of the conventional "franchised territory" monopolistic grant coupled with a "duty to serve", and replacing it with a system encouraging cost reduction incentives. Many state regulatory agencies are seriously considering such policy changes - as are many state legislatures.

I would recommend encouraging the KCC to provide for a practice that is currently in use on some Kansas gathering pipeline systems. I am advised that a producer, shipper and rural user can transport gas across the gathering pipelines of Williams Pipeline Company, for instance, merely by paying the regular "gathering charge" of approximately 12 cents/MMBTU, more or less. Such an arrangement can certainly benefit Kansas producers and rural users. The producer gets a higher price, the user a lower price. Both benefit and the State of Kansas encourages industry by maximizing wellhead prices for producers and minimizing fuel costs to rural industries. The charges exacted by the non-performing distribution company are rightly eliminated. Unused "mainline" transportation services are not charged nor paid for. Absent legislative action, the KCC should adopt a procedure for bypassing or eliminating distribution utility charges where no distribution utility pipelines are installed, and eliminating "mainline" transportation charges where no "mainline" transportation is utilized.

VIII
EFFECT ON TAX REVENUES

Taxation of oil and gas and facilities for transportation of gas is very important to southwest Kansas governmental entities. The primary taxes are:

(a) severance tax
(b) ad valorem tax on product
(c) ad valorem tax on physical property

Severance tax and ad valorem production taxes are both based upon the wellhead price of natural gas. Any reduction in wellhead prices occasioned by excessive gathering charges results in reduced severance and ad valorem tax on producing properties.

Ad valorem tax on pipelines and other public utilities or common carriers is based upon an assessed valuation of 33 1/3% of true market value. Other business property is assessed at 25% of true market value. Thus a mere change in what a pipeline is called can substantially reduce the tax collected for support of city and county governments, schools, hospitals and other governmental taxing authorities. I live in Seward County and am advised by our tax assessor that:

(a) Mere reclassification of gathering pipelines from utility or common carrier status to private business property would result in a reduction of more than $1,000,000.00 in assessed valuation, and approximately $300,000.00 reduction in actual tax receipts.

(b) The total assessed value on oil and gas production properties is approximately $56,000,000.00, yielding ad valorem tax revenues of $5,500,000.00, being approximately 38% of all Seward County ad valorem taxes. A 10% reduction in wellhead commodity prices due to excessive transportation charges would reduce the tax receipts from this source by as much as, or more than, $550,000.00.

(c) I was not furnished a number for severance tax impact, but note that it is also a wellhead commodity priced based tax. Excess gathering charges would result in directly proportionate reduction of severance tax receipts.

IX
RECOMMENDATIONS

The legislative imposed time constraints and nature of these hearings does not permit presentation of nor inquiry into specific examples of monopolistic practices. However, I have been asked by legislators, and others, to whom I have expressed reservations or complaints about H.B. 2041 or lack of regulatory enforcement of current law.

What should be done about it?

I recommend the following:

A.
LICENSING FOR OVERSIGHT OF PIPELINE SAFETY

Be certain the KCC has authority to require registration (or licensing of operators) of all off lease gas pipelines and other transmission facilities to insure ability to enforce pipeline safety standards.

B.
GAS PIPELINE TRANSPORTATION - REGULATED FIXED UNIFORM RATES

1. Make no other immediate changes in the current law governing gas transportation pipelines except to provide for open access to transportation across a portion of a pipeline system situated upstream of a mainline transportation pipeline, for a charge no greater than the charge made to transport gas from the wellhead onto the main transmission pipeline.

2. Encourage the KCC to require all owners of pipelines "spun down" to interstate pipeline affiliates, or sold to third parties, to obtain certificates of convenience and necessity and file the pipeline companies' last effective FERC approved rate schedules as initial KCC filed rates, to stay in effect until revised rates can be supported.

   It should be noted that there are probably fewer than 10 "spin down" companies, or gathering system wanna bes at the present time. There would be no need to conduct cost of service studies for these companies since that has already been done by the FERC.

   Any contracts entered into prior to grant of a certificate which are inconsistent with the initial filed rates should not be permitted unless modified to conform to the filed rates, or otherwise justified as reasonable exceptions.

   It should be noted that the FERC two (2) year default contract provisions are FERC imposed limitations on prices charged by "spin down" companies, but are not filed rates.

3. Encourage the KCC, including specific grant of authority, if necessary, to devise an alternative method of rate making which would not require future cost of service studies, unless deemed necessary by the KCC to meet the legislative mandate of uniform just and reasonable rates.

4. Any alternative rate making methodology should result in rate structures and operating practices which would accomplish the following:

(a) Just and reasonable transportation rates uniformly charged to all persons desiring to use transportation services.

(b) Rates charged for transportation from the wellhead to a delivery point on a main transmission line would be stated as a single charge which would include all necessary elements required to meet the standard tariff conditions for delivery onto the interstate pipeline.

(c) Rates charged for transportation across short connecting pipelines owned by different carriers would be prorated on a mileage and compression ratio, or other reasonable basis, so that the total transportation charge from wellhead onto a main transmission pipeline would be no more than the highest charge made by any of the connecting pipeline companies for transportation from wellhead to main line.

(d) All parties desiring transportation services on a pipeline would have open access to such service, and the right to select and pay for only the service utilized.

(e) Persons desiring to transport gas from a wellhead to a rural user across a portion of a pipeline system situated upstream of a main transmission pipeline would have access to such service by paying a charge no greater than the rate paid for transmission from the wellhead to the main transmission pipeline.

(f) Where in tying in new gas supplies or making new sales to rural users, responsible producers, shippers, marketers or rural users are able to supply equipment of equal quality and specification to that furnished by a pipeline, for a price that is less than the pipeline will charge, then they should be permitted to do so, unless the pipeline is willing to lower its charge.

(g) All pipeline companies should take ratably from all wells, connected to its pipelines if required in order to prevent waste and protect correlative rights.

(h) Any new legislation should address the fact that not so long ago, virtually all pipeline companies operating in the Hugoton Field - and many in other fields - had exchange agreements whereby gas delivered by one pipeline into the gathering system of another pipeline and vice versa, could be exchanged and volumes balanced between them. These contracts have, we are told, been canceled due to FERC requirement. The KCC should be authorized to direct interconnects at previously existing or convenient crossover points in order to prevent economic waste and unnecessary duplication of facilities.

C.

SELLING AND PURCHASING OF NATURAL GAS - MARKET COMPETITION

The legislature should follow the FERC lead in allowing market competition to control gas prices. It should encourage the KCC to exercise its current authority, or give it authority and direction, to eliminate - or permit competition by non-utility sellers of natural gas within - the historically protected franchised distribution utility areas. That is --

> permit and encourage competition in the buying and selling of natural gas -- at least by rural industrial and large commercial consumers in producing regions having extensive gathering pipeline systems.

1. Where the distribution utility owns no distribution pipelines, permit by-passing of utility services and charges.
2. Where the utility owns distribution pipelines, require the utility to transport gas as a common carrier at uniform just and reasonable transportation rates the same as other common carriers.
3. Sellers, including distribution utilities, should be required to post their gas sale prices to ultimate consumers -- which could be fixed stated prices -- or could be based upon current spot prices or other indexed or variable prices. A consumer should be enabled to select a supplier from the posted price list.

Respectfully submitted,

Eugene L. Smith

ELS/lw

57

1-66

Hearings On Natural Gas Gathering
Kansas Corporation Commission
January 10, 1996
Docket #193, 135-C (C-27, 760)
Testimony by Ron R. Poor

Good morning. I am Ron Poor. I am the president of the First National Bank of Liberal. First National of Liberal is the largest independent bank in western Kansas. We are committed to the economic well-being of the area that we serve.

Very briefly, I want to share with you some of my concerns. Also, there are some things that I am very thankful for - and, I want to share this list with you.

First, the concerns. I'm concerned when local farmers are paying more for natural gas, gas that's used to power their irrigation engines, than the gas consumers of Chicago, Detroit, and Cleveland. This natural gas is produced here ~~there~~ on their farms. I'm concerned that farmers, situated on top of one of the riches pools of natural gas in the world, are investing in electric motors to power their irrigation engines - because, electricity is more efficient. Does that make sense? No! Is that fair? No! Is this consistent with the principals of free enterprise and deregulation - that is, the factors of supply and demand will assure everyone of a fair and equitable price? No! Is the deregulation of the gas gathering lines working? No! Not in western Kansas - and, I'm concerned.

I'm also concerned because gas producers and royalty owners are receiving less net income from their production. Is this decrease in net income the result of a lower spot price? No! Is the decrease in net income the result of less demand for the product? No! Why did the net profits go down? When the gas gathering lines were deregulated, the expenses identified with the transmission through the gas gathering lines were shifted from the consumers to the producers. So, the net incomes went down because of the increased cost of transmitting gas through the gas gathering lines. There's the problem. So, if deregulation is suppose to promote competition - and, competition promotes competitive prices, why have the prices gone up? It's simple, the gas gathering lines are a monopoly. I'm concerned.

Most importantly, I'm concerned when I see these things having a serious impact on the economic well-being of my community and my State. I'm concerned when I see the local tax base decline - and, when I see the wealth of our area and our State being shifted out of Kansas. When I see the local schools, the college, and the units of local government put into economic strain, not because of a declining economy - but, simply because of some rule changes that were ill-conceived. I'm concerned! What's caused all of these concerns? Simply stated, it's the deregulation of the gas gathering transmission lines.

I said that I had some concerns. I also said that I wanted to express my thanks and appreciation. I'm thankful that the KCC has come the Liberal to allow us an opportunity to express our concerns. I'm thankful that we have laws in this country to protect the farmers, the gas producers, and royalty owners, and the taxpayers of our State. Most of all, I'm thankful that we have the KCC - a governing entity who's responsible for safeguarding the economic well-being of our State by regulating monopolies that would, otherwise, wreck our economic system. A system that, until now, has generally been based on the principal that, when dealing with monopolies and the public interest, rules are made ~~the~~ that protect those that cannot protect themselves.

Thank you for your consideration!

Testimony of William J. Wix
Assistant General Counsel
Kansas Corporation Commission
Conservation Division
before the
Senate Committee on Energy and Natural Resources
March 14, 1996

Good morning, Mr. Chairman, members of the Committee. I am William J. Wix, Assistant General Counsel for the Conservation Division of the State Corporation Commission. I am appearing before you today to testify in support of House Bill 2041.

Historically, the Federal Energy Regulatory Commission ("FERC") has dominated the field of regulatory jurisdiction over natural gas. Under this regulation, most interstate pipelines were considered wholesale merchants of natural gas. As merchants, the pipelines could sell "bundled services" that included both the commodity (gas) and the transportation of that commodity. In 1985 FERC initiated the move toward deregulation of the natural gas industry by the issuance of Order No. 436. In that Order FERC began to change the concept of operators of interstate natural gas pipelines as merchants and made them transporters of natural gas. The result was that large industrial customers and local distribution customers were permitted to acquire their own supplies of gas and to arrange for the transportation of those supplies on interstate pipelines.

In 1992 FERC issued Order No. 636 which was designed to mandate total unbundling of the transportation of natural gas from the wellhead to the city gate or town border station. Under that Order, pipelines were required to divide their services into parts such as gathering, storage, and transportation. Once gas gathering became a separate service many pipeline companies began to spin off their gathering systems into separate subsidiaries or to sell them to third parties. Previously, gas gathering was considered to be an integral part of interstate pipelines and therefore was regulated at the federal level by the Federal Power Commission and later the FERC.

In May of 1994, FERC issued a series of decisions which held that if a pipeline spun off its gathering facilities to a subsidiary and if the

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Attachment 2

subsidiary was truly operated as an arm's length affiliate of the interstate pipeline, then FERC would no longer exert jurisdiction over gathering rates. FERC also indicated that states were free to exercise jurisdiction if they so desired. FERC provided for a two year time period which would enable states to make the necessary legislative changes to begin state regulation of gathering systems. Recent comments from the Commissioners of FERC indicate that they are somewhat dismayed that the states have not been more aggressive in drafting such legislation. Specifically, Oklahoma is the only state to date which has adopted legislation to deal with the regulation of gathering systems.

During the 1995 Kansas legislative session H.B. 2041 was introduced and amended by the House of Energy and Natural Resources Committee. This Bill was introduced at the request of the Commission. The Bill was passed by the House of Representatives, subsequently referred to the Senate Committee on Transportation and Utilities and finally referred to the Senate Committee on Energy and Natural Resources.

In its present form H.B. 2041 would amend several provisions of existing law with regard to the regulation of gas gathering systems, operators of those systems and operators of underground natural gas storage operations. H.B. 2041 defines a "gas gathering system" in K.S.A. §55-150 to mean a natural gas pipeline system used primarily for transporting natural gas from a wellhead or a metering point for natural gas production by one or more wells to a point of entry into a transmission line. The primary purpose of H.B. 2041 was to expand the definition of operator found in K.S.A. §55-150 to include operators of gathering systems. Also "gas gathering services" was defined to include the gathering, compression, or dehydration for natural gas transportation or distribution.

The bill, in addition, would add cathodic protection, gas gathering, and underground natural gas storage operation to those operations covered in the definition of "contractor." Further, the bill would add persons responsible for gas gathering systems or underground gas storage facilities to the definition of the term "operator," and therefore would require the licensure of operators of gas gathering systems and underground gas

storage facilities. Also, under the bill, the term "well" would include those that have been recompleted.

In addition, the bill would specifically exempt gas gathering systems from the definition of public utility in K.S.A. 66-104, thereby insuring that such systems would not be regulated in the same manner as other public utilities. Further, the bill would amend the definition of "natural gas public utility" to mean any public utility defined as a public utility which sells or transports natural gas.

Pursuant to Senate Concurrent Resolution 1613, the Commission opened a generic docket to hear testimony on the regulation of gas gathering. Public hearings were held in Wichita, Liberal and Chanute. As a result of those hearings, the Commission furnished a report to the Legislature on March 1. The Commission believes that gas gathering could best be regulated under Chapter 55 as opposed to Chapter 66. That report concluded with proposed legislation on the type of regulation the Commission feels is proper and just.

The bill would prohibit any person performing gas gathering service for hire from charging any fee or engage in any practice which is unjustly or unlawfully discriminatory. Any person seeking gas gathering service who is aggrieved by an unjust or unlawful fee or practice would be able to file a complaint with the State Corporation Commission. The Commission would conduct a hearing and would have the authority to order the remediation of any unjustly or unlawfully discriminatory fee for gathering services or practices in connection with gathering services. An order of the Commission would be subject to review in accordance with the Act for Judicial Review and Civil Enforcement of Agency Actions.

If you have any questions, I would be glad to answer them. Thank you.

Kansas Corporation Commission

Bill Graves, Governor Susan M. Seltsam, Chair F.S. Jack Alexander, Commissioner Timothy E. McKee, Commissioner
Judith McConnell, Executive Director David J. Heinemann, General Counsel

MEMORANDUM

TO: Pat Saville, Secretary of the Senate
Janet E. Jones, Chief Clerk of the House of Representatives
Chairperson Don Sallee/Senate Committee on Energy and Natural Resources
Chairperson Carl D. Holmes/House Committee on Energy and Natural Resources
Janis Lee, Ranking Minority Member/Senate Committee
Robert Krehbiel, Ranking Minority Member/House Committee

FROM: Chair Susan M. Seltsam
Commissioner F.S. Jack Alexander
Commissioner Timothy E. McKee

DATE: February 29, 1996

RE: Gas Gathering Report

Pursuant to Senate Concurrent Resolution No. 1613, this memorandum shall serve as the report regarding possible regulation of natural gas gathering systems within the State of Kansas.

Historically, with minor exceptions not important here, the Federal Energy Regulatory Commission ("FERC") has dominated the field of regulatory jurisdiction over natural gas. Under this regulation, most interstate pipelines were considered wholesale merchants of natural gas. As merchants, the pipelines could sell "bundled services" that included both the commodity (gas) and the transportation of that commodity. In 1985 FERC initiated the move toward deregulation of the natural gas industry by the issuance of Order No. 436. In that Order FERC began to change the concept of operators of interstate natural gas pipelines as merchants and made them transporters of natural gas. The result was that large industrial customers and local distribution customers were permitted to acquire their own supplies of gas and to arrange for the transportation of those supplies on interstate pipelines.

M.L. Korphage, Conservation Division Director
Conservation Division, Wichita State Office Building, 130 S Market, Room 2078, Wichita, Kansas 67202-3802 (316) 337-6200

FERC proceeded to further deregulate the natural gas industry by issuing Order No. 451 which had a significant impact on the natural gas fields in Kansas. The Hugoton Field is the largest known gas field in North America. Order No. 451 allowed producers that were tied to specific pipelines under long term contracts to obtain a release from the pipeline and sell directly to large users.

In 1992 FERC issued Order No. 636 which was designed to mandate total unbundling of the transportation of natural gas from the wellhead to the city gate or town border station. Under that Order, pipelines were required to divide their services into parts such as gathering, storage, and transportation. Once gas gathering became a separate service many pipeline companies began to spin off their gathering systems into separate subsidiaries or to sell them to third parties. Previously, gas gathering was considered to be an integral part of interstate pipelines and therefore was regulated at the federal level by the Federal Power Commission and later the FERC.

In May of 1994, FERC issued a series of decisions which held that if a pipeline spun off its gathering facilities to a subsidiary and if the subsidiary was truly operated as an arm's length affiliate of the interstate pipeline, then FERC would no longer exert jurisdiction over gathering rates. Similar treatment was given to systems which were sold to unrelated parties by the pipelines. FERC also indicated that states were free to exercise jurisdiction if they so desired. FERC provided for a two year time period which would enable states to make the necessary legislative changes to begin state regulation of gathering systems. Recent comments from the Commissioners of FERC indicate that they are somewhat dismayed that the states have not been more aggressive in drafting such legislation.[1] Specifically, Oklahoma is the only state to date which has adopted legislation to deal with the regulation of gathering systems.

During the 1995 Kansas legislative session H.B. 2041 was introduced and amended by the House of Energy and Natural Resources Committee. This Bill was introduced at the request of the Commission. The Bill was passed by the House of Representatives, subsequently referred to the Senate Committee on Transportation and Utilities and finally referred to the Senate Committee on Energy and Natural Resources. H.B. 2041 remains in that Committee.

[1] In the December 4, 1995 issue of Inside FERC it states: If and when producer-shippers believe that gathering companies are taking advantage of monopoly positions to deny access or to charge unreasonable rates, their sole source of regulatory relief will emanate from state capitols, commissioners asserted last week in making clear that FERC has washed its hands of the matter and fearful that states have not adequately prepared for their new role, Commissioners James Hoecker and Donald Santa, Jr. urged them to gear up. (See also February 26, 1996 Inside FERC, attached)

In its present form H.B. 2041 would amend several provisions of existing law with regard to the regulation of gas gathering systems, operators of those systems and operators of underground natural gas storage operations. H.B. 2041 defines a "gas gathering system" in K.S.A. §55-150 to mean a natural gas pipeline system used primarily for transporting natural gas from a wellhead or a metering point for natural gas production by one or more wells to a point of entry into a transmission line. The primary purpose of H.B. 2041 was to expand the definition of operator found in K.S.A. §55-150 to include operators of gathering systems. Also "gas gathering services" was defined to include the gathering, compression, or dehydration for natural gas transportation or distribution.

Pursuant to Senate Concurrent Resolution No. 1613, the Commission's General Counsel, David J. Heinemann, provided a legal opinion to the legislature stating that authority for regulation of gas gathering systems could either be found under Chapter 55 (Conservation) or Chapter 66 (Public Utilities) of the Kansas Statutes Annotated. (copy attached)

Senate Concurrent Resolution No. 1613 also directed the Commission to hold public hearings investigating the necessity and extent of such regulation. Public hearings were held in Wichita on January 4, 1996, Chanute on January 9, 1996, and Liberal on January 10, 1996. Approximately 36 witnesses appeared and 107 people attended the hearings. The witnesses gave testimony ranging from recommending no or extremely light-handed regulation to the creation of a very comprehensive cost of service utility approach by the Commission.

The public hearings demonstrated that vast differences exist throughout the state in terms of the nature of gas production and gathering facilities. Obviously Western Kansas produces the majority of gas in the State of Kansas. As such, Western Kansas has large sophisticated gathering systems. Those gathering systems located in Southeastern Kansas quite often are under ten miles in length and do not possess the technical sophistication that is found in Western Kansas.

This report is also being supplied to the members of the Senate and House Committees on Energy and Natural Resources. The following is a summary of the different positions taken by the parties who offered testimony at the public hearings. Those who were designated to receive this report are also receiving a complete notebook which includes the transcripts of the three hearings. We have prepared a specific summary of each individual witness's testimony which is included.

kdd

Summary of Public Testimony and Written Comments

Small Eastern Kansas Operators

Small Eastern Kansas producers presented a unified front in their opposition to extensive or stringent regulation. The wells, reserves, volumes and conditions in Eastern Kansas are so different from Western Kansas that a two tier structure of regulation was preferred.

Typically, the gas wells in Eastern Kansas produce from 3 mcf to 50 mcf per day, often with associated water. These wells are low volume and require more compression. This situation makes them marginally economic. The gathering systems themselves are six to fifteen miles long and most are owned by the operator of the gas wells. The reserves will not attract construction of large gathering systems. Most owners of these gathering systems have no more than two or three employees thus regulation that would require more employees would have an extremely negative impact upon the operators of these systems.

It was suggested that limited regulation consisting of licensing by the KCC, filing maps depicting pipeline size, location, proper identification and marking be adopted. It was also suggested that in the absence of contracts between the producer and gathering system operator, the KCC's Conservation Division should be the forum for handling complaints under Chapter 55.

Local Governmental Units

Stevens and Morton Counties testified as to potential erosion of the tax base and loss of income to Western Kansas communities.

If these hearings result in "light handed" regulation under Chapter 55 (Conservation) as opposed to regulation in Chapter 66 (Utility Division) there is a concern that the gathering systems would be re-classified as industrial and commercial as opposed to public utility thereby causing a drop from 33% to 25% of assessed value with a potential loss of $1,000,000 per year in tax revenue to Seward county. If the transportation costs are transferred back to the operator or well head, these costs would be shared by the county through the loss of county ad valorem taxes and by the state through a loss in severance taxes.

Regulation of the gathering systems should allow the KCC to know prevailing rates, charges, terms, and conditions for gathering fees and services. The regulations should be an extension of Chapter 66 because some gathering systems have been paid for

through the utility rate base in the past, and the systems function as a monopoly and regulation is needed from the well head to the mainline, including all steps in between. Gathering systems and pipelines should charge just and reasonable rates. Any regulations or legislation should not adversely affect economic returns to the Southwest Kansas area.

Large Gas Gatherers and Producers

Testimony from this group came from representatives of two large gathering systems and two large producers who favored a "light-handed" approach under Chapter 55 of the Conservation Statutes. Where truly free market conditions do not exist, a case by case complaint forum should be established to determine individual gathering rates. This group supports H.B. 2041 which grants the Commission authority to regulate gas gathering systems. They also favor the complaint forum as enacted in Oklahoma.

One major producer/gatherer testified that in order for gathering systems to expand they must be receptive to the producers needs and would not survive if perceived, to be abusive and monopolistic.

Two of the producers testified that their gathering systems were private and should be exempt from compelled access.

Mid-Sized Producers Favoring Chapter 66 Regulation

Four witnesses testified on behalf of this group. Their testimony stated that they represented small to medium producers and irrigators. Their position is that FERC Order No. 636 opened the door for a flood of monopolistic abuses. This group believes that the KCC should step into the void left by FERC and assert similar regulatory authority. Examples of alleged abuses cited were improper relationships between affiliate companies, no competitive alternative for gathering, and discrimination against low BTU gas and low volume wells. This group favors the filing of tariffs, full open access to any gathering system and public disclosure of rates being charged.

Independent Producers

This group believes that H.B. 2041 in its present form is inadequate to prevent the abuse that is inherent with a monopoly. As a whole this group favored regulation under Chapter 55. They do not believe sufficient competition exists in the gas gathering business to warrant a non-regulatory policy. This group would favor more expansive regulations such as those used in Oklahoma but stopping short of Chapter 66 regulation. They fear that a utility approach would be too expensive.

Irrigators and Agricultural Interests

Irrigators use approximately four to five percent of the total production from the Hugoton field for irrigation purposes. This group believes that: (1) any legislation should require equal access for the use of gathering and/or main pipelines; (2) the KCC should monitor good faith negotiations between carriers and irrigation users; (3) charges for pipeline transportation should be based on sound and fair economics; (4) rates should be made public by way of filings with the KCC; and, (5) that any regulation adopted should not adversely affect Southwest Kansas. This group favors open access to permit anyone to tap into the gathering lines and purchase irrigation gas. They believe that deregulation has already resulted in escalating costs of natural gas with respect to the operation of irrigation wells. They are greatly concerned about the dwindling pressures and the life expectancy of the Hugoton field and further believe that deregulation of transportation without government oversight would create monopolies and thereby deny equal and fair access to the pipelines.

Gas Storage

Only one large gas storage operator testified and took the position that gathering systems within a storage field should be exempt from any regulation.

Conclusion and Recommendations

The Commission believes that Kansas is possessed of one of the more valuable natural gas reserves in the Continental United States if not in the world. This asset is too valuable to the citizens of this state and the nation to allow the forces of the market place alone to dictate its future. The Legislature has already recognized these facts by virtue of its enjoinder to the Commission to protect correlative rights and to prevent waste of the natural gas resources of this state. (Kansas Statutes Annotated §§55-701 et seq.) The Commission is therefore of the view that a regulatory structure for the gathering of natural gas is appropriate.

It is the Commission's view that this regulatory authority would be in addition to the statutory amendments proposed in H.B. 2041. That legislation provides for licensing of gas gatherers and gas storage operators. The legislative changes suggested in Appendix "A" set forth the scope and nature of the complaint based regulatory oversight. Some changes to H.B. 2041 will have to be made to harmonize it with the proposed legislation in Appendix "A".

The Commission heard from many diverse interests in its public hearings over a period of two years and believes that it has sufficient factual basis upon which to fashion the regulatory structure to protect the interests of the citizens of this state with a "light handed" approach to the regulation of natural gas gathering.

The Commission requests that the Legislature grant sufficiently broad statutory authority to the Commission to complement and augment the authority already existing in K.S.A. §§55-701 through 713 by the addition of three statutory sections shown in Appendix "A" attached. Also H.B. 2041 will have to be modified to be certain it is consistant with Appendix "A".

Appendix "A" was drafted by the Commission after consideration of the evidence offered by mineral and royalty owners, lessees, producers (regardless of size), gathering interests, farmer/irrigators, and the public hearing participants.

By way of explanation the Commission is attempting to accomplish the following with its draft of proposed legislation in Appendix "A" which would give the Commission the authority to:

1) Hear complaints between persons who are unable to reach an arm's length agreement with respect to gas gathering services and the fees therefore. It is the intention of the Commission not to involve itself in contractual disputes or in cases where the parties have an existing contract governing gathering

services and fees. The resolution of disputes covered by existing contracts is clearly a matter for the judiciary and not the Commission.

2) Hold hearings and to take such evidence as it deems appropriate to fashion an order governing the gathering of natural gas in any particular case through and including the setting of fees for gathering services to the end that a fair and nondiscriminatory system of gas gathering is established.

3) The Commission believes that except for safety, registration, licensing and informational purposes, the following should be exempt from the complaint based regulation of the Commission:

   a) Gathering systems utilized exclusively for the gathering of natural gas produced by the owner of the gathering system.

   b) Lead lines owned by the producer which connect the well to the gathering system.

   c) Gathering injection lines used exclusively for gas storage purposes.

The Commission believes that a complaint based system, not unlike that system adopted in Oklahoma, is the least intrusive mechanism available while still providing a knowledgeable governmental entity with authority to protect the interests of all parties with respect to the production and gathering the natural gas resources of Kansas.

Respectfully submitted,

The Kansas Corporation Commission

APPENDIX "A"

PROPOSED LEGISLATION

55-702. Definitions. The term "waste", in addition to its ordinary meaning, shall include economic waste, underground waste and surface waste. Economic waste shall mean the use of natural gas in any manner or process except for efficient light, fuel, carbon black manufacturing and repressuring, or for chemical or other process by which such gas is efficiently converted into a solid or a liquid substance. The term waste shall not include the use or flaring of natural gas if permitted pursuant to an order issued or rule and regulation adopted under the provisions of subsection (b) of K.S.A. 55-102, and amendments thereto. **The term "common source of supply" shall mean any underground accumulation of natural gas which constitutes a single natural pressure system whereby production of natural gas from one portion thereof will affect the pressure in other portions thereof. Common source of supply shall include those natural gas reservoirs which contain one or more wells for production of the accumulated natural gas. Further** the term "common source of supply" shall include that portion lying within this state of any gas reservoir lying partly within and partly without this state. The term "commission" shall mean the state corporation commission of the state of Kansas, its successors, or such other commission or board as may hereafter be vested with jurisdiction over the subject matter of this act.

55-7 (a) No person offering services for the gathering of natural gas for a fee or other consideration shall engage in any unduly discriminatory services or offer gathering services for a fee which is or otherwise anti-competitive.

(b) Upon the filing of a complaint by any aggrieved person, the corporation commission shall, after due notice and hearing, be authorized to issue an order directing the remediation of any unduly discriminatory fee or unduly discriminatory service for the gathering of natural gas.

55-7 Any aggrieved party as referred to in this act shall be required to allege and prove to the satisfaction of the corporation commission that the operator of the natural gas gathering systems which is offering services for a fee or other consideration has sufficient facilities to accommodate the producer's natural gas, that there is no other natural gas gathering system conveniently located to gather the complainant's gas and willing to do so; that the quality of complainants's natural gas will not have an adverse affect of the gatherer's facilities or the safety thereof and is of a quality and content consistent with gas being gathered by the gathering entity.

55-7 (a) Upon proof satisfactory to the commission, the commission shall have authority to require any gas gathering entity to provide open access and non-discriminatory gas gathering and to establish a fee for such gathering services.

(b) In determining the fee to be charged for gathering services, the commission shall consider among such other evidence as it shall determine is proper, the following:

1) The historic fee or consideration for gathering services for gas of like kind and quality in relevant geographic area as the gas which is the subject of the proceeding, given all the facts and circumstances.

2) The fee that would fairly compensate the gatherer for the gathering services, the fees the gatherer charges and receives from other producers, the capital, operating and maintenance costs of the operation of the gathering system and such other factors as the commission deems relevant.

55-7 (a) This act shall not apply to: (1) the gathering of natural gas produced from wells owned and operated by the gatherer and where the gathering system is used exclusively for its own private purposes (2) to lead lines from the wellhead to the connection with the gathering system which are owned by the producing entity and (3) to gathering systems used exclusively for injection and withdrawal from natural gas storage fields.

(b) The corporation commission shall have authority to promulgate rules and regulations for the administration of its authority over natural gas gathering as authorized herein.

HOECKER, OTHERS PONDER NEW REGULATORY ENVIRONMENT FOR GATHERING

It is difficult to know whether gathering service is being offered competitively in Texas, or in other states for that matter, Commissioner James Hoecker said at the Texas Railroad Commission's Gas Forum in Houston last Thursday. As the nature of gathering regulation and organization has changed in recent years, Hoecker has been among those asserting that states must move faster to fill the gap created by Ferc's withdrawal from the field (*IF*, 19 Feb, 1).

"If you look at gathering across the state [of Texas], you see that there are lots of different gathering companies and what seems to be good competition. If you look on a [TRC] district-by-district basis, you see less competition. And if you look at it on a county-by-county basis, there is even less competition," Hoecker said. "But I really don't know if anticompetitive behavior is a problem in this state, or in others."

According to TRC statistics filed at Ferc in 1994, about 20% of the producers in Texas are in areas where gatherers exhibit market power and have little competition. But even if gathering is not being offered competitively, there is little Ferc can do, Hoecker said. Since May 1994, when Ferc loosened its policy on regulating gathering facilities, the commission's role has been limited. Now, it regulates only about 22% of gathering facilities nationwide, he said.

Gathering "may be anticompetitive in some regions, and the TRC [information filed with Ferc] tends to show this," Hoecker said. "But the burden is on the states, not on Ferc," to deal with the matter.

Katherine Edwards, a Washington attorney who represents producers in gathering cases, said Ferc "really blew it on gathering. Ferc had an obligation and [it] stepped away from that obligation." She said she is convinced that gathering in many areas of the country is provided in an anticompetitive environment.

"There may be some pockets of competition, but that is the exception, not the rule," Edwards maintained, adding that statistics on gathering can be deceiving. "You have to look at things on a case-by-case, a wellhead-to-wellhead basis," to determine whether gathering service is competitive.

Edwards' firm, Travis & Gooch, represents major producers in gathering cases, "and you would think that being major producers, they would have clout." But that is not the case, she said. Even majors are having difficulty finding reasonably priced and competitive gathering services.

Since the proliferation of spindowns/spinoffs of gathering facilities, gathering rates have skyrocketed, said Taylor Yoakam, a gas consultant representing independent producers. "With higher gathering fees and lower prices, there is no incentive for the independent producer to drill," Yoakam said. "We would like to see the TRC get involved in this."

But M.J. Panatier, president of GPM Gas Corp., said the criticism of gathering companies is unwarranted. During the spinoff/spindown process, the gathering industry has gone from a subsidized to an unsubsidized industry, he said.

He explained that when interstate pipelines commonly owned and operated gathering systems, they could subsidize gathering services, or offer them for free, because they were making money by attaching gas to their interstate system. But as gathering companies were spun down or spun off, it became obvious that gathering services could not be offered for free if a gathering company was to stay in business, he said.

"Gathering costs money," Panatier said. "I sympathize with producers who had subsidized rates before and now they don't. But I didn't create the situation, and just like the producers, I have to deal with it." Responding to criticism that GPM and other gathering companies use their market power to charge exorbitant prices for gathering services, Panatier replied, "If I can't compete, I go out of business. If I provide a service, and I can't compete doing it, I have to sell out. Someone else will come in and provide the same service, but rates will go up because there are fewer competitors." He added that GPM does not take advantage of any market clout (see related story on page 7). "We have a reputation to protect because our success as a gatherer is based on repeat business," Panatier said.

Since the spindown/spinoff process, about 40% of GPM's gathering customers aren't under contracts "because they didn't want the default contract," he related. About 20% still are negotiating new gathering contracts and 40% are operating under existing contracts, he said. — *Cathy Landry, Houston*

KANSAS CORPORATION COMMISSION

Senate Energy + Natural Res.
March 14, 1996
Attachment 3

As Amended by House Committee

Session of 1995

HOUSE BILL No. 2041

By Committee on Energy and Natural Resources

1-10

AN ACT concerning oil and gas; relating to natural gas gathering systems and underground storage facilities; providing for licensure and regulation of certain entities; **concerning certain natural gas public utilities;** amending K.S.A. 55-150, **66-104 and 66-1,200** and repealing the existing ~~section~~ **sections**.

Be it enacted by the Legislature of the State of Kansas:

Section 1. K.S.A. 55-150 is hereby amended to read as follows: 55-150. As used in this act unless the context requires a different meaning:

(a) "Commission" means the state corporation commission;. • • •••

USE LANGUAGE FROM 55-702

The term "commission" shall mean the state corporation commission of the state of Kansas, its successors, or such other commission or board as may hereafter be vested with jurisdiction over the subject matter of this act.

(b) "Contractor" means any person who acts as agent for an operator as a drilling, plugging, service rig or seismograph contractor in such operator's oil and gas, *cathodic protection, gas gathering or underground natural gas storage* operations;.

(c) "Fresh water" means water containing not more than 1,000 milligrams per liter, total dissolved solids;.

(d) *"Gas gathering system" means a* ~~*pipeline that transports natural gas from a central metering point for natural gas produced by one or more wells to the point of compression or entry into a sales or transmission point*~~ **natural gas pipeline system used primarily for transporting natural gas from a wellhead, or a metering point for natural gas produced by one or more wells, to a point of entry into a main transmission line**.

(e) "Operator" means a person who is responsible for the physical operation and control of a well;, *gas gathering system or underground natural gas storage facility*.

~~(e)~~ *(f)* "Person" means any natural person, partnership, governmental or political subdivision, firm, association, corporation or ~~any~~ other legal entity;.

~~(f)~~ *(g)* "Rig" means any crane machine used for drilling or plugging wells;.

~~(g)~~ *(h)* "Usable water" means water containing not more than 10,000 milligrams per liter, total dissolved solids;.

~~(h)~~ *(i)* "Well" means a hole drilled *or recompleted* for the purpose of:

(1) Producing oil or gas;

(2) injecting fluid, air or gas in the ground in connection with the exploration for or production of oil or gas;

(3) obtaining geological information in connection with the exploration for or production of oil or gas by taking cores or through seismic operations;

(4) disposing of fluids produced in connection with the exploration for or production of oil or gas; ~~or~~

(5) providing cathodic protection to prevent corrosion to lines; *or*

(6) injecting or withdrawing natural gas.

New Sec. 2. (a) As used in this section:

(1) "Commission" means the state corporation commission.

(2) "Gas gathering services" means the gathering ~~or preparation~~, **compression or dehydration** of natural gas for transportation or distribution.

(3) "Person" means any natural person, partnership, governmental or political subdivision, firm, association, corporation or other legal entity.

(b) No person performing gas gathering services for hire shall charge any fee for such services, or engage in any practice in connection with such services, which is unjustly or unlawfully discriminatory. Any person seeking any gas gathering service who is aggrieved by reason of any such unjustly or unlawfully discriminatory fee or practice may file a complaint with the commission. The commission shall conduct a hearing and take evidence as necessary to determine the complaint. The hearing shall be conducted and notice given in accordance with the Kansas administrative procedure act. Upon such hearing, the commission shall have authority to order the remediation of any unjustly or unlawfully discriminatory fee for gathering services, or any unjustly or unlawfully discriminatory practice in connection with such services, to the extent necessary for remediation as to the aggrieved person with respect to the particular fee or service involved.

(c) Any order of the commission pursuant to this section shall be subject to review in accordance with the act for judicial review and civil enforcement of agency actions.

~~Sec. 3. K.S.A. 55-150 is hereby repealed.~~

Sec. 3. K.S.A. 66-104 is hereby amended to read as follows: 66-104. ~~The term "public utility,"~~ As used in this act~~,~~ ~~shall be construed to mean every~~, *"public utility" means* corporation, company, individual, association of persons, their trustees, lessees or receivers, that now or hereafter may own, control, operate or manage, except for private use, any equipment, plant or generating machinery, or any part thereof, for the transmission of telephone messages or for the transmission of telegraph messages in or through any part of the

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55-702. Definitions. The term "waste", in addition to its ordinary meaning, shall include economic waste, underground waste and surface waste. Economic waste shall mean the use of natural gas in any manner or process except for efficient light, fuel, carbon black manufacturing and repressuring, or for chemical or other process by which such gas is efficiently converted into a solid or a liquid substance. The term waste shall not include the use or flaring of natural gas if permitted pursuant to an order issued or rule and regulation adopted under the provisions of subsection (b) of K.S.A. 55-102, and amendments thereto. **The term "common source of supply" shall mean any underground accumulation of natural gas which constitutes a single natural pressure system whereby production of natural gas from one portion thereof will affect the pressure in other portions thereof. Common source of supply shall include those natural gas reservoirs which contain one or more wells for production of the accumulated natural gas. Further** the term "common source of supply" shall include that portion lying within this state of any gas reservoir lying partly within and partly without this state. The term "commission" shall mean the state corporation commission of the state of Kansas, its successors, or such other commission or board as may hereafter be vested with jurisdiction over the subject matter of this act.

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state, or the conveyance of oil and gas through pipelines in or through any part of the state, except ~~pipelines less than 15 miles in length and not operated in connection with or for the general commercial supply of gas or oil~~ *gas gathering systems as defined in K.S.A. 55-150 and amendments thereto*, or for the operation of any trolley lines, street, electrical or motor railway doing business in any county in the state; also all dining car companies doing business within the state, and all companies for the production, transmission, delivery or furnishing of heat, light, water or power. No cooperative, cooperative society, nonprofit or mutual corporation or association which is engaged solely in furnishing telephone service to subscribers from one telephone line without owning or operating its own separate central office facilities, shall be subject to the jurisdiction and control of the commission as provided herein, except that it shall not construct or extend its facilities across or beyond the territorial boundaries of any telephone company or cooperative without first obtaining approval of the commission. As used herein, ~~the term~~ "transmission of telephone messages" ~~shall include~~ *includes* the transmission by wire or other means of any voice, data, signals or facsimile communications, including all such communications now in existence or as may be developed in the future.

~~The term~~ "Public utility" ~~shall also include~~ *also includes* that portion of every municipally owned or operated electric or gas utility located outside of and more than three miles from the corporate limits of such municipality, but nothing in this act shall apply to a municipally owned or operated utility, or portion thereof, located within the corporate limits of such municipality or located outside of such corporate limits but within three miles thereof except as provided in K.S.A. 66-131a, and amendments thereto.

Except as herein provided, the power and authority to control and regulate all public utilities and common carriers situated and operated wholly or principally within any city or principally operated for the benefit of such city or its people, shall be vested exclusively in such city, subject only to the right to apply for relief to the corporation commission as provided in K.S.A. 66-133, and amendments thereto, and to the provisions of K.S.A. 66-131a, and amendments thereto. A transit system principally engaged in rendering local transportation service in and between contiguous cities in this and another state by means of street railway, trolley bus and motor bus lines, or any combination thereof, shall be deemed to be a public utility as that term is used in this act and, as such, shall be subject to the jurisdiction of the commission.

The term "public utility" shall not include any activity of an oth-

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55-7 (a) No person offering services for the gathering of natural gas for a fee or other consideration shall engage in any unduly discriminatory services or offer gathering services for a fee which is or otherwise anti-competitive.
DISCRIMINATORY

(b) Upon the filing of a complaint by any aggrieved person, the corporation commission shall, after due notice and hearing, be authorized to issue an order directing the remediation of any unduly discriminatory fee or unduly discriminatory service for the gathering of natural gas.

55-7 Any aggrieved party as referred to in this act shall be required to allege and prove to the satisfaction of the corporation commission that the operator of the natural gas gathering systems which is offering services for a fee or other consideration has sufficient facilities to accommodate the producer's natural gas, that there is no other natural gas gathering system conveniently located to gather the complainant's gas and willing to do so; that the quality of complainants's natural gas will not have an adverse affect of the gatherer's facilities or the safety thereof and is of a quality and content consistent with gas being gathered by the gathering entity.

55-7 (a) Upon proof satisfactory to the commission, the commission shall have authority to require any gas gathering entity to provide open access and non-discriminatory gas gathering and to establish a fee for such gathering services.

(b) In determining the fee to be charged for gathering services, the commission shall consider among such other evidence as it shall determine is proper, the following:

1) The historic fee or consideration for gathering services for gas of like kind and quality in relevant geographic area as the gas which is the subject of the proceeding, given all the facts and circumstances.

2) The fee that would fairly compensate the gatherer for the gathering services, the fees the gatherer charges and receives from other producers, the capital, operating and maintenance costs of the operation of the gathering system and such other factors as the commission deems relevant.

55-7 (a) This act shall not apply to: (1) the gathering of natural gas produced from wells owned and operated by the gatherer and where the gathering system is used exclusively for its own private purposes (2) to lead lines from the wellhead to the connection with the gathering system which are owned by the producing entity and (3) to gathering systems used exclusively for injection and withdrawal from natural gas storage fields.

(b) The corporation commission shall have authority to promulgate rules and regulations for the administration of its authority over natural gas gathering as authorized herein.

erwise jurisdictional corporation, company, individual, association of persons, their trustees, lessees or receivers as to the marketing or sale of compressed natural gas for end use as motor vehicle fuel.

Sec. 4. K.S.A. 66-1,200 is hereby amended to read as follows: 66-1,200. As used in this act:

(a) "Natural gas public utility" means any public utility defined in K.S.A. 66-104, and amendments thereto, which ~~supplies~~ ***sells or transports*** **natural gas.**

(b) "Commission" means the state corporation commission.

Sec. 5. K.S.A. 55-150, 66-104 and 66-1,200 are hereby repealed.

Sec. ~~4~~ **6.** This act shall take effect and be in force from and after its publication in the statute book.

K.S.A. 66-105 is hereby amended to read as follows:

The term "common carriers," as used in this Act, shall include all railroad companies, express companies, street railroads, suburban or inter-urban railroads, sleeping-companies, freight-line companies, equipment companies, pipe-line companies, except natural gas pipeline systems used primarily for transporting natural gas from a central metering point for natural gas produced by one or more wells, to a point of entry into a main transmission line, and all persons and associations of persons, whether incorporated or not, operating such agencies for public use in the conveyance of persons or property within this state.

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STATEMENT OF POSITION BY PANENERGY CORP.
(Formerly Panhandle Eastern Corporation)
BEFORE SENATE ENERGY AND NATURAL RESOURCES COMMITTEE

MARCH 14, 1996

RE: HB 2041

PanEnergy (PE) filed its Statement of Position regarding Proposal No. 26 before the Special Committee on Energy and Natural Resources on September 25, 1995, stating its support of HB 2041 in the form as passed by the House of Representatives last session, but expressing concern lest an open-ended an undefined regulatory regime be substituted for the light-handed complaint type regulation originally envisioned by the Bill.

In response to an ongoing dispute between PE and First National Oil, Inc. and as to the type of regulation urged by National, PE filed the appended statement in connection with the KCC hearings held pursuant to SCR 1613. With respect to the KCC report issued pursuant thereto, and particularly "Appendix 'A'", which is proposed to be incorporated in HB 2041, although PE generally supports the conclusions and recommendations of the Commission, we believe the following provisions should be included, which are in harmony with the Commission's Report, to-wit:

1. The conclusion that it is not the intention of the Commission to involve itself in contractual disputes should be set forth in the Bill. Accordingly, we urge that amendatory language be included as follows:

> By adding an additional exception on Page 2, "(4) To disputes over existing contracts governing gathering services and/or fees, or where such gathering is inconsistent with an existing contract which governs the

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gas of the person seeking gathering or remediation or the fee relating thereto."

We concur in the Commission's conclusion that contractual disputes should be left for resolution by the judiciary, and we believe that by specifically including this provision, litigation over contractual disputes would not be clouded by a potential contention that the KCC might otherwise have jurisdiction and that failure to pursue the issue before the Commission could be raised in court for failure to exhaust administrative remedies, thus averting or at least prolonging judicial determination of the dispute.

2. We urge that Section 3 of HB 2041 be retained as now in the Bill. This provision is necessary to eliminate regulation of gathering systems under the public utility concept contained in Chapter 66, which specifically amends K.S.A. 66-104 to eliminate gas gathering systems from the "public utility" definition. We believe such to be consistent with the Commission's expressed intent of regulating gas gathering under Chapter 55, covering the Commission's gas conservation powers for the purpose of prevention of waste and protection of correlative rights of royalty owners and operating interest in Kansas gas fields.

3. Consistent with the transfer of regulation from Chapter 66 to Chapter 55, it is also vital that K.S.A. 66-105 be amended to eliminate regulation of gathering facilities as common carriers. A suggested new Section 4 to HB 2041 is appended hereto for consideration. The result of the amendment would be retention of

pipeline companies in the "common carrier" definition, but excepting gathering systems from such regulation. Unless Sections 3 and 4 are retained in HB 2041, we would simply be adding yet another layer of regulation on natural gas gathering. We abhor unnecessary regulation and PE would oppose HB 2041 unless Section 3 and proposed Section 4 are included in the Bill. We believe that such inclusion is envisioned by the Commission in proposing regulation under Chapter 55. Chapter 55 regulation is stand alone, which will provide an adequate remedy for an aggrieved producer. We cannot believe that producers desire cost of service type regulation with the attendant expense, delay and confusion that would be wrought by having a choice of remedies under either Chapter 66 or 55.

Indeed, as pointed out by Professor David Pierce of Washburn University School of law in his presentation last week to the Kansas Bar Association Natural Gas Gathering Seminar, it is his opinion that the KCC additionally has authority to regulate gathering under K.S.A. 55-703 which has the objective of preventing "inequitable or unfair taking" and "unreasonable discrimination" with respect to natural gas production. In any event, we submit that regulation under the Conservation Act belies the necessity or appropriateness of regulation under Chapter 66. We don't need a dual system that could lead to a litigation free-for-all.

4. Although the apparent intent of the Commission's proposed legislation is to not require the extension or expansion of facilities by the gatherer, as implied by requiring proof that the

gatherer ". . .has sufficient facilities to accommodate the producers natural gas." we believe that any uncertainty should be eliminated by amendatory language, inserted between "facilities" and "to accommodate the producers natural gas", the words "without extension or expansion thereof". The phrase would then read,

> ". . .has sufficient facilities, without extension or expansion thereof, to accommodate the producers natural gas."

This language is contained in the Oklahoma act adopted last year, which is referred to in the Commission report. Although such exclusion is implicit in the language, we believe that spelling it out could avoid litigation over the issue. Requiring a gatherer to construct additional lines is inconsistent, even with a public utility obligation, under present law and requiring facility construction would necessarily involve the cost of service methodology of ratemaking that is not intended by the Bill nor desired by any of the affected parties.

In conclusion, we offer the proposed amendatory language and the retention of the amendment of K.S.A. 66-104 in the firm belief that the foregoing is not only consistent with the conclusion and recommendations of the Commission, but is essential to clearly express the Legislature's intention and for avoiding confusion and litigation in administration of the proposal.

Respectfully submitted,

Jack Glaves
Legislative Counsel
PanEnergy Corp.

NEW SECTION 4 TO HB 2041

K.S.A. 66-105 is hereby amended to read as follows:

The term "common carriers," as used in this Act, shall include all railroad companies, express companies, street railroads, suburban or inter-urban railroads, sleeping-companies, freight-line companies, equipment companies, pipe-line companies, except natural gas pipeline systems used primarily for transporting natural gas from a wellhead, or a metering point for natural gas produced by one or more wells, to a point of entry into a main transmission line, and all persons and associations of persons, whether incorporated or not, operating such agencies for public use in the conveyance of persons or property within this state.

BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

IN THE MATTER OF THE GENERAL INVESTIGATION INTO GAS GATHERING SERVICES IN THE STATE OF KANSAS	))))	Docket No. 293,195-C (C27,760)

STATEMENT OF RUSSELL BISHOP IN BEHALF
OF PANENERGY CORP, FORMERLY
PANHANDLE EASTERN CORPORATION

I am Russ Bishop, Director of State Governmental Affairs, for PanEnergy Corp., formerly Panhandle Eastern Corporation, parent company of various subsidiaries including Panhandle Field Services that owns and operates an extensive gathering system in Kansas, primarily located in the Hugoton Field and other gas producing areas in Southwest Kansas. I will refer to PanEnergy and its various subsidiaries without distinction as "PE."

I previously appeared and presented testimony to the House Energy and Natural Resources Committee last session and to the Special Interim Legislative Committee on Energy and Natural Resources last fall. We were supportive of House Bill 2041 and the concept of providing producers with a forum for complaints concerning gathering and for the reason that it eliminates the potential for regulation of gathering facilities as a public utility, which we believe is impractical and unwarranted.

PE has been the subject of a vocal campaign by various spokesmen for First National Oil, Inc. No less than four witnesses appeared before the Special Interim Committee, all representing, in some fashion, the interests of First National. Two attorneys, its, primary gas marketer, and Montgomery Escue as President, have appeared at one time or another asserting accusations of unfair dealings by PE that support First National's apparent desire for utility-type regulation of

gas gathering. The supposed abuses cited by the various spokesmen for First National, when reviewed with all of the facts, offer a sound argument against the regulations espoused by First National.

Though PE has been the subject of these allegations of gathering abuses by First National, it has not responded to each and every allegation made in these legislative forums. We believe this would not constructively contribute to resolving the fundamental policy questions at hand, and would only involve the legislature and the Commission in what are, essentially, private negotiations. Neither law nor regulatory policy should emanate from such an isolated situation. Negotiations with First National, to date, have not been successful but nevertheless PE is still pursuing, in a good faith effort, a fair resolution through the negotiating process.

One of the many unfounded claims which we do want to address is the example of the "gathering affiliate" exercising "monopoly control" when it offered 95% of market index to a producer to purchase its gas resulting in an effective gathering rate of $.09 per MMBtu. The gatherer is unnamed in the example quoted, however, this appears to be an allegation against PE. The contention is that third party purchasers cannot compete for gas supplies against such a "preferential rate". PE has stated many times that its affiliate purchaser, Centana Gathering Company (CGC) does not receive a "preferential rate". Additionally, PE has provided a copy of the standard default agreement CGC moves its gas under to the FERC for its review. Thus, CGC does not have available to it revenue from discounted gathering service. Instead, it derives revenue from extraction of products in the rich gas stream made available by the producer in this example. In the example used the gas is rich enough to justify bearing a portion of the gathering charge otherwise incurred by the producer by paying the standard default rate for gathering

service while only collecting the effective rate of $.09 from the producer. CGC was able to do this in return for the opportunity to process the gas. Additionally, CGC takes on the costs and risks associated with operating a plant and relying on processing economics for revenue. In contrast, CGC cannot bear the gathering rate if the gas stream delivered by the producer does not contain enough extractable products to cover these costs. This results in a situation where the producer must bear the gathering cost.

This points out the impossibility of generalizing about the economics in providing gathering service which belies the "one size fits all" mentality that is inherent in operating under posted prices or filed tariffs. These variables are alien to applying traditional utility rate making concepts to the widely disparate economics inherent in gas gathering. In short, uniform rates and cost of service methodology simply do not work where gas quality, volumes of gas, pressures, pipeline distances, reserves, reservoir characteristics and market requirements are so varied as to make well-by-well or even system-by-system comparisons extremely difficult.

This example also calls into question claims previously made that there is no knowledge about specific gathering contract rates or terms by producers; that there is no competition occurring; and that gatherers are forcing "purchase-type" contracts on the producers. The producer chose from a menu of contractual offerings to enter into a "purchase" contract rather than a straight transportation contract. Furthermore, the producer in this example, as in many cases we have encountered in negotiations, knows exactly what rate and terms are being offered in the gathering/producing community.

Essentially, what First National appears to be seeking, is uniform gathering rates so that a marginal producer with low pressure/low BTU/low volume gas can receive the exact same rate as

another producer (large or small) with high-pressure/high BTU/high volume gas to be gathered. We have already addressed why such uniform, utility rate making should not be applied to the thousands of different and distinct gathering systems in Kansas. What marginal producers are, in effect, seeking is for the State of Kansas, through the Offices of the Commission, tó reinstate subsidies which previously existed in the federal regulatory scheme prior to Order 636. One segment of the industry, the gatherer, is being targeted to provide this subsidy. If the state determines subsidies should be provided to maintain uneconomic production the subsidy should be shared by all Kansas constituents, i.e., producers, consumers, gatherers, distributors, etc. in an equitable manner.

We would also like to respond to the underlying contentions, expressed by certain spokesmen at the previous hearings, that the traditional contract confidentiality in the private sector should be denied to gas gatherers, requiring them to operate as regulated monopolies by posting and charging uniform rates. Such contention is presumably premised on the assumption that the gatherer, in fact, has a monopoly in the providing of gathering service and that its conditions of service and charges are excessive and unreasonable. All of the pipelines have addressed the fact that competition exists in the Kansas gathering arena. This is reflected by the maps; by the ability of producers to access markets throughout the nation by reason of the interconnected national pipeline system that now exists and by the fact that barriers to entry into this business are very low. It does not behoove pipelines to act like monopolies, even assuming for the sake of argument there was a lack of competition. Such actions are economically suicidal. If we price ourselves out of the market, our gas volumes will decline and disappear. We can't make money on nonexistent volumes. Abusive business practices will not maintain current

customers nor attract new customers in this competitive environment.

There are undoubtedly instances where a producer can contend that there are no alternative pipeline facilities available and it deems the pipelines' required charges or conditions of service unreasonable and uneconomic, from its perspective. On the other hand, the pipeline has the incentive to transport the producers gas if economically possible, i.e., to the extent that it can realize positive margin from transporting such gas. If it can't do so, but is nevertheless required to operate at a loss, it will have to be subsidized by other producers, the state, consumers, or simply go out of business. The effect of requiring the pipeline to provide uneconomic service would clearly be a constitutionally prohibited burden on interstate commerce. In our opinion, it would not withstand judicial scrutiny, and the purported regulation would be for naught.

PE reaffirms its support for House Bill 2041 in the form as passed by the House of Representatives last session. We are not opposed to the concept of the complaint mechanism that provides a forum for producer concerns over gathering services. As stated in our September 25th Statement of Position with the Special Committee of the legislature, we do have serious concerns and reservations over an open-ended and undefined regulatory regime that, we believe, is inherent in the suggested enlargement of the regulatory standard from unlawful or unjust discriminatory practices as contained in House Bill 2041 to that of remediation of "unreasonable" fees or services. The adoption of this standard without boundaries, thresholds or limitations would, we believe, result in heavy-handed regulation, the need for which is not, and we believe cannot be established and which is costly to all participants. Such is totally contrary to the free market philosophy that has prompted the deregulation of natural gas at the federal level, and has been the historic philosophy of Kansas generally and as to the marketing of natural gas, in particular.

As I have previously reiterated, PE would be willing to work with other parties to accomplish a fair and equitable legislative solution to these issues.

Respectfully submitted,

Russell Bishop

COMMENTS OF
WILLIAMS FIELD SERVICES COMPANY
SUBMITTED TO
THE SENATE ENERGY AND NATURAL RESOURCES COMMITTEE

By
Joe Staskal

March 14, 1996
HB 2041

Williams Field Services Company gathers and processes natural gas in several states. WFS will own a gas gathering system in the Hugoton Field following Federal Energy Regulatory Commission approval. WFS has participated in the various Commission and legislative forums concerning gas gathering in Kansas.

In its February 29, 1996, Gas Gathering Report the KCC has made a good effort at drafting a case-by-case, complaint-based regulatory proposal. The Commission's proposal addresses the major concerns of many interested parties. The Commission's explanation of what it is attempting to accomplish is positive from our point of view. WFS would like to support a bill which reflects the Commission's intent. However, the bill should be changed to accomplish the Commission's stated intent.

Most importantly, the Commission's intent not to involve itself in cases where the parties have an existing contract governing gathering services and fees' needs to be confirmed by a clear statement in the bill that existing contracts are exempt from the new regulation. Second, an exemption from common carrier regulation for gathering systems should be added to the proposed exemption from public utility regulation to harmonize existing HB

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2041 with the newly proposed regulatory regime. This is consistent with the intent to create one mechanism for the regulation of gathering. Finally, WFS does not know what the anti-competitive standard is, but would like to know what it means.

CONCLUSION:

Williams Field Services Company supports a case by case complaint mechanism for the purpose of gathering regulation. We would like protections for existing contracts added to the Commission proposal to be consistent with their stated intent. While the current Commission believes that gathering regulation should not interfere with existing contractual relationships, there is no guarantee that future Commissions will share this belief. For that reason, we believe that the legislature can solve potential problems by limiting the Commission's authority over existing contractual relations. Also, multiple layers of regulation are not needed. Exemption from common carrier and public utility statutes is consistent with the enactment of a new regulatory scheme.

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SENATE ENERGY & NATURAL RESOURCES COMMITTEE
MARCH 14, 1996

Testimony of Donald P. Schnacke, Executive Vice President
Kansas Independent Oil & Gas Association

RE: HB 2041 - KCC Gas Gathering Regulation

We are appearing today in favor of passing natural gas gathering regulatory legislation. We opposed HB 2041 in the House last year and urged the interim study. We not only participated in those hearings, but appeared twice at hearings held by the KCC. We have reviewed the recent KCC report of February 29, 1996 to the legislature which is now contained in the balloon of the bill and agree with most of their observations and conclusions. It's a good report. You now seem to have adequate material in front of your to pass meaningful legislation to protect the independent gas producers when dealing with gas gathering entities. Additionally, we have the following comments:

In the KCC recommendations contained in *Appendix A* under 55-7(a) we are still troubled with the finding standard of what is *"anti-competitive."* We continue to believe the historically acceptable of what is *"just and reasonable"* is a better standard. There are examples of proposed contracts that have been brought to our attention that are not *"anti-competitive,"* but are clearly not *"just and reasonable."*

The term *"discriminatory"* which is suggested to be added on page 3 also troubles us. You can have a contract between a gas gatherer and a producers that is not *"discriminatory,"* but still is not *"just and reasonable."* An example would be a gatherer with his own production charging all production, including his own, at $1/mcf.

We would like the proposed legislation to expand the KCC authority to include a public disclosure of gathering rates, so that a producer can determine if a gathering rate being offered is fair. In the absence of this disclosure, a producer would be compelled to file his application for a hearing of a complaint before he can discover what rates are being charged to other producers.

We would like the KCC to set a *"fair"* gathering rate for an entire line, applicable to all producer on the gathering line, whether all producers were complainants before the KCC or not. The procedure outlined by the KCC would appear to be limited only to a complaining party.

55-7(b)(2) indicates one of the considerations to be used in determining gathering rates would be *"capital costs."* This should be clarified to specifically exclude inflated capital costs used in spin-down or spin-off arrangements.

Authorizing a forum for a complaining party to come to the KCC under USA Chapter 55 is supported by our Association. We stand ready to assist you in any way possible to finally accomplish this goal.

Donald P. Schnacke
Senate Energy & Natural Res
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SENATE ENERGY AND NATURAL RESOURCES COMMITTEE
TESTIMONY RE: HB 2041
Presented by Ronald R. Hein
on behalf of
MESA
March 14, 1996

Mr. Chairman, Members of the Committee:

My name is Ron Hein, and I am legislative counsel for MESA. MESA is one of the nation's largest independent natural gas producers and currently has approximately 65% of its natural gas reserves in the state of Kansas.

MESA specifically supports the existing language in HB 2041, and supports that legislation.

MESA understands the rationale presented by the Kansas Corporation Commission regarding their findings and suggested recommendations for amending HB 2041 with the language set out in the KCC's gas gathering line report. MESA expresses some of the same concerns with such language that it has testified to at previous hearings. That concern remains that if the KCC has the ability to set rates, even on a complaint basis, that after contracts have expired, there will be an encouragement for producers to take the issue to the KCC to seek the rate which has been approved as reasonable under similar factual circumstances under earlier complaints before the KCC.

This will have a twofold impact on MESA: 1) This will cause MESA to spend time, energy, money, resources and legal and technical resources appearing before the KCC regarding these matters. In addition, MESA will have to hire counsel to appear on each of these issues, as well as spend its internal resources preparing for the hearing. When technical information is necessary, the cost to send technical representatives from MESA to the Commission to testify will prohibit them from doing their real job, which is to operate an oil and gas exploration company.

2) MESA will be leveraged into agreeing to a contract price that is more in line with the "set price" utilized by the KCC under similar circumstances, with the producer utilizing the leverage of threatening to take the case to the KCC on a complaint basis. This will have a chilling impact on MESA's ability to negotiate these matters as an arm's length transaction, and will ultimately result in most contracts seeking the "price" approved by the KCC. The net effect will be that the rate will be impacted over the long haul as a result of the regulatory lag in keeping up with market forces.

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MESA is primarily a gas gatherer for its own production. The KCC has proposed that those gathering lines which are used exclusively for gathering for a producer's gas should be exempt. However, by requiring exclusivity, this means that the only way that MESA can be exempted from the KCC provisions which MESA considers to be onerous, is to not permit any other producers to utilize their entire gas gathering system.

This seems to be a policy which would encourage a waste of not only the natural resources which are produced, but also the physical facilities which are available to transport gas.

MESA would propose that the KCC proposed language be modified to provide that any gas gatherer whose gas gathering pipeline is used more than two-thirds for the gas gathering of their own gas would be exempt from the Commission's jurisdiction. In this way, the physical pipe itself owned by MESA, which exists primarily for MESA's purpose to gather its own gas, would be available on an as needed basis pursuant to whatever contracts in which MESA is willing to enter. In this way, MESA can accommodate additional transportation of gas, retain the flexibility to insure that when it needs to utilize its own pipe for its own production, that it may do so without having assumed a common carrier responsibility for all producers that exist who might be able to hook up to MESA's gathering system.

With the adoption of such an amendment, a balloon of which is attached to this testimony, MESA would be willing to withdraw its opposition to the proposed amendment to HB 2041. As stated above, MESA would still be willing to support HB 2041 as drafted.

Thank you very much for permitting me to testify, and I will be happy to yield to questions.

REGULATION OF GAS GATHERING: HOUSE BILL No. 2041

Senate Committee on Energy and Natural Resources
March 14, 1996

Statement of: David E. Pierce

I am a professor at Washburn Law School where I teach courses concerning oil and gas law, natural gas regulation, and public utility regulation. I am appearing today on behalf of Allied Small Producers and Consumers ("Allied"): an association of natural gas producers and farmers who use gas to fuel irrigation pumps.

* Allied opposes HB 2041.

* Allied opposes the approach to gas gathering regulation recommended by the Kansas Corporation Commission ("KCC") in its February 29, 1996 Gas Gathering Report.

* Allied supports the Legislature taking no action on this matter at this time.

* Allied supports relying upon existing law, found at Kansas Statutes Annotated §§ 66-104, 66-105, and 55-703(a), to address gas gathering problems that may arise.

The debate centers on what authority the KCC should have to ensure access, and to regulate the terms of access, to pipeline facilities that are essential to gas producers and gas users. The problem is that many gathering systems wield considerable economic power because they are classic monopolies: (1) they provide an essential link to the pipeline grid required to move gas in or out of the fields where it is produced; (2) it is not economically feasible for producers or gas users to construct their own gathering facilities; and (3) in many instances there are no competing gathering facilities and therefore no alternative to shipping gas on the existing gathering pipeline link.

To respond to monopolistic concentrations of economic power possessed by some gas gatherers, the KCC must have the authority to do two things: (1) require nondiscriminatory access to gathering services; and (2) require that access be provided on reasonable terms--including reasonable service conditions and reasonable rates. It is our belief that the existing Kansas statutes can be effectively used to accomplish these goals. It is our belief that HB 2041 and the KCC's proposals cannot accomplish these goals; instead they take away regulatory authority that is essential to effective regulation of gas gathering monopolies.

HB 2041 and the KCC's proposal are flawed because:

* They only apply to persons who offer gas gathering services "for hire" or "for a fee."

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- A gatherer could obtain control over a producer's gas supply by refusing to offer any "service" and thereby force the producer to sell its gas to the only market available: the gas gatherer.

- There is no protection against such monopsonistic concentrations of economic power--where the gatherer becomes the only potential buyer of the producer's gas.

* There is no obligation to provide gas gathering services, nor to continue existing services.

* Under HB 2041, if gathering services are offered, the fees and terms of service can be unreasonable so long as they are imposed indiscriminately.

* Under the KCC's proposal, if gathering services are offered, the fees can be unreasonable so long as they are not "anti-competitive."

  - Arguably, the higher and more unreasonable the fee the less anti-competitive it will be since it would invite others to try and compete for the poorly served and over charged producers.

  - Unless "anti-competitive" means "unreasonable" it offers the producer no practical protection.

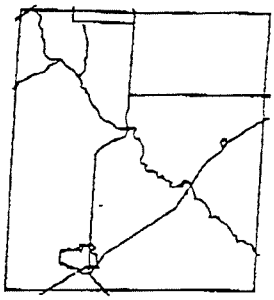
Existing law offers gas producers and gas users what HB 2041 and the KCC's proposal would take away:

* Nondiscriminatory access to gathering services.

* On reasonable terms.

The KCC proposal is a product of its practical concerns that gas gathering regulation under existing law might prove too cumbersome. However, Allied believes the KCC has considerable latitude to customize its regulatory responses so it can effectively address those situations that present a real potential for abuse of economic power.

We ask that this Committee give the industry, and the KCC, a chance to operate under the same monopoly-regulating regime that has been effectively used in Kansas since 1911. Through a case-by-case application of existing authority, the KCC will be in a better position to evaluate if an alternative approach is actually required. To date, the KCC has not had the opportunity to apply its authority in the gas gathering context. We simply ask that this Committee not take any action to change existing law until the need is clearly demonstrated and the nature of any change can be fully evaluated.



SEWARD COUNTY APPRAISER

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GARY POST, C.K.A.
APPRAISER
STELLA TAYLOR
DEPUTY

March 13, 1996

Senator Don Sallee, Chairman
and Members of Committee on Energy and Natural Resources
Statehouse,
Topeka, Kansas

RE: Gas Gathering Regulation ie: HB 2041

Dear Senator Sallee and Committee Members:

Seward County continues to have real concerns with the regulation of gas gathering systems as proposed in the Kansas Corporation Commission report to your committee. We are in midst of real estate hearings with property owners for 1996 values and are unable to present these concerns in person. Please accept this inferior substitute and share with other esteemed members.

The KCC refers to a need for " **just and reasonable rates**" in their report under Local Governmental Units, however in the recommendation they leave intact the "**fair and nondiscriminatory**" language from HB 2041. They further recommend that gathering systems owned and used exclusively by a producer be exempt from regulation. This is truly a "**light handed**" approach to regulation. Seward County is very convinced that this will lead to "**high hatted**" gas gathering charges that will adversely impact the ad valorem tax value of gas in Seward and surrounding counties. Ron Cook, a Petroleum Engineer, addressed this situation in a study (attached in part) he made for Seward and Morton Counties and presented to KCC on January 10, 1996. He demonstrated convincingly that any incremental increase in gathering charges results in a decrease in the gas price as rendered to the county.

We urge You and the Committee to legislate the KCC to a more active role of regulation of these sometimes spun-down and spun-off monopolies.

Thank you.

Best Regards,

Gary Post, CKA G-224
Seward County Appraiser

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Reservoir Engineering
Property Evaluation
Regulatory Affairs

Gas Contracts
Gas Marketing
Expert Witness

STATEMENT OF RONALD L. COOK, P.E
PETROLEUM CONSULTANTS, INC.

Kansas Corporation Commission Hearing
January 10, 1996
Liberal, Kansas

My name is Ronald L. Cook and my address is 8717 W. 110th Street, Suite 440, Overland Park, Kansas 66210. I am a Petroleum Engineer and have my own consulting business, Petroleum Consultants, Inc. I am submitting this statement on behalf of Seward and Morton Counties. I was retained by the counties to make a study as to the effect incremental gas gathering costs would have on assessed values for ad valorem tax purposes in their respective counties. This statement summarizes the results of that study.

The premise of this study is that any incremental increase in the gathering charge would result in a decrease in the gas price that is rendered by the producer on the tax rendition form. Using the Oil & Gas Appraisal Guide from the Property Valuation Division a decrease in the gas price results in a lower appraised value, a lower assessed value and thus, lower ad valorem taxes to the County.

I have prepared six (6) exhibits which will show how the incremental increase in the gathering charge will reduce the assessed value at various gas prices.

Exhibit 1 shows the percent reduction in the assessed value based on various increases in gathering charges at different gas prices. The first column shows the increases in gathering charges in 5 cent intervals from 10 to 50 cents per Mcf. The second column shows the percent reduction in assessed value using a $1.00 per Mcf gas price. The third and fourth columns show the percent reductions at gas prices of $1.50 and $2.00 per Mcf respectively. The example at the bottom of Exhibit 1 shows that for a 30 cent increase in the gathering charge at an original price of $1.50 per Mcf the adjusted price after the added gathering charge would be $1.20 per Mcf which is a reduction of 20 percent. If a gas lease had a working interest value of $ 500,000 before the gathering

charge increase the appraised value would be reduced to $ 400,000. The assessed value for most gas leases is 30 percent of the working interest appraised value. In this example the assessed value would be reduced from $150,000 to $120,000.

Exhibit 2 is a graph of the data shown in Exhibit 1. The graph shows that the percent reduction in value is proportional to the same percent reduction in gas price due to the incremental increase in gathering charges.

Exhibits 3, 4, and 5 are tax rendition forms on Hugoton, Hugoton Deep, and AOK wells respectively. Exhibit 3 shows that for a 30 cent increase in the gathering charge at an original gas price of $1.50 per Mcf (a 20% reduction in price) will result in a reduction of 20.7% in the working interest value. Exhibit 4 shows that at $1.50 per Mcf a 20 cent increase in the gathering charge (a 13.3% reduction in price) results in a reduction of 13.8% in the working interest value. Exhibit 5 shows that for a 40 cent increase in the gathering charge at an original price of $1.50 per Mcf (a 26.7% reduction) results in a 27.9% reduction in the working interest value. These exhibits show that the percentage reduction in price is nearly the same reduction in the value shown on the rendition.

Exhibit 6 shows the comparison of the gas assessed values for 1994 and 1995 for various counties including Seward and for the State. This exhibit was obtained from the Property Valuation Division. In 1994 Seward County had an assessed gas value of $ 63.4 million. The average gas price in 1994 in Seward County was $1.67 per Mcf. Assuming that the average increase in gathering charges was 30 cents per Mcf the net price would be $1.37 per Mcf which is an 18% reduction. Applying this 18% reduction to the assessed value would have resulted in a decrease in the gas assessed value to the County by $11.4 million.

In 1995 Seward County's assessed gas value was $ 49.9 million. Assuming that the average gas price will average $1.30 per Mcf and the average increase in gathering charges is 30 cents the reduction in value is estimated at 23%. This would decrease the assessed value to Seward County by approximately $11.5 million. Based on the county's mill levy this would result in a loss in tax dollars of approximately $1.1 million.

In Morton County the 1994 assessed value was $ 98.6 million. The average gas price was $1.68 per Mcf. A 30 cent increase in the gathering charge results in an 18% reduction in the net price. This would decrease the assessed value by $17.7 million. In 1995 the gas assessed value was $ 90.7 million. Based on an average gas price of $1.30 per Mcf and a 30 cent increase in the gathering charge the reduction in value is estimated at 23% or a decrease in the assessed value of $ 20.8 million. Based on the county's mill levy the tax dollars lost would be estimated at $1.8 million.

In 1995 the assessed gas value for all the counties statewide is $1,110,735,044. Assuming that the average gas price in Kansas in 1995 is $1.30 per Mcf and the average increase in gathering charges is 15 cents statewide the reduction in value is estimated at 11.5%. This decrease would reduce the gas assessed value for all the counties by approximately $128.2 million.

These studies show that the impact of increased gas gathering charges can have a significant decrease in the assessed gas values and thus, a major decrease in ad valorem taxes to the counties.

It should be noted that there are certain other factors which will impact the true effect increased gathering charges will have on assessed values. It is probable that the impact of higher gathering charges may affect smaller producers more than major producers. It may be that major producers will have little or no increase in gathering charges while small producers with smaller volumes of gas, even with large increases in gathering charges, may not have that significant decrease in the assessed value. However, major producers which own their own gathering systems may have the gathering entity initiate large increases in the gathering charge and thereby reduce the net price shown on the tax rendition resulting in lower assessed values to the producer. Until it is known what the gathering charges were before the gathering systems were "spinned down" and the charges afterward it is speculative as to what the true effect will be on the assessed values for the counties. Any reduction in values will also have an impact on the reduction of severance tax values to the State. A decrease in values due to increased gathering charges should have a proportional decrease in the severance taxes.

My recommendation to the Commission is that the producer and the gas gathering company file their gathering charges with the Commission and any future changes in those charges. The Commission would then have a record of the charges by producer and by the gathering company so that when a complaint is filed the Commission would know if the complaint was justified as to those charges being unfair or discriminatory by comparing the disputed charge with offsetting producer charges on that same gathering system. Although many producers and gatherers have entered into private contracts on gathering charges the Commission should still have on file a record of those charges.

I appreciate the opportunity to appear before the Commission in this matter. If you have any questions I will try to answer them.

Respectfully submitted,

Ronald L. Cook

Ronald L. Cook, P.E.

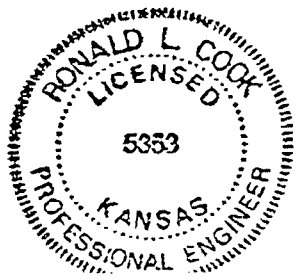

Exhibit 1

GATHERING CHARGE INCREASES
vs
REDUCTION IN WORKING INTEREST APPRAISED VALUE
and
THE ASSESSED VALUE

Gathering charge	Gas Prices		
Increase (cents/Mcf)	$1.00/Mcf	$ 1.50/Mcf	$ 2.00/Mcf
	Percent (%) Reduction		
10	10	7	5
15	15	10	7
20	20	13	10
25	25	17	13
30	30	20	15
35	35	23	18
40	40	27	20
45	45	30	23
50	50	33	25

Example:

If a gas lease has a 30 cent increase in gathering charges and the original gas price was $ 1.50/Mcf the reduction in the working interest appraised value and the assessed value is 20 %. If the lease had a working interest appraised value of $ 500,000 before the gathering charge increase the appraised value would be reduced to $ 400,000 and the assessed value reduced from $150,000 to $120,000.

Exhibit 2

Percent Value Reduction vs. Incremetal Increases in Gathering Charges
at Gas Prices of $1.00, $1.50 & $2.00 per Mcf