

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairperson Don Myers at 9:00 a.m. on January 28, 1997 in Room 514-S of the Capitol.

All members were present

Committee staff present: Lynne Holt, Legislative Research Department
Mary Ann Torrence, Revisor of Statutes
Mary Shaw, Committee Secretary

Conferees appearing before the committee: David Pierce, Professor, Washburn University School of Law
Chas Wilson, Member, Spec. Natural Gas Gathering Task Force
Emery Biro, Member, Spec. Natural Gas Gathering Task Force

Others attending: See attached list

Chairperson Myers mentioned that the Committee would hear two briefings on natural gas gathering. The Chair then introduced David Pierce, Professor at Washburn University School of Law.

David Pierce mentioned that he was present by request of the Committee and basically would be giving background information. He distributed historical information on natural gas gathering beginning prior to 1938 and concluding with recent information (Attachment #1). In closing, Mr. Pierce mentioned what needs to be done now is what type of regulatory technique is appropriate under the circumstances. Also, he mentioned that under the Natural Gas Act, the states have exclusive jurisdiction over the regulation of gas gathering systems.

The Chair introduced Charles Wilson, Member of the Special Natural Gas Gathering Task Force, and works for Berexco, Inc. (Attachment #2). In conclusion, he mentioned a proposed bill that was passed by the Task Force, but it needs fine tuning. He felt it imperative that legislation be passed this year. He mentioned that the Kansas gas producers need to have an inexpensive forum whereby complaints can be promptly addressed if producers are being treated unfairly by gas gatherers when competition for gas gathering does not exist. He felt the Kansas Corporation Commission was the logical choice for that forum.

The Chair introduced Emery Biro, III, Member of the Special Natural Gas Gathering Task Force and works for Anadarko Petroleum Company (Attachment #3). In concluding his remarks, Mr. Biro mentioned that the Legislature must determine whether there is a compelling need for gathering regulation in Kansas at this time. And if such a determination is made, then a reasonable approach to complaint-based regulation under the Resource Conservation Statute should be considered.

Questions and discussion followed. The Chair thanked all conferees for their information.

The meeting was adjourned at 10:00 a.m.

The next meeting is scheduled for January 29, 1997.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: January 28, 1997

NAME	REPRESENTING
Brady Contrell	CURB
Jack Graves	P-N-KN & Oly
MONTGOMERY ESCUE	C.C.E.
Brenda Parks	Jonathan Small
Patrick Doherty	KAP
Tom Bruno	Allen & Assoc.
John Federico	Pete McGill & Assoc
Leslie Kaufman	Ks Farm Bureau
Jamie Clover Adams	Governor's Office
WALKER HENDRIX	CURB
Ken PETERSON	KS Petroleum Council
Don Schnacke	KIOGA
Charlie Wilson	BEREXCO
J. C. Long	UtiliCorp/United, Inc.
TOM DAY	KCC
Doug Smith	SWKROA

Gas Gathering Background Information

by

David E. Pierce
Professor of Law
Washburn University School of Law

* Pre-1938

Interstate transportation of gas, and the sale of gas for resale, were subject to exclusive federal regulation. State regulation was preempted by the Commerce Clause.

* 1938

Congress passed the Natural Gas Act to regulate interstate transportation of gas and the sale of gas for resale. However, the Act specifically excluded from federal regulation the following activities:

- 1) Intrastate transportation of gas.
- 2) Sales of gas that are for use and not resale.
- 3) Local distribution of gas.
- 4) Production of gas.
- 5) Gathering of gas.

* 1938 to 1985

The federal regulatory agency administering the Natural Gas Act (Federal Power Commission (FPC) until 1977 and the Federal Energy Regulatory Commission (FERC) since 1977) regulated all aspects of the transportation and sale of gas as a "public utility."

"Public utility" generally refers to situations in which the activity possesses "monopoly" characteristics that require regulation to ensure adequate service at reasonable rates and terms of service.

"Monopoly" refers to situations in which the supplier of a good or service is not subject to the normal economic forces of supply and demand. The focus in public utility regulation is on the "natural monopoly" where the first party entering the market, because of substantial sunk costs, has a distinct advantage over subsequent would-be entrants that want to try and compete.

The traditional remedy for natural monopoly is to allow the market to be served by a single firm with its terms of service regulated: public utility regulation.

House Utilities
1-28-97
Attachment 1

"Public utility regulation" generally refers to the process of controlling who can provide the service ("entry" restrictions imposed by requiring a "certificate of public convenience and necessity"), specifying the minimum level of service (the "service" obligation) and the rates and terms of service (rates are typically based upon what it costs the utility to provide the service plus the opportunity to earn a reasonable rate of return on their investment). Typically the utility must also obtain permission to "exit" the service ("abandonment"). In addition to ensuring the terms of service are reasonable, and that rates are not excessive, utility regulation also seeks to ensure persons similarly situated are treated the same (no "discrimination").

* 1938 to 1995

The FPC, and later the FERC, elected to regulate gathering systems owned and operated by the interstate pipelines as part of an integrated transportation system.

* 1985

The FERC began to identify those portions of the gas business which, although regulated as a natural monopoly for decades, were not truly natural monopolies. First, it was recognized that the sale for resale of natural gas is not a natural monopoly and therefore does not require a public utility approach to set prices and terms of service. Since the sale for resale of natural gas is structurally competitive, there is no justification for treating it as a public utility.

The FERC recognized that to make its "deregulatory" approach work, it must continue to regulate, as a natural monopoly, the transportation function. Open, non-discriminatory access to transportation services, at reasonable rates, would permit the FERC to rely upon market forces to "regulate" (or "deregulate") the sale of gas for resale.

* 1995 to Present

Interstate pipelines have been divesting the pipeline systems that "gather" gas in the field of production and transport it to a central connection, or connections, on the interstate pipeline. The FERC has indicated it will not regulate these intermediate pipeline systems once they are no longer owned by the interstate pipeline.

Under the Natural Gas Act, the states have exclusive jurisdiction over the regulation of these gas "gathering" systems.

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CHARLES B. WILSON

**STATEMENT BEFORE THE
KANSAS HOUSE OF
REPRESENTATIVES**

UTILITIES COMMITTEE

JANUARY 28, 1997

House utilities
1-28-97
Attachment # 2

My name is Charles B. Wilson. I am a vice president with BEREXCO INC. Our headquarters are in Wichita. BEREXCO, and its affiliated companies are owned by the Robert Beren family of Wichita. The companies began doing business in Kansas in the early 1950's. BEREXCO currently employs over 260 employees and has oil and or gas operations in 44 Kansas counties. In each of these counties we are employing personnel, paying property taxes and purchasing goods and services. Additionally, we have operations in Nebraska, Colorado, Oklahoma, Arkansas and Texas.

Over the last twelve years, we have focused most of our new exploration efforts in the oil and gas fields that lay underneath the shallow (Hugoton) gas field in southwest Kansas. During this time, I have observed first hand the evolution of decontrol of the gas industry by the Federal government. First was the transfer of government price controls of gas to free market pricing. Second was the transformation of the interstate pipeline system from its merchant/transportation role to that of primarily providing open access transportation. And now we are in a transition period in which the Federal government has turned over to the individual states the regulation of the gathering systems owned (or formerly owned) by the interstate pipelines. These gathering systems which were formerly regulated by FERC have been in existence for decades, and their costs have been paid for many times over by the fees established by the FERC. These same gathering systems have now been "spun-down" to new affiliated corporations or have been sold to other companies, all of which results in a new cost structure. A cost structure which will be paid for again by fees.

It is my responsibility within the company to secure markets for our oil and gas. The exploration department finds the oil and gas, the production department brings the oil and gas to the surface, and it is my department's job to sell the product. Crude oil can be marketed either by pipeline connections or by truck transport. Natural gas, however, can be moved only by a pipeline connection. With oil, if a producer is not satisfied with a purchaser's service, practices or pricing, then the producer has the luxury of true free market competition, in that any another purchasing company can bring in their truck to move the oil away, regardless of producing volume. This is not the case with natural gas. Typically in Kansas, once a producing gas well is connected to a gathering line that well is "married" to that line until the well is economically abandoned; such well generally has no other

economic alternative by which it can sell its product. If a well has significant reserves and there are several pipelines in the vicinity there may be some competition when a well is first completed. However, once decline sets in, the producer loses its ability to attract competition. If a well does not have significant reserves, most pipelines will not compete to connect a well. I am not saying this to be critical of gathering pipelines, it is merely the nature of the gathering business in Kansas. In Oklahoma and Texas, due to a number of reasons, it is not unusual for a gas well to not only have competing pipelines nearby, but to also have more than one gathering pipeline connected to a well. That provides competition in a perfect form! Unfortunately in Kansas, such competitive opportunities are exceptionally rare. I have been involved in over 75 Kansas gas well connections since 1985, and I can show only a few instances where our wells had a multiple choice of gas gathering company alternatives to choose from. And it is worth noting that only 3 of our Kansas gas wells are connected to more than one gathering system.

Furthermore, from my personal experience if pipelines are free to establish gathering rates and practices subject only to competitive market forces, producers and wells with less than significant reserves will be disadvantaged in negotiations with the gatherers. Only active drillers, newer wells or wells with significant reserves will command the ability to negotiate with any presence. Otherwise, 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 for the state.

We are now entering our third legislative session in which the issue of gas gathering regulation has been addressed. To date, no final action has been taken. In the last two sessions, a sense of urgency was not apparent, because the FERC granted a two year "default" period to give the states the opportunity to fully study the issues before laws or state regulations were passed. However, the default period will begin to expire this year for some pipelines and we producers are beginning to receive notices of new rates. The time is at hand to establish how Kansas is going to respond to and manage gas gathering in our state.

This past year legislation was passed which established a task force to 1) study the effect of Federal deregulation of the interstate gathering systems, and if deemed necessary by the Task Force to 2) recommend appropriate legislation. The 14 member Task Force was chaired by Senator Sallee and was comprised of Senator Wisdom and Representatives Freeborn and Krehbiel. The other task force members represented county appraisers, royalty owners, gas producers, gatherers, an oil and gas lawyer, and the chairman of the KCC. I was appointed to this task force as an Independent Gas Gatherer-Producer representative.

The task force held 7 formal meetings and 2 field trips to gathering facilities in southwest and northeast Kansas. We listened to testimony from FERC experts, large and small gas producers, pipeline gathering companies, gas aggregator/marketing companies, royalty owners, irrigators, an economist, engineers, attorneys, bankers, and representatives from the Kansas Corporation Commission, Oklahoma Corporation Commission, and Texas Railroad Commission.

We heard well prepared and thought out testimony. To summarize the differing positions established during testimony:

- producers and their representatives held that competition does not exist and provided anecdotal evidence to support heavy-handed utility type regulation.
- two gathering companies stated that competition does exist and, therefore regulation of any type is unnecessary.
- attorneys stated that existing Kansas statutes already provide the KCC with the authority to regulate, but the KCC disagrees.
- a gathering company believed that the FERC has retained authority to re-enter gathering regulation, if abuse occurs. (*But the cost to file with FERC would be horrendous, and the well would probably be depleted before the producer would receive a ruling, if ever.*)
- irrigators and their bankers stated that new pipeline charges are driving them out of business.
- the Oklahoma Commission chairman said that their light-handed regulation works for Oklahoma.
- a representative of the Texas Commission and others criticized the Oklahoma legislation as too expensive for producers to use and difficult to work with.

- a public policy economist, who said he represented no one in particular other than the economics of the southwest Kansas region, discussed the definition of a natural monopoly, and by that definition, he believed that there was a likelihood that monopolistic practices will be created and flourish in Kansas if the legislature and the KCC don't adopt affirmative regulations.
- an engineer commissioned by a group of county appraisers showed us how slightly increasing gathering costs would cause a deterioration of assessed values, and thus lower ad valorem taxes to producing counties.

As you can imagine we heard conflicting and at times contentious testimony. Basically, the gatherers are fearful of over-regulation and the producers are anxious about being monopolized. But from this testimony, the Task Force came to the conclusion that 1) Federal deregulation has and would continue to affect gas gathering fees and practices in Kansas, and therefore, 2) regulation at the state level was necessary to keep the playing field level. We felt that light-handed, complaint based regulation would be most efficient and effective. This conclusion is basically no different than that reached by the last two task forces that studied this issue (Special Committee on Energy and Natural Resources-1995, KCC-1996).

The Proposed Bill that came from the Task Force could be described as providing light-handed government involvement through a case-by-case complaint based process, but with a kicker. If after hearings, the KCC determines that a gatherer is engaging in abusive monopolistic practices, then Chapter 66 public utility and common carrier statutes can be applied to the gatherer.

Under the Proposed Bill, if a producer believes they have been aggrieved by a discriminatory or unfair gathering fee or practice, the producer may ask the KCC to act as an informal mediator. The KCC's opinion, at this point would be non-binding. However, if either party wants to continue the process, then a more formal hearing would be held before the KCC, and the resulting opinion would be binding.

We used the broad terminology "unduly, unlawfully, or unreasonably discriminatory or unfair gathering fees or practices" to encompass any abuse. We believed that the average person, provided with sufficient facts,

can look at a given situation and determine if a “discriminatory or unfair fee or practice” has occurred.

In conclusion, we have a Proposed Bill that was passed by the Task Force. I admit there needs to be a little fine tuning of the administrative mechanics for the complaint hearing process, referred to in the Proposed Bill as New Section 3 (c). That language was hastily written as the task force was compromising similar language of two bills before the group. **But this Proposed Bill and certainly the spirit of the bill was supported by an overwhelming majority of the members of the Task Force, including all the legislator members present.** It is imperative we have legislation passed this year. For not only the gas producers, but also for the benefit of royalty owners, Kansas severance taxes and ad valorem valuations. The Kansas gas producers need to have an inexpensive forum whereby complaints can be promptly addressed if producers are being treated unfairly by gas gatherers when competition for gas gathering does not exist. The Kansas Corporation Commission is the logical choice for this forum.

TO: Chairman Don Myers
and the House Utilities Committee

FROM: Mr. Emery J. Biro, III
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Member, Governor's Task Force on Natural Gas Gathering

RE: Natural Gas Gathering

DATE: January 28, 1997

As a member of the Governor's Gas Gathering Task Force and a co-sponsor of the Task Force Minority Report, I would like to make the following observations and recommendations to the members of the House Utilities Committee:

- I. THERE HAS BEEN NO DEMONSTRATED NEED BEFORE THE TASK FORCE FOR GAS GATHERING REGULATION.
 - A. Testimony before the Task Force consisted primarily of unsubstantiated claims by several small producers of unwarranted gathering rate increases, with no opportunity for rebuttal or explanation by the relevant gatherer.
 - B. In many cases, increases in gathering rates are associated with the installation of compression which is necessary to offset declining reservoir pressures in the Hugoton.
 - C. A significant amount of gathering in Kansas has never been subject to FERC regulation, yet has taken place largely without incident.
 - D. Despite FERC's default contract requirement, the vast majority of gathering contracts for service on spun-down or spun-off facilities have been mutually agreed upon by producers and gatherers.
 - E. Default contracts are being offered/honored by gatherers despite the federal court remand to FERC.

House Utilities
1-28-97
Attachment 3

II. PUBLIC UTILITY REGULATION IS AN UNWORKABLE AND UNDESIRABLE FORM OF GATHERING REGULATION.

- A. All segments of the natural gas industry, including small independent producers, oppose public utility regulation of gathering because of the time and expense involved.
- B. Additionally, public utility regulation is inappropriate for gathering because:
 - 1. Gatherers do not operate in franchised service territories which are legally protected from competition, and are not guaranteed a minimum rate of return on their investment.
 - 2. Gathering rates are not susceptible to advance determination in a manner which will not require subsidization of some producers by other producers.
 - 3. Public utility, cost-of-service regulation may well result in increased costs, as illustrated by public utility rates for irrigation gas service.

III. THE COMPLAINT-BASED REGULATION PROPOSED BY THE TASK FORCE IS UNWORKABLE, AND WILL NECESSARILY LEAD TO UNNECESSARY AND COUNTERPRODUCTIVE GOVERNMENT INVOLVEMENT IN THE NATURAL GAS INDUSTRY.

- A. There is no meaningful distinction between the basis for a complaint under the resource conservation statute and a complaint under the public utility statute.
- B. The standards incorporated in the proposed resource conservation statute are overly vague (eg., "unfair" gathering fees) and will result in excessive and expensive litigation before the KCC.
- C. Unlike the Oklahoma approach which recognizes limited protections for gatherers against frivolous complaints, the Task Force proposal contains no such protections, even where competitive gathering conditions exist.

IV. THE LEGISLATURE MUST DETERMINE WHETHER THERE IS A COMPELLING NEED FOR GATHERING REGULATION IN KANSAS AT THIS TIME. IF SUCH A DETERMINATION IS MADE, THEN A REASONABLE APPROACH TO COMPLAINT-BASED REGULATION UNDER THE RESOURCE CONSERVATION STATUTE SHOULD BE CONSIDERED.