Approved: Carl Dean Holmes
Date 2-17-99

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairperson Rep. Carl Holmes at 9:00 a.m. on February 5, 1999 in Room 522-S of the Capitol.

All members were present except: Rep. Richard Alldritt
Rep. Thomas Klein

Committee staff present: Lynne Holt, Legislative Research Department
Mary Torrence, Revisor of Statutes
Jo Cook-Whitmore, Committee Secretary

Conferees appearing before the committee: Representative Dennis McKinney
John Black
Robert Krebiel
Erick Norlding, Executive Secretary, SWKSRA
Stanley Withers
Ken Melbourne, Williams Gas Pipelines
James Flaherty, Atmos Energy Corp.
Ann Rider, Northern Natural Gas
Steve Luthye, Mid Continent Market Center
Jack Glaves, Pan Gas Storage
Diana Edmiston, KCC

Others attending: See Attached List

Hearing on HB 2045 - underground storage of natural gas

Rep. Dennis McKinney (108th District-Greensburg) opened testimony on **HB 2045** by reading a statement prepared by Dean Dyche from Cunningham, Kansas (Attachment 1). Rep. McKinney also distributed written testimony from Lloyd McClellan of Cunningham (Attachment 2) and Kenneth Glenn, also of Cunningham (Attachment 3). All three testimonies were in support of **HB 2045**. Rep. McKinney also introduced Stanley Withers of Pratt, who would testify later.

John Black, an attorney from Pratt, provided testimony in favor of the bill (Attachment 4). Mr. Black included in his testimony a copy of a letter received from Northern Natural Gas Company and an Annual Rental Payment Agreement and Release.

Robert Krehbiel, attorney from Pretty Prairie, Kansas, presented testimony in favor of the bill (Attachment 5).

Erick Nordling, Executive Secretary of the Southwest Kansas Royalty Owners Association, presented testimony in favor of the bill (Attachment 6).

Stanley Withers presented testimony in favor of the bill (Attachment 7).

Chairman Holmes then opened the floor for the committee to ask questions of the proponents.

Ken Melbourne, Williams Gas Pipelines, presented testimony in opposition to **HB 2045** (Attachment 8).

James Flaherty, on behalf of Atmos Energy Corporation, then presented testimony in opposition to the bill (Attachment 9).

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES, Room 522-S, Statehouse, at 9:05 a.m. on February 5, 1999.

Ann Rider, attorney representing Northern Natural gas Company, testified on their behalf in opposition to **HB 2045** (Attachment 10).

Steve Luthye, Manager-Gas Control of Mid Continent Market Center, testified in opposition to the bill (Attachment 11).

Jack Glaves, representing Pan Gas Storage, also appeared in opposition to the bill (Attachment 12).

Diana Edmiston, Kansas Corporation Commission, distributed a copy of a memorandum from William Wix, Assistant General Counsel of the KCC, who indicated opposition to part of the bill (Attachment 13).

Testimony was concluded with conferees responding to questions from the committee.

Chairman Holmes announced the formation of a subcommittee to further discuss and make recommendations back to the full committee on **HB 2045**. The subcommittee will consist of Rep. Ward Loyd, Chair; Rep. Dan Johnson, Rep. Billie Vining, Rep. Annie Kuether, and Rep. Tom Klein.

Meeting adjourned at 10:53 a.m.

Next meeting is Monday, February 8.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: February 5, 1999

NAME	REPRESENTING
Whitney Damron	Kansas Gas Service / Mid-Continent
Ken Milburn	Williams Gas Pipeline Central
Steve Luthye	Mid Continent Market Center
JIM BARTLING	UNITED CITIES GAS CO
Doug Smith	SWKS Royalty Owners Assn.
ERICK NORDLING	SWKROA
Ron Geeslin	Williams Company
Ann J. Rider	Northern Natural Gas Co.
JOHN ROSE	Northern Natural Gas Co.
Rob Wilson	NORTHERN NATURAL GAS CO.
George Barbee	ENRON
BOB ALDERSON	ATMOS ENERGY CORPORATION
Chuck Debart	Williams
JAY ALLEN	WILLIAMS
TIM THOMPSON	WILLIAMS

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: February 5, 1999

NAME	REPRESENTING
John V Black	Self
Stanley Withrow	Self

SWORN TESTIMONY OF DEAN DYCHE
REGARDING HOUSE BILL 2045

TO BE PRESENTED TO THE HOUSE UTILITIES COMMITTEE ON FEBRUARY 5, 1998

My name is Dean Dyche, and I live in Cunningham, Kansas. I own land that is in the Cunningham Gas Storage Field.

The Cunningham Gas Storage Field was established in 1976. At the time it was set up, the landowners negotiated contracts for the use of the Viola Formation under their land for storage of natural gas. These contracts provided for annual rental payments of $4.00 an acre, which would increase every five years by $1.00 an acre. I have been paid these rentals on my land, although at times I was required to sign liability release documents before they would pay my rental checks. In 1993, Northern Natural Gas, the operator of the Cunningham Gas Storage Field, determined that their gas was leaking into the Simpson Formation underlying the Viola Formation in the gas storage field. They sent agents to contact the landowners requesting them to sign a document deeding to them the minerals and the Simpson Formation under their land for a one-time payment of $10.00. I felt this was not reasonable.

A second agent came to see us later. He told us that if we did not sign the agreement and sell them our formation for $10.00 an acre, they would take us to court and condemn it. They made the implication that we might possibly lose the rentals in our Viola Formation. Many of the other landowners in the area who are retired went ahead and sold their interest for $10.00, because they were apprehensive of losing the rentals in the Viola Formation. I did not accept the $10.00. We went to condemnation and were awarded $55.00 an acre in Pratt County, $25.00 an acre in Kingman, which was appealed and finally settled for $45.00 an acre.

I do not feel it is right that I should be forced to sell my property rights, namely the right to the Simpson Formation, to add to the profits of a large, multinational gas company. Our attorney contacted an expert, Mr. Bill Henry. He is a former Vice President of Northern Natural Gas Company and an individual who has been involved in setting up gas storage fields all over the

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ATTACHMENT 1

United States. He calculated the income value of the Simpson formation over the 17-year period that Northern had been using it. He calculated that income value to be $684.00 an acre. The landowners should receive a fair rental value for the use of their formation on an economic endeavor of this size. This is particularly true since the gas industry has been deregulated.

The United State Constitution protects the property rights of landowners. It is not fair or equitable to allow someone to use the landowners' property, in this case the Simpson formation underlying their land, and derive a profit from it and not pay a fair rental to the landowners. The condemnation process currently established determines the value of the property being taken by an estimate of the before and after values of the property. The statutory scheme does not allow the courts to take into account the rental value of the property being taken. It is no relationship to the income stream this property should produce for its owner.

For the above reasons, the present statutory scheme is unfair and inequitable, and it denies the property owners the full right to use and enjoy their property or receive the benefits of their property. I feel House Bill 2045 will go a long way to correct this. I respectfully ask that you pass the same.

Dean Dyche
DEAN DYCHE

Subscribed and sworn to before me this 3rd day of February 1999.

Debra K. Patterson
NOTARY PUBLIC

DEBRA K. PATTERSON
NOTARY PUBLIC
STATE OF KANSAS
My Appt. Exp. 8-31-2001

(SEAL)
My Commission Expires: 8-31-2001

BEFORE THE STATE OF KANSAS
HOUSE UTILITIES COMMITTEE

RE: HOUSE BILL 2045

SWORN TESTIMONY OF LLOYD MCCLELLAN

My name is Lloyd McClellan. I live on a farm near Cunningham, Kansas. Northern Natural Gas Company has their Cunningham Gas Storage Field under land I own. Due to my age and health condition, I did not feel I was able to testify before the House Utilities Committee regarding House Bill 2045. I submit the following information and please ask the Committee to consider my testimony in support of the bill.

In 1976, Northern Natural Gas Company came to us to rent the Viola formation under our land so they could establish a storage field for natural gas. They presented us with contracts providing an annual rental payment of $4.00 per acre for the first five years, which increased $1.00 an acre for each five years thereafter. I have been paid the rentals on the Viola formation under my land. Sometimes they have been late, and sometimes they have demanded my signature on a liability release document before they would pay my rental check. After signing this initial contract, I learned that about the same time Kansas Power and Light negotiated a rental contract at arms-length, with no threats of condemnation, for land in Pratt County, which is about 15 miles from the Cunningham Gas Storage Field, and paid $10.00 an acre with an escalation clause for the rental to increase each year.

In 1993, Northern Natural Gas, the operator of the Cunningham Gas Storage Field, determined that their gas was leaking into the Simpson formation, which underlies the Viola Formation, and is also under my land. They sent land agents to contact the landowners requesting them to sign a deed granting Northern Natural Gas the minerals and the rights to the Simpson formation under this land for a one-time payment of $10.00 per acre. I did not feel this was just and reasonable and would not sign the deed. Later, they sent a second agent to see us. He informed us that if we did not sign the agreement and sell the Simpson formation under

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our land to Northern Natural for $10.00 an acre, there would be a court proceedings to condemn this acreage, and we would have great legal expense. The implication was made that we might even lose the rentals from the Viola formation, as it might be condemned as well. My attorney has since advised me that it was not possible to condemn the Viola formation that they had rented. Many of my friends who own land near me were apprehensive they would lose the benefits of the Viola rental agreement and signed the deed selling their Simpson formation to Northern Natural Gas Company for $10.00 an acre. We were then involved in a condemnation action in Pratt County and were awarded $55.00 an acre in the condemnation.

I did not feel it was right that in the condemnation case the rental value of the formation was not allowed to be considered. Actually, this was a property right we were losing. Our attorney contacted an expert who is a former Vice President of Northern Natural Gas Company and who was involved in setting up not only gas storage fields for Northern Natural, but also gas storage fields all over the United States. He calculated the income value of the Simpson formation over the 17-year period that Northern Natural Gas Company had been trespassing on and using it. He set this value at $684.00 an acre. I feel the landowner should be entitled to receive the fair rental value for the use of the formation under their land on an economic endeavor of this size. I feel this is particularly true since the gas industry is now deregulated.

The Fourteenth Amendment protects the property rights of the landowners. If their rights are to be taken, the bundle of rights being taken and their value should be considered. It is not fair or equitable to allow a corporation to take the landowner's property for their private use and benefit. In this case, the Simpson formation underlying our land was taken for the private use and benefit of Northern Natural Gas Company. They will derive a profit from it. They will not pay a fair rental for its use. The current condemnation process that was used in taking our property did not consider the fair rental value of the property. It considered the value of the property before and after the taking. Since the property had never been rented, that rental value was not factored in to the before and after values. In fact, the before and after values

were established by using sales of land in the area which had nothing to do with the consideration of the rental value of the formation (the storage value of the formation).

I don't believe a large multinational company or anyone for that matter should be able to take property that is suitable for use for storage such as a warehouse, a barn, or another building and not compensate for the rental value of the property. It is not fair for a large private corporation to use the powers of the government to take property from the citizens for the corporation's private use and benefit, or the benefit of its stockholders. I believe the corporation should be required to negotiate rental contracts at arms-length with the individuals who own the property. It is no more right for them to be able to take the Simpson formation under my property than it would be for them to be able to take a warehouse in Wichita, Kansas, by condemnation just for their use and benefit. It is particularly unfair when the process used has no relationship to the income stream the property would produce. I believe the company should be required to pay a reasonable annual rental for the use of the Simpson formation under our property.

For the above reasons, I feel the present statutory scheme is unfair and inequitable and does not consider my constitutional rights and my property. It denies me the full use, enjoyment and benefit of my property. I feel House Bill 2045 will go a long way to correct this. I respectfully ask that you pass the same.

Lloyd McClellan
LLOYD McCLELLAN

Subscribed and sworn to before me this 4th day of February, 1999.

Debra K. Patterson
NOTARY PUBLIC

DEBRA K. PATTERSON
NOTARY PUBLIC
STATE OF KANSAS
My Appt. Exp. 8-31-2001

(SEAL)
My Commission Expires:

BEFORE THE STATE OF KANSAS
HOUSE UTILITIES COMMITTEE

RE: HOUSE BILL 2045

SWORN TESTIMONY OF KENNETH GLENN

My name is Kenneth Glenn. I live on a farm near Cunningham, Kansas. I own land and also farm land that is included in the Northern Natural Gas Company's Cunningham Gas Storage Field.

The Cunningham Gas Storage Field was established in 1976. It was initially for storage of gas in the Viola formation under the land. The landowners entered into contracts providing rental payments at $4.00 an acre per year, with a clause to increase the rental payment by $1.00 an acre every five years. I have been paid the rentals on my land. At times, the checks were late. At times, the checks were held up as they were trying to require me to sign a liability release before they would pay my rental checks.

In 1993, Northern Natural Gas Company, the operator of the Cunningham Gas Storage Field, determined that their gas was leaking into the Simpson formation underlying the Viola formation in the gas storage field. They sent land men to contact the landowners requesting them to sign a document deeding the minerals and the Simpson formation under the land to Northern Natural Gas Company. They offered to pay a one-time payment of $10.00 per acre for this deed. I felt this was not reasonable, and they would not negotiate.

It was a "take or leave it" situation. If we refused to take the $10.00 per acre they had arbitrarily set, they informed us they would condemn it, and we would have legal expense connected with that. They did, in fact, condemn it and paid $55.00 an acre on the land in Pratt County. After the first contact, they had another individual contact us. At that time, they made the implication they might also condemn the Viola formation (which my attorney advised me was not possible), and we would lose the rentals on the Viola

formation. Many of the landowners at that time, particularly those who were older or retired and were relying on the rental payments to pay the taxes on their land, went ahead and signed up for $10.00 an acre.

I do not feel it is right, just or equitable that I should be forced to sell my property rights (in this case, the rights to Simpson formation) to add to the profits of a large multinational gas company. In the process of the condemnation and a related lawsuit, our attorney contacted an expert witness, Mr. Bill Henry, a former Vice President of Northern Natural Gas Company. He has set up gas storage fields all over the United States and initially worked on Northern Natural's Cunningham Gas Storage Field. My attorney showed me papers that Mr. Henry prepared and calculated the income value of the Simpson formation under our land over the 17-year period that Northern had been using it without permission. This income value was $684.00 an acre. I believe if there is that much value in the use of this acreage, the company should pay a fair rental amount annually, and not be allowed to take the formation away from us in this manner. I believe this is particularly true since the gas industry is now deregulated, and the gas storage under our land is principally going to other states.

I understand that the Fourteenth Amendment of the United State Constitution protects the property rights of landowners. I don't believe it is fair, just or equitable to allow a large corporation to use a landowner's property (in this case, the Simpson formation underlying my land) and derive a profit from it and not pay a fair rental to the landowners.

The condemnation process used on our property did not allow us to show the rental value of the property, but rather determined values based on the value of the surface of the land itself as established by before and after sales in the area. There was no necessity to show that these sales in any way took into account the rental value of the Simpson formation. Thus, rights were being taken away that were not even properly valued in the

action. I would also point out that any recoverable minerals in the Simpson formation were being taken away. The landowner is at a distinct disadvantage to show those recoverable minerals without great expense hiring geological experts. To give you an idea of the magnitude of the expense, Northern Natural Gas Company hired a company out of Dallas, Texas, to do a study and paid over $625,000 for that study. Certainly, individual landowners cannot afford this. This is one reason I believe that a much better and equitable way to handle these storage leases is with a rental agreement and not letting them come in and use the sovereign powers of the government to take away the land rights.

In addition, under the statute, I understand we could be held liable for past production taken from our property. This would be production that might have occurred as a result of their trespass on our land. I do not believe this is just either. There is no provision made for compensation for the past use of the unleased storage area. Certainly, if there is going to be some claim for gas produced from it, there should be compensation for the use of the storage area.

I understand the large corporations feel that making monthly or annual rental payments is a nuisance. I wonder how they reconcile renting warehouses and other land. I don't believe it is any more fair for them to take our property rights than it would be for them to go into a large city and condemn a warehouse or a lot for storage that they wanted to use in connection with their operations. The same principles should apply.

In our action over the Cunningham Gas Storage Field, there was also the question of costs and attorneys fees. The statute as it exists today says the landowners should be allowed reasonable attorneys fees. We feel this should be modified to say, "allowed attorneys fees in accordance with the contract with their attorney, if the court finds that contract to be reasonable." We do not think they should be able to dictate what they think is reasonable attorney's fees.

The current statute also does not make provision for payment for past use of the formation. I feel it is very defective in that regard.

If the Committee feels that we should have to give up our property rights through the condemnation process, then I request that you pass House Bill 2045 which will at least remedy part of the complaints I have regarding the present system. I do not feel it is right to allow these companies to avoid bargaining at arms-length for what they want to use or need and just simply go to court using the sovereign power to condemn these rights and then do it under a system that doesn't even take into account the rental value of the formation.

Thank you for your consideration.

Kenneth Glenn

KENNETH GLENN

Subscribed and sworn to before me this 4th day of February, 1999.

Debra K. Patterson

NOTARY PUBLIC

(SEAL)

DEBRA K. PATTERSON
NOTARY PUBLIC
STATE OF KANSAS
My Appt. Exp. 8-31-2001

My Commission Expires:

BEFORE THE STATE OF KANSAS
HOUSE UTILITIES COMMITTEE

RE: HOUSE BILL 2045

SWORN TESTIMONY OF JOHN V. BLACK

My name is John V. Black. I am an attorney in Pratt, Kansas, and I have recently represented a number of landowners in litigation involving the Cunningham Gas Storage Field. This involved both a condemnation and an action for trespass. In working with this litigation, I found there were several things that were unjust in the current provisions of Article 12 of Chapter 55 of the Kansas Statutes Annotated. This Article deals with underground storage of natural gas and was amended in July of 1993, basically at the request of Williams Gas Company.

The first thing this amendment did was to remove the rule of capture, which has been the historic rule in the State of Kansas, from application to storage gas. It specifically concerned storage gas that had leaked out of the storage formation where it was supposed to have been contained. The amendment was basically concerned with the rights of the gas company storing the gas and overlooked the rights of the landowners owning the formations where the gas had leaked into.

The first problem we ran into in dealing with the litigation was the eminent domain procedure. I question whether it is right to use the sovereign power of the State to condemn private property for public purposes for the gain of a large multinational gas company or pipeline company. The gas distribution system has been partially deregulated and will eventually be completely deregulated. They should be able to negotiate at arms-length just as any individual would be required to negotiated at

arms-length if they wanted to buy a storage facility, whether it be for grain, cars, gas, or any other type of commodity. As our nation formed and public utilities and railroads were first being established for a public benefit, the right to use the sovereign power of the State was granted to the public utilities. On the other side of the fence, the public utilities and railroads were regulated, and their profits were controlled. That is history. Today, the pipelines are either being deregulated or have been deregulated. Their facilities have been established many times with the use of eminent domain, and they have grown from small regional companies to giant multinational companies. They have a distinct advantage over a small landowner when it comes to litigation. They have a distinct advantage over a small landowner when it comes to having studies done to show the condition of an underground formation. Yet, we have followed the old system of letting them use the power of the sovereign for eminent domain. Now it is being used for private profit of the large companies and their shareholders.

One of the problems with the current system is what they are allowed to condemn. If that would be limited to a condemnation of a rental right for an amount to be established by the court, it would be fairer and much more equitable than condemning and taking the whole right.

Another property right they take is the recoverable minerals in the formation. Once they inject their gas into the formation, it is like a secondary or tertiary recovery operation and many minerals that are native to the formation will be forced out and taken to the surface. There is no provision to pay the landowners for these minerals. Thus, we now have landowners who have had a property right taken away from them, namely, the right to use their formation for storage, and then we've gone further and in

effect confiscated their mineral rights based on speculative studies by engineers. Thus, I believe a lease would be much more equitable and fair, than a complete taking.

In the condemnation proceeding, we encountered problems in the way the commodity being taken was valued. Statute and case law limited us to a standard that was set by showing the value before and after based on sales in the area. There was no requirement to show that these sales took into account the rental value of the subsurface formation. If a knowledgeable seller and buyer had knowledge of the rental value of the formation, it would materially affect the sale. Thus, if eminent domain is to be used, it should specifically address the commodity that is being taken, namely the rental value of the storage formation. We were not allowed to do this in the condemnation case.

The following are five specific questions I believe should be taken into account in considering these bills: (a) the recoverable minerals, (b) past production, (c) compensation, (e) periodic payments, and (d) costs and attorney's fees. I am addressing these from the assumption that the Committee will allow the utility to go ahead and use the sovereign government's right for condemnation.

A. RECOVERABLE MINERALS

The first point was the matter on how to deal with recoverable minerals in the formation where the gas is being injected.

In the Northern Natural Gas Cunningham Gas Storage Field and KP&L Brehm Field there are separate oil and gas leases, just like you have a lease on any oil or gas well, covering the oil and condensate recovered from the storage formation. These

leases were negotiated between the gas company and the landowners at arms-length. They provide for payment of an agreed royalty.

It is not fair or just to the mineral owners to make them give up their rights to the minerals under their property, which the gas company is condemning for storage use. It is bad enough to let the cavalier gas company condemn the use of their storage formation, rather than negotiating a private contract. It is a further intrusion upon their rights when you confiscate their minerals rights based on speculative studies by engineers. I realize this can work both in their favor and against them, but it is fairer to all of the parties if there is simply a lease on the recoverable minerals.

In the Brehm Field, which is a Simpson formation in Pratt County, the lease on minerals from the storage formation was for a 3/16th royalty interest (A 3/16th royalty interest has become customary on negotiated leases). In the earlier Northern Natural Cunningham/Viola gas storage field in Pratt County, the accompanying oil and gas lease was for 1/8th royalty.

These terms should be negotiated at arms-length and should not be a cram down situation for either party. If the parties cannot arrive at a mineral amount, a court can certainly set that amount or it could be set by mediation. I do not think that would normally be necessary. However, when one can abuse the privilege of condemnation generously given them by the legislature, inequities and unfairness result.

If it is to be fair to all concerned, the gas companies must not be allowed to abuse the condemnation process. This is clearly what Northern Natural Gas Company did with their $10.00 leases on the Simpson and Arbuckle formations crammed down the throats of the owners of 16,000 acres of land by threat of condemnation and deceit.

B. PAST PRODUCTION

With respect to the liability for past production, this is clearly to pay for minerals that have been taken during the trespass without compensation. You might even say they have exerted unauthorized control over these minerals, which they did not have permission to take. Justice and equity would demand that there should be compensation for these minerals. Even though the gas company may have paid someone other than the mineral owner for minerals produced, it was their mistake, not the owners of the minerals in the trespass formation. If they paid the wrong parties, it was clearly due to their error.

It is much more equitable for them to have to pay for this mistake than it is to look to the mineral owners and say the gas company made a mistake; we are just going to let them have the benefits of that mistake, and you are going to lose. If the proper studies are prepared for certification by the KCC, the gas company will have reservoir information from which they can determine the percentages of the reservoir in the trespassed area. From that they could allocate the percentages of production and compensate the mineral owners in the trespass area proportionately on that production.

C. COMPENSATION

Next, please consider the issue of compensation for the past use of the unleased storage area. It is grossly unfair to say the gas companies can use the formation or area for a period of time and not compensate for that use (pay rent). In the case in Pratt County, eighteen years is a long period of time to not compensate (pay rent) for the storage use. This allows the gas company to have the benefits of the unjust enrichment. If the gas companies are to have the privilege of condemnation, they

should first have to pay for the fair rental value of the storage area they have trespassed upon.

They should be required to do what is just and equitable, to the landowners, before they subject the landowners to the condemnation proceedings. There are plenty of existing gas storage formation contracts that can be used as a standard to determine fair rental value of the storage. Evidence presented of these contracts could certainly be presented to and used by the KCC to set this fair rental value. The KCC should make the payment of the fair rental value a condition of their certification of the formation for storage.

D. PERIODIC PAYMENTS

What are the advantages and disadvantages of periodic payments? The only disadvantage I see to periodic payments is the one raised by Williams saying they did not like to write checks annually.

Contracts bargained at arms-length in the oil and gas industry for years have provided for delay rentals. These delay rentals have been paid in annual payments remitted to bank accounts of the Lessors. Likewise, contracts bargained at arms-length for storage of natural gas in underground formations have provided for payments in annual rentals.

The rental payments for the gas storage used are really no different from the delay rental payments. The only difference being the purpose for which they are made. They are far more fair and equitable than a lump sum payment; because first, they pay the current property owner for the use of their property.

Secondly, they provide for the effects of inflation. In the Northern Natural Gas Company Viola contract, there is a provisions for increasing the annual payments by $1.00 every five years to account for the effect of inflation. In the Richfield Gas Storage lease, the inflation factor is a $2.00 increase every five years. In the Brehm Field Storage Lease, the inflation factor is 10 percent per annum compounded annually.

All of these arms-length bargained contracts provided for periodic payments and provide for compensation for the effects of inflation. They are more fair and just than the lump sum payment, because they provide for a current value payment for the time use of a portion of the owner's property.

In the Northern Natural Gas condemnation case, a lump sum payment was made based on speculation by the appraisers as to two factors:

1. Future value of the formation.
2. The period of time the formation was used. (Might be 20, 50 or 100 years.

Certainly, what is a fair rental for ten years would not be a fair rental for twenty, thirty or fifty years. The fair and equitable way to handle this is with an annual lease payment. The appraisers in the condemnation can easily set the value of that annual lease payment from evidence presented by the parties. This is a small consideration for the use of the great privilege of the right of condemnation. It is truly due process compensation for the property right being taken.

E. COSTS AND ATTORNEY FEES

The Statute as it exists today provides that if the landowners prevail, they are entitled to recover reasonable attorney's fees. I have been told that at the time this

compromise was put in the statute the parties' intent was that the landowner should not have to pay the trial costs and attorneys fees if they had to sue and prevailed. Those costs were to be borne by the gas company.

As this worked out in the Northern Natural case, only part of these costs were borne by the gas company, because while the judge found the contingency contract to be reasonable and also found the hourly rates to be reasonable, he ruled compensation was to be made by the gas company only for the hourly rates and not to the attorneys based on their contract with the landowners.

Thus, the clause on attorney's fees should read that the "attorney's fees are to be allowed to the landowners in accordance with the contract with their attorney, if the court finds said contract to be reasonable." This would insure that the landowners are fully compensated for their damages by award from the court.

You may have read in the tobacco cases where there was argument about ordering the tobacco companies to pay contingency contracts. The U.S. Circuit Court Judge in the 7th Circuit stated that to get the lawyers with the skill to handle the cases, the states were not willing to risk the high costs of hourly attorney's fees. Therefore, it was reasonable for them to contract on a contingency basis. Thus, the court held that the tobacco companies should pay based on the contingency contracts. That same type of principle applies in a case as complex as mineral condemnation cases.

With respect to attorney fees for the Corporation Commission proceedings. When the gas company applies to the Corporation Commission for certification of the formation, they place a large unwanted burden on the landowners. That burden is in the form of having to acquire expert opinions to answer the experts of the gas

companies and to acquire counsel to present their case to the KCC. Since the landowners are not asked to have their land condemned and they are not asking to have the storage field established, it is only fair and equitable that those costs should be borne by the parties who are asking for the action by the KCC.

It is just not due process of law to place a burden on the landowners when they have not done anything wrong. They are not really a happy or willing participant in the procedure. It is a procedure being started by a party who has already been given a privileged position in the law under the theory of meeting public convenience. Thus, it is only fair there should be a mechanism in the Statute to insure that the landowners are not out expenses created for the convenience of the gas company.

In order to grasp the inequities and unfairness of the present statute, you really need to represent the mineral owners and landowners in a court case and deal with the claims and allegations and tricks of the pipeline and gas companies.

In 1993, these companies expedited a bill through the Legislature without the Legislature having adequate time to study and consider all of the issues involved and without the landowners and mineral owners having the time to adequately develop the issues and present them to the Legislature.

It was only after I represented landowners and mineral owners, in both a condemnation action and a trespass action that I came to realize the many facets of gas storage and the gross unfairness of the rules as they are today. We are dealing with cherished property rights that could not be taken or acquired by other than arms-length bargaining without the cherished privilege granted by the sovereign in the form of condemnation.

It must always be remembered that the greatness of our nation is embedded in our Constitution, which protects individuals and protects individual property rights. Anything that contravenes these, should be done only with extreme caution.

The area of eminent domain should be selfishly guarded. Anything that expands the area of eminent domain reduces the rights of the citizens. In a democracy, citizen's rights are of primary concern. In a totalitarian type government, they are of little concern. Under socialization, they take a secondary seat to what leaders perceive to be the "interests of society". The United States became great based on democratic principles. I believe further socialization will only lead to its decline. Thus, I believe it is very important that we take an interest and a stand on legislation that has the potential of reducing the property rights guarded by the constitution.

John V. Black

JOHN V. BLACK

Subscribed and sworn to before me this 4th day of February, 1999.

Debra K. Patterson

NOTARY PUBLIC

(SEAL)

DEBRA K. PATTERSON
NOTARY PUBLIC
STATE OF KANSAS
My Appt. Exp. 8-31-2001

My Commission Expires:

ANNUAL RENTAL PAYMENT AGREEMENT AND RELEASE

August 25, 1998

FOR AND IN CONSIDERATION of the sum of EIGHTY Dollars ($80.00), the undersigned ROBERT WITHERS, on receipt of payment by NORTHERN NATURAL GAS COMPANY, hereby releases, relinquishes and discharges all claims, demands, damages, actions and causes of action against said NORTHERN NATURAL GAS COMPANY, its contractors, successors or assigns, which have arisen or which may arise because and on account of annual rental for the following property:

Well # 34-33

FOR THE SAME CONSIDERATION, it is further agreed by the undersigned that payment of the above named sum shall in no way constitute an acknowledgement of liability on the part of NORTHERN NATURAL GAS COMPANY, its contractors, successors or assigns, but that execution of this release shall constitute an effective and binding bar against the undersigned for any claims, demands, damages, actions or causes of action because and on account of the reasons set forth above.

Dated this ____ day of_____, 1998

_____

ROBERT WITHERS
% DALE WITHERS
10026 COUNTRY CLUB ROAD
PRATT, KS 67124-8189

Taxpayer I.D. Number(s): 510-34-0460

Agreement offer by: Leon Fischer ,
Leon Fischer
for NORTHERN NATURAL GAS COMPANY.

Charge to: Date Paid:_____

ADR No._____

Approved by:_____ Check No._____

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Northern Natural Gas Company

P.O. Box 178 Cunningham, Kansas 67035 (316) 298-5111

RE: Payment Procedures

The Northern Natural Gas Company procedures for issuing yearly rental and damage claim payments are as follows

1) Prior to issuing rental or damage claim payments, an "Annual Rental Payment Agreement and Release Form" or a "Damage Claim Payment Agreement and Release Form" must be completed by our office and the release signed by the landowner or tenant involved. This form reflects the reason for the claim, the location of the property involved, and the amount of payment to be made.

2) Upon completion of the aforementioned, you will find a self-addressed, stamped envelope enclosed for your convenience in returning this form to the Northern Natural Gas Company Office for payment.

3) Upon receipt of this completed and signed form, payment will be issued.

Your cooperation in helping us to expedite this procedure is appreciated.

If you have any questions, please feel free to call.

Sincerely,

NORTHERN NATURAL GAS COMPANY

Leon Fischer

Leon Fischer
Well Service Technician

4-12

Robert E. Krehbiel, Atty
P.O. BOX 7 • 131 SOUTH ADAMS • PRETTY PRAIRIE, KANSAS 67570 • (316) 459-6464

Testimony of
Robert E. Krehbiel
before the House Committee on Utilities
on H. B. 2045
February 5, 1999

Mr. Chairman and Members of the Committee:

My name is Robert E. Krehbiel and I am appearing here today in support of H. B. 2045. Last year this bill was introduced late in the session and, because various legal issues were involved, it was heard in the House Judiciary Committee. With little time left in the Session no action was taken on the bill.

K.S.A. 55-1201 was amended several years ago at the request of major pipeline companies involved in the gas storage industry to address problems related to leaking underground gas storage fields. The amendment solved the problems for the companies involved in gas storage but, unfortunately, did not resolve, and in some cases, created a new set of inequities for landowners, leaseholders and mineral owners who must co-exist with the gas storage fields. H. B. 2045 is designed to address those inequities and, hopefully, establish fairness for all interests involved.

The problems are identified by changes set out in italics in the bill. I will focus only on what I believe are the four main issues:

1) The need to limit the power of condemnation to the interest necessary to operate underground gas storage and leave the landowner's minerals intact.

2) The need to establish a method of determining the value of storage space, including past use, when the method of valuation provided by the laws of condemnation do not

HOUSE UTILITIES
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bear any relationship to determining the value of the interests condemned.

3) The need to fairly determine title to gas when trespass has contaminated the storage space and experts reasonably disagree or lack valid data to analyze a formation.

4) The need to clearly define the term "suitability" to assure that gas storage systems are separate and distinct and not in communication with non-storage space.

With respect to the first item, Robert L. Driscoll, writing in the University of Kansas Law Review in an article entitled Condemnation of Underground Reservoirs For Storage of Natural Gas, Volume 11, 1963, concluded that "every statute should contain a provision stating what type of interest will be acquired by condemnation so that the condemnor may not choose at his discretion. Such a denomination would also give appraisers a more definite concept of what they are appraising." This is clearly true. The interest condemned should be the least interest necessary to store gas. That is a leashold interest only, not a mineral interest. The condemnor has no need for any other interest. If he wants to purchase a mineral interest in addition to a leasehold interest he can certainly make an offer. But he should not be permitted to make an offer backed by the threat of condemnation.

Second, the current law of condemnation did not contemplate the unique values related to underground gas storage and the considerations relating to valuation do not reflect real values for gas storage rights. There is no consideration for the past use of storage space. If a gas storer has enjoyed the benefits of a much greater storage space than he has been paying for he should be required to pay for such use before he condemns its future use.

Third, after gas has been circulated through a reservoir hundreds of times over a period of many years it is absolutely impossible to determine what, if any, native gas, oil, condensates might have been flushed from that reservoir. It is totally inappropriate to require landowners to

prove what might have existed in the reservoir before the trespasser's gas contaminated the formation. Since this is indeterminable due to trespass by the injector, the gas in place at the time of condemnation should belong to the mineral owner.

Finally, formations can not be determined to be suitable for gas storage without maintaining the integrity of adjoining formations and lands. Under current law, gas can escape to whatever formation it might to the detriment of adjoining landowners and without concern to the injector. The injector can now simply follow the gas wherever it might wander and condemn the land to recover it. Such public policy is clearly absurd and totally ignores basic property rights.

We need underground gas storage but we need to protect the rights of adjoining landowners who make substantial sacrifices to co-exist with these operations.

Thank you very much.

SWKROA
SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION

Greeley, Hamilton, Kearny, Finney, Stanton, Grant, Haskell, Morton, Stevens, Seward

Phone (316) 544-4333
Fax (316) 544-2230

E-mail: SWKROA@pld.com
http://users.pld.com/swkroa

209 E. 6th St. / P.O. Box 250
Hugoton, Kansas 67951

PHIL DICK, PRESIDENT
ERICK NORDLING, EXECUTIVE SECRETARY
B.E. NORDLING, ASS'T. SECRETARY

STATEMENT OF
ERICK E. NORDLING, EXECUTIVE SECRETARY
SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION
HUGOTON, KANSAS 67951

February 5, 1999

TO THE HONORABLE MEMBERS OF THE HOUSE UTILITIES COMMITTEE

Re: HB 2045 - Underground Gas Storage

INTRODUCTION

Chairman Holmes and Members of the Committee:

My name is Erick E. Nordling of Hugoton. I am Executive Secretary of the Southwest Kansas Royalty Owners Association (SWKROA). I am appearing on behalf of members of our Association and on behalf of Kansas royalty and land owners in support of House Bill 2045 dealing with proposed changes in the statute covering underground storage of natural gas.

I am a lawyer and member of Kramer, Nordling and Nordling, LLC. Much of our law practice has involved the representation of landowners on oil and gas issues, mainly in the Hugoton Gas Field.

HISTORICAL BACKGROUND OF SWKROA

SWKROA is a non-profit Kansas corporation organized in

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1948 for the primary purpose of protecting the rights of landowners in the Hugoton Gas Field. We have a membership of approximately 2,400 members. Our membership primarily consists of landowners owning mineral interests in the Kansas portion of the Hugoton Field who are lessors under oil and gas leases as distinguished from oil and gas lessees, producers, operators, or working interest owners.

For those of you who are not familiar with the Hugoton Gas Field, it covers parts of eleven southwest Kansas counties, including Seward, Stevens, Morton, Stanton, Grant, Haskell, Finney, Kearny, Hamilton, Wichita and Gray. The Kansas portion of the Hugoton Field encompasses some 2,600,000 acres. The field extends through the Oklahoma Panhandle into Texas. It runs 150 miles north and south and 50 miles east and west and is one common source of supply.

BACKGROUND OF HOUSE BILL NO. 2045

House Bill No. 2045 is designed to solve some of the problems created by Senate Bill No. 168 passed during the 1993 legislative session. Current Section K.S.A. 55-1210 contains the provisions of SB 168 and deals with, among other things, natural gas migrating from an established gas storage area to adjoining property.

The Legislature has addressed this issue in the 1997 and 1998 sessions, under HB 2522, although no action has been taken on the bill. Upon comparison, HB 2045 appears to be the same bill as HB 2522.

The Conservation Division of the Kansas Corporation Commission appeared in opposition to SB 168 when it was passed in 1993. The Commission took the position that the courts already deal with the determination of the ownership of natural gas escaping from underground storage facilities and should continue to do so. The Commission undoubtedly was referring to at least two Kansas cases dealing with natural gas storage, Anderson, et al, vs. Beech Aircraft Corporation, 237 Kan. 336,699 P.2d 1023 (Kan. 1985) and Union Gas System, Inc., v. Carnahan, et al, 245 Kan. 80, 774 P.2d 963 (Kan. 1989).

In Anderson vs. Beech Aircraft Corporation, the Kansas Supreme Court held, among other things, that Beech, having purchased, injected and stored non-native gas in a common reservoir under Anderson's adjoining property without obtaining a license, permit or a lease, lost its ownership in that gas and could not thereafter preclude plaintiffs from producing that gas as their own when the Corporation Commission had not issued a certificate

authorizing an underground storage facility and no natural gas public utility was involved.

The Union Gas case involved a natural gas utility (Union Gas Systems, Inc.). The Kansas Supreme Court held that: (1) The utility was not entitled to recover for any of its injected gas that had been taken by the surface owners, lessees, or working interest owners before the issuance of a certificate authorizing underground storage; (2) The underground storage of natural gas did not meet the statutory element of open and exclusive possession for adverse possession purposes; (3) The date of taking for purposes of condemnation was the date the award was paid; and (4) The utility was entitled to an offset for the amount of gas captured after issuance of its certificate.

SB 168 CHANGED KANSAS LAW ON RULE OF CAPTURE

Kansas courts have long held that the person vested with the title to land is deemed to own, in addition to the surface, any oil, gas or other minerals which might be located beneath the surface boundaries of the land. As early as 1904, in Zinc Co. v. Freeman, 68 Kan. 691, 696, 75 P. 995. 997, the Court held that although the landowner has a present ownership in oil and gas beneath his land, rights in the resource are lost once it moves outside surface boundaries. Only by "capturing" the oil and gas

can the landowner perfect his ownership interest. This is known as the "rule of capture" and Kansas has long followed this rule, extending the rule in Anderson v. Beech Aircraft Corp., supra, to gas injected into a private gas storage reservoir. (For a discussion of the "ownership in place" theory and the "rule of capture", see Sections 3.01, 3.02, and 3.03, Chapter 3, The Oil and Gas Property Interest, Kansas Oil and Gas Handbook, by Law Professor David E. Pierce (1986)).

The Kansas Legislature, by passing Senate Bill 168 (now K.S.A. 55-1210), overruled Anderson and changed the Kansas law of "rule of capture" by providing that title to the natural gas migrating to adjoining property remains in the injector. This has caused litigation to result and raises the question of its constitutionality by depriving the adjoining property owner of his property rights and the opportunity to be heard on a level playing field.

HB 2045 is intended to cure many of the problems created by the passage of SB 168 in 1993 and that is why we are appearing in support of the bill.

RIGHTS OF ADJOINING OWNERS

Although we are strongly appearing in support of the bill, we have some additional suggestions to make the bill more

effective in protecting the rights of owners within the defined boundaries of the storage area, as well as the rights of owners of adjacent surface and mineral interests.

The proposed calculation of factors to consider in a damage award for condemnation of the underground gas storage area, just refers to "any oil produced or other minerals recovered from the premises,..." Line 6 on page 3 of the bill should be revised to include royalties paid for any natural gas in place at the time of condemnation.

We also feel that the gas injector should not be given an unfettered right to go on adjoining property to test for migrating gas as they are permitted to do under the current law. As such, adjoining property owners of both the surface estate and the mineral rights should be entitled to receive notice of any natural gas public utility desiring to exercise the right of eminent domain for the establishment of an underground gas storage area.

Further, once an area has been certified as an underground gas storage area, the confines of the storage area should be well defined. If gas is suspected to have migrated from the known confines of the storage area, then notice should be given by the injector to the owners of the adjoining property or stratum or portion thereof of the injector's intent and desire to conduct

tests to determine if any gas has migrated from the storage area, and an explanation of the theory causing the migration.

Another area of concern involves compensation to the owner of the stratum and the owner of the surface to enforce the provisions of K.S.A. 55-1210 (c)(3). The current law requires that such owner would be compensated for reasonable attorney fees only if litigation was necessary to enforce their rights. By the time such an owner is forced to file a lawsuit there has already been a lot of time and expense expended. There may be many times where the conflict could be resolved short of litigation. Also, if it is necessary to file enforcement through the Corporation Commission, then attorney fees should be allowed to such owner. Provision (c)(2) of Section 4 of HB 2045 should be amended (line 30) to delete the words "if litigation is necessary," or add a provision to include allowance for attorney fees and expenses incurred in connection with representation before the Corporation Commission to enforce the act.

SUMMARY

The proposed changes in HB 2045, will cure some of the problems created by the passage of SB 168. The other proposed changes will provide a more equitable method of determining damages

in condemnation proceedings brought under Article 12, Chapter 55, K.S.A., dealing with the underground storage of natural gas.

Thank you for this opportunity to be heard.

Respectfully submitted,

Erick E. Nordling
Executive Secretary
SOUTHWEST KANSAS ROYALTY
OWNERS ASSOCIATION

EEN:ckh

F:\WPDATA\ERICK\SWKROA\LEGIS\test.gas storage HB2045.299.wpd

BEFORE THE STATE OF KANSAS
HOUSE UTILITIES COMMITTEE

RE: HOUSE BILL 2045

SWORN TESTIMONY OF STANLEY WITHERS

My name is Stanley R. Withers. I live in Pratt, Kansas. I am the manager of my father's L.L.C., which owns farmland included in the Northern Natural Gas Company's Cunningham Gas Storage Field.

The Cunningham Gas Storage Field was established in 1976. It was established to store gas in the Viola formation under the land. The landowners entered into rental contracts, which provided for payments of $4.00 per acre per year, with a clause to increase the rental payment by $1.00 an acre every five years. We also have a well site on the property, and there is rental to be paid on it each year. We have been paid the rentals. However, at times the rentals were late in being paid. Northern Natural Gas has a policy that before they will issue us a check, they want us to sign a liability release on the property. I do not believe they should hold a rental check hostage to get a liability release signed. I feel this is improper.

In 1993, Northern Natural Gas Company, the operator of the Cunningham Gas Storage Field, determined their gas was leaking into the Simpson formation, which is under the Viola formation in the field. They sent land men to contact the landowners requesting them to sign a document deeding the minerals in the Simpson formation and the Simpson formation under the land to Northern Natural Gas Company. They offered to pay a one-time payment of $10.00 per acre for this deed. We felt this was not reasonable, and they would not negotiate the purchase price.

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DATE: 2-5-99
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It was a "take it or leave it" situation, and if we refused, they told us there would be a condemnation proceedings. There was a condemnation proceedings. They were ordered to pay $55.00 an acre on this Pratt County land. I would note, after the first contact, they later contacted many of the people in the field and told them if they didn't sign up for $10.00, they might even lose the rentals they got on the Viola formation (our attorney advised us this was not possible). Many of the landowners in the area fearing the loss of the Viola rentals particularly those who were older or retired and were relying on the rentals to pay their taxes went ahead and signed up for $10.00 an acre.

I do not feel this was right, just or equitable that I should be forced to sell my property right (in this case, the rights to the Simpson formation under my land), to add to the profits of a large multinational corporation. When we were fighting the condemnation, our attorney contacted an expert witness, Mr. Bill Henry, a former Vice President of Northern Natural Gas Company. Mr. Henry has been instrumental in setting up gas storage fields all over the United States and is knowledgeable of the value of gas storage. My attorney showed me papers that Mr. Henry prepared calculating the income value of the Simpson formation under our land over the 17 year-period that Northern Natural Gas Company has been using it without permission, i.e. trespassing. This income value was $684.00 an acre. I believe if there is that much value in the use of this acreage, the company should pay a fair rental amount annually and not be allowed to take the formation away from us in this manner. I believe this is particularly true since the gas industry is now deregulated, and gas storage under our land is principally going to other states.

I own what used to be a warehouse and pipeyard for a gas company on the south side of Pratt, Kansas. I certainly do not feel it would be right to let a gas company come in and condemn that storage property and take it from me. The County at this time is trying to purchase it and trying to negotiate with me. I realize they may have the right to use eminent domain and condemn my property for public use. I do not think a gas company should be able to come in and do that simply because they wanted it for storage for profit. I see no difference between this and gas storage under my land.

I do not feel the condemnation process used on our property was fair for the following reasons: (1) it took more than just a rental contract, it took the whole interest; and (2) it did not take into account the rental value of the formation. The standard used in determining the value of the property was comparable sales in the area before and after, and these sales had nothing to do with the rights of the Simpson and their value. Thus the rights being taken away were not even properly valued in the condemnation action.

The statements made were that the primary production in the Simpson formation had been exhausted. I don't know whether it had or not, but I think there is a chance that is true. However, there was no value put on the minerals that would be recovered by repressuring with gas. These were minerals that belonged to me as a landowner and that Northern Natural Gas Company will extract from the Simpson formation by storage of gas. Thus, this value should have also been taken into account in the condemnation.

As a landowner or even the group of landowners I was working with could not afford the expense to do the geological studies to establish the recoverable minerals or

the geological characteristics of the formation. To give you an idea of the magnitude of the expense, Northern Natural Gas Company has testified that they hired a company out of Dallas to do the study and paid over $625,000 for the study. You can easily see that a few individual landowners cannot afford this type of expense. This is one of the reasons I believe it would be much better to handle these storage leases with a rental agreement negotiated at arms-length and not rely on the sovereign powers of the government to take away the land rights. It must be remembered that our rights to the land are protected under the Fourteenth Amendment of the United States Constitution and they should not be dealt with lightly.

I understand that large corporations do not like to make monthly or annual rental payments. They feel it is a nuisance. However, I would point out that they do rent warehouses and other land and make monthly payments, and they hire employees and pay them monthly. I do not believe it is any more fair for them to take our property right to avoid making payments than it would be for them to take property rights in a city or condemn the warehouse I have just because they do not want to make payments, or in some way try to diminish their obligation to pay their employees because it is inconvenient.

In the action we have maintained over the Cunningham Gas Storage Field, there was also a questions of the costs and attorney's fees. The statute as it exists today does not make it clear that the legislature's intent was that the landowners if they prevailed should not have to pay attorney's fees and court costs. I feel the statute as it is written should be modified to say that they would be allowed attorney's fees in accordance with the contract with their attorney if the court finds that contract to be

reasonable. We do not think it should be left up to the oil company to determine what is or isn't reasonable on the contract.

Another problem with the current statute is that it does not make provision for payment of the use of the formation during the period of the trespass. There should be a statutory way to set that value and order it paid without having to go to the expense of a lawsuit. I would point out that the present lawsuit we have been involved in has been appealed to the Tenth Circuit Court of Appeals in Denver, Colorado, and the expenses in connection with that lawsuit have been a burden for all of the landowners.

If the Committee feels that we should give up our property rights through condemnation, then I request that you pass House Bill 2045, which will at least remedy part of the complaints I have regarding the present system and make it somewhat more palatable to landowners. I do not feel it is right to allow these companies to avoid bargaining at arms-length for what they want to use to generate profits for their companies. I do not think they should be able to simply go to court using the sovereign power of the state to condemn these rights and then do it under a system that does not even take into account the fair rental value of the formation. If they have to take an interest, it should be a leasehold interest and not an ownership interest.

_____
STANLEY R. WITHERS

Subscribed and sworn to before me this _____ day of _____, 1999.

_____
NOTARY PUBLIC

(SEAL)
My Commission Expires:

February 4, 1999

Gas Pipelines - Central
One Williams Center
P.O. Box 3288
Tulsa, Oklahoma 74101
918/588-2000

Rep. Carl Holmes
Chairman, Committee on Utilities
Kansas House of Representatives

Re: Kansas House Bill 2045

Dear Rep. Holmes:

Following are the comments of Williams Gas Pipelines Central, Inc. ("Williams") regarding the above-referenced bill (the "Bill"). In our view, passage of the Bill would be detrimental to the interests of the citizens of Kansas. As discussed below, the changes proposed in the Bill would increase the rates paid by Kansas consumers for natural gas service and would cause migration of investment dollars out of Kansas.

Passage of the Bill would discourage gas storage projects in the State. The current law encourages outside investment in Kansas by offering reasonable rules for those who risk their capital by operating storage fields. Replacing those rules with the provisions in House Bill 2045 would increase the risks of gas loss for storage operators.

Defining the boundaries of a storage field is not an exact science. Gas migration is not a common event but it does occur from time-to-time. Expecting storage companies to know exactly where their gas will remain is unreasonable. Unfortunately, the Bill does just that by stripping title to migrating gas from the storage companies. That change would have the effect of encouraging undesirable behavior around the borders of storage fields. In fact, it would create the appearance that Kansas approves of such behavior. For example, in 1995 a company established by two former Williams employees began producing gas from leases located immediately next to a Williams storage field. That production was made possible by the fact that the size of the field had not been known to Williams at the time of certification of the field. Despite its use of the best reservoir engineering/geological practices at that time, Williams could not determine that it had not acquired rights covering the entire areal extent of the storage formation. It was not until the offset production began that Williams became aware of the problem. Under the current law, Williams was able to file suit, test the producer's wells, prove title to its gas, and recoup a portion of its losses. That would not have been possible under the changes proposed in the Bill. The current law provides protections for landowners, as well. In the rare event that gas migrates, landowners may collect for their actual damages that result from the migration.

House Bill 2045 also sets an unreasonable standard for the certification of storage fields. If passed, the Bill would require storage companies to show that their field will be located in "a separate and distinct stratum or formation from which natural gas cannot migrate to another stratum or formation." As noted above, the imprecise nature of reservoir engineering makes proof of such a

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requirement nearly impossible. Even if the areal extent of the storage formation is well defined, old, non reported or improperly plugged wells that predate the storage operators efforts can cause gas to migrate. This requirement alone will likely eliminate the possibility of future storage projects being approved in Kansas.

Even if that standard could be met, the risk of loss from migration would cause storage companies to acquire too much buffer acreage around their fields as a form of insurance against gas losses (assuming FERC allows its regulated companies to acquire the otherwise unnecessary acreage). This would unnaturally increase the amount of property on which the companies' rates are based. Such increased and unnecessary costs would be borne in part by Kansas gas consumers who take gas service from local distribution companies who store and transport gas on Williams' system. Since the working gas in storage no longer belongs to Williams, a substantial portion of any gas lost due to migration would belong to local distribution companies serving Kansas consumers.

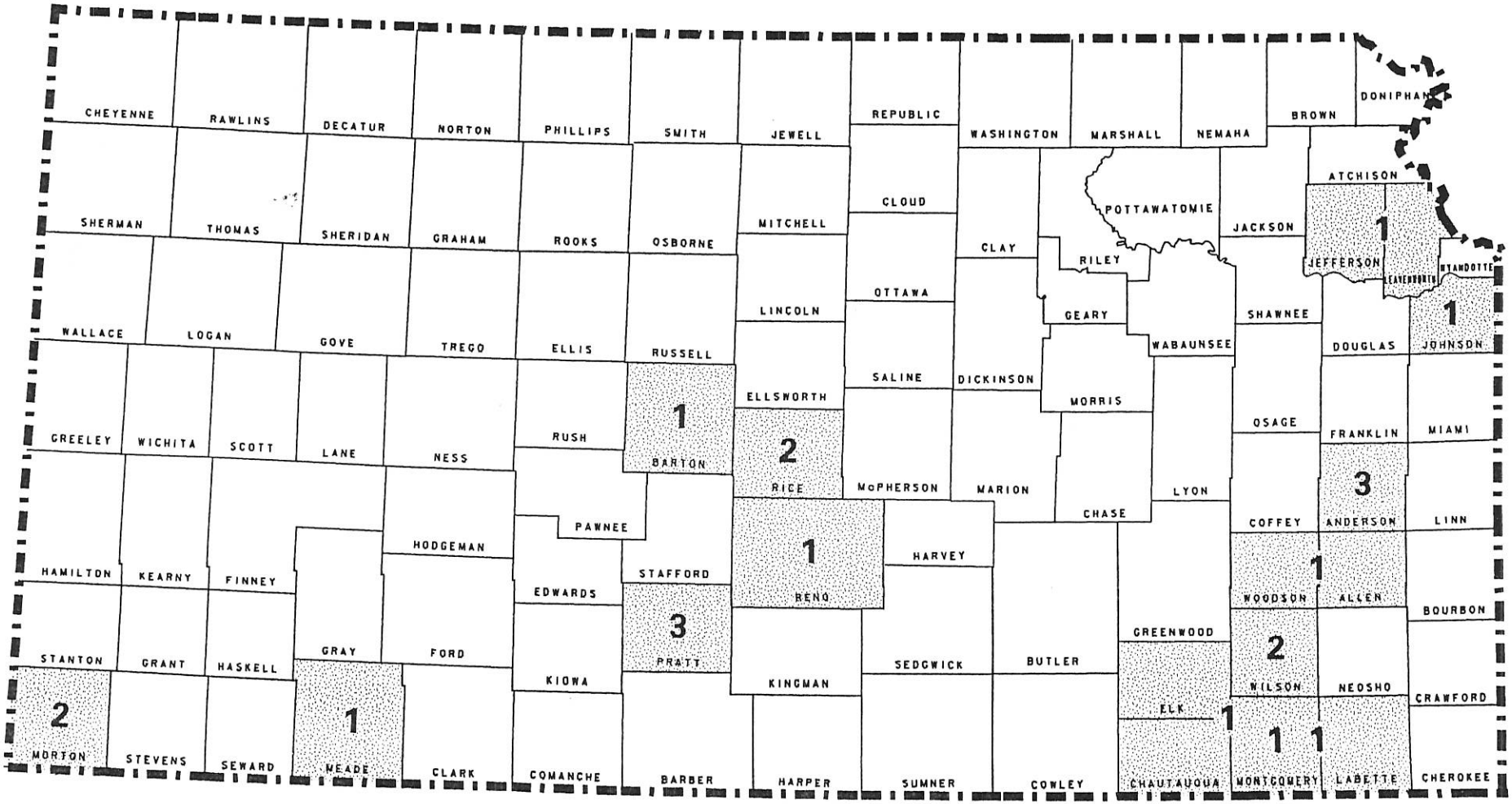
The overall impact of House Bill 2045 is to limit future investment in Kansas gas storage projects. Those investment dollars will migrate to neighboring states with more favorable laws (e.g., Oklahoma). This will cause a decrease in tax and job opportunities for the State of Kansas. In contrast, the current law benefits Kansas consumers and encourages storage investment. Thus, the public interest will be best served if the Bill is defeated.

Very truly yours,

James D. Henderson
Director, Gas Management

Williams holds a major business interest in Kansas and will be impacted if this legislation were to pass. Total Kansas revenue for Williams in1997 was $398,889,938 with fixed assets of $705,789,450. In 1997 Williams paid property taxes of $10,415,250. We have an annual payroll of $18,068,390 for 396 employees.

STATE OF KANSAS
GAS STORAGE FIELDS BY COUNTY



2 – NUMBER OF STORAGE FIELDS IN THE COUNTY

TOTAL NUMBER OF FIELDS DEPICTED ON THE MAP = 21

LAW OFFICES OF

ANDERSON, BYRD, RICHESON, FLAHERTY & HENRICHS

A Limited Liability Partnership

216 S. HICKORY, P. O. BOX 17
OTTAWA, KANSAS 66067
(785) 242-1234, *Telephone*
(785) 242-1279, *Facsimile*
E-MAIL: abrfh@ott.net

JOHN L. RICHESON
JAMES G. FLAHERTY
DEE A. HENRICHS

OF COUNSEL:
RICHARD C. BYRD

R. SCOTT RYBURN
JEFFREY D. STOWMAN

ROBERT A. ANDERSON
(1920 - 1994)

TESTIMONY BEFORE THE HOUSE COMMITTEE
ON UTILITIES ON BEHALF OF ATMOS ENERGY
CORPORATION IN OPPOSITION TO HOUSE BILL 2045
February 5, 1999

I. GENERAL COMMENTS ABOUT HOUSE BILL 2045

I am James G. Flaherty and I am appearing today on behalf of Atmos Energy Corporation as its Kansas legal counsel. Atmos Energy Corporation is opposed to House Bill 2045.

Atmos Energy Corporation, through its divisions Greeley Gas Company and United Cities Gas Company, serve over 100,000 natural gas customers throughout Kansas. Atmos, through its subsidiary, United Cities Gas Storage Company, owns and operates three natural gas storage fields in Kansas. Atmos also leases storage space in Kansas gas storage fields that are operated by Williams Natural Gas Company. Use of these storage fields is essential in providing reliable natural gas service to our customers in Kansas. Atmos, as well as the other local distribution companies in Kansas, would not have enough gas available to serve its customers on the coldest days of the year without being able to use gas that is stored in these underground formations.

House Bill 2045 seeks to overturn legislation that was enacted in 1993. In 1993, Senate Bill No. 168 was approved by the Kansas legislature and signed into law. Senate Bill 168 addressed the issue of ownership of natural gas injected into a storage field which then migrates outside of previously approved storage field boundaries. Under the law enacted in 1993, it was determined by the legislature that gas storage companies should not lose title to the underground storage gas merely because the gas migrated onto another's property. As I will discuss in my comments, the action taken

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by the Kansas legislature in 1993 is consistent with case law and legal commentary on this issue and is in the public interest. House Bill 2045, which attempts to overturn the law that was enacted in 1993, should therefore, be rejected.

The issue of who owns natural gas injected into a storage field which then migrates outside of the storage field boundaries has been the subject of many cases and law review articles. This issue was first addressed in *Hammonds v. Central Kentucy Natural Gas Co.*, 75 SW2d 204 (1934). In that case, the court found that if non-native injected gas wandered onto the land of an adjoining landowner, the company injecting the gas would not be liable for trespass as the company no longer owned the gas. The *Hammonds* theory was roundly criticized by legal writers. It was noted in McGinnis, Some Legal Problems in Underground Gas Storage, Southwestern Legal Foundation, 17th Annual Institute on Oil and Gas Law Taxation, 35 (1966), the authorities in oil and gas law almost universally rejected the *Hammonds* doctrine. Citations are given to eight law journal articles rejecting the *Hammonds* approach. In fact, in 1987, the State of Kentucky repudiated the reasoning of *Hammonds* in the decision in *Texas American Energy Corp. v. Citizens Fidelity Bank & Trust Co.*, 736 SW2d 25 (Ky1987). In that case, the Supreme Court of Kentucky found that "it was time to limit *Hammonds* and to now hold that natural gas once converted to personal property by extraction remains personal property notwithstanding its subsequent storage in underground reservoirs with confinement integrity." *Id.* At 28.

Professor Ernest Smith, an expert in oil and gas law, recently pointed out that *Hammonds* has a very limited following and the theory has been rejected or limited in all recent cases. Professor Smith made the following comment in support of his position:

The demise of *Hammonds* is not to be mourned. The decision simply cannot be justified by any cogent line of reasoning. The only bona fide issue is one of identification. *Hammonds* can hold

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up to scrutiny only when reinjected gas cannot be traced with reasonable certainty when produced by a neighboring well. As legal critics have long pointed out, the analogy between wild animals and reinjected hydrocarbons is foolishness. As a matter of geology and petroleum engineering, reinjected and natural gas remains capable of identification and measurement, even when the reservoir still contains some native (residue) gas." Smith, Ownership and Use of Subterranean Space, 14 Eastern Mineral Law Institute, p. 4-5 (1993).

The Kansas Supreme Court has also held that once a certificate of public convenience and necessity was obtained by a company operating a gas storage field, the rule of capture no longer applies to storage gas which migrated beyond the area where storage rights had been acquired and the ownership of that gas should remain with the storage company. *Union Gas System Inc. v. Carnahan*, 245 K. 80, 91, 774 P.2d 962 (1989).

The trend both in case law, legal commentary and the legislatures support the law enacted in 1993. House Bill 2045, on the other hand, is contrary to that trend. Atmos believes that the existing law protects the public interest and that House Bill 2045 should be rejected in its entirety.

II. COMMENTS REGARDING SPECIFIC PORTIONS OF HOUSE BILL 2045

A. New Section 1(e). The meaning of the term "suitable for the underground storage of natural gas" should be rejected.

Under the existing law, the Kansas Corporation Commission (KCC) is required to make a determination as to whether an underground formation is "suitable for the underground storage of natural gas" before such formation can be used as a storage field. The existing law does not define the term "suitable for the underground storage of natural gas". Instead, the existing law correctly leaves it to the KCC's discretion as to whether a certain formation is suitable for use as a storage field. Under the existing law, the KCC conducts a hearing and takes evidence from experts as to whether

the underground formation is suitable to be used as a storage field. Section 1 (e) of House Bill 2045, on the other hand, would change the existing law so that the only formations that could be certificated as storage fields would be those formations "which natural gas cannot migrate to another stratum or formation." The problem with such a definition is that natural gas does migrate even in the best storage fields. The result of using such a definition is that the KCC would be unable to find any formation where natural gas does not migrate. The KCC would therefore, be unable to issue certificates for new gas storage fields in Kansas.

While the gas industry has been very successful over the years in converting old and depleted underground oil and gas fields into very good gas storage fields, it is impossible to assure that injected gas won't migrate outside the field of the boundaries onto adjoining properties. In most cases, injected gas that migrates outside the field can be identified as injected gas through isotopic testing, a sort of DNA test on natural gas. The isotopic test can determine whether the natural gas is injected storage gas or native gas. If the test determines that the gas is injected gas that has migrated onto the neighbor's property, under existing law, the gas can be retrieved by the storage company. It is like the cattle rancher who brands his cattle, puts up fences, and takes reasonable care to make sure his cattle stays on his property. If some of the cattle get off the ranch and are found on the neighbor's property, the cattle do not belong to the neighbor. The neighbor does not receive ownership of the cattle merely because the cattle have somehow gotten onto the neighbor's property. Instead, the cattle are returned to the rancher. It should work the same way with the owner of a gas storage field. If the owner of the gas storage field has taken reasonable care to keep the gas within the boundaries of the field and the gas migrates outside the field, that gas should remain the property of the gas storage company. That is how the existing law works. The existing law should not be overturned and House Bill 2045 should be rejected.

If House Bill 2045 is not rejected in its entirety, then Section 1(e) should be deleted from House Bill 2045. The legislature should leave it to the discretion of the KCC to determine, based upon expert testimony, on whether an underground formation is suitable for use as a storage field.

B. New Sections 3 (b)-(f) are not necessary.

New Sections 3(b)-(f) which describe what procedure should be followed and what property rights the appraisers should take into account in a underground natural gas storage condemnation case are unnecessary and should be rejected. The procedure to be followed by the appraisers is already covered by the eminent domain procedures act (K.S.A. 26-501 et seq.).

For the reasons mentioned previously, new Section 3c should be changed so it does not require the gas storage company to pay its neighbor for injected gas that has migrated onto the neighbor's property.

C. Section 4 c (1) and (2) should not be deleted.

House Bill 2045 would delete those provisions of the existing law (K.S.A. 55-1210(c)) that provide that the owner of natural gas injected into a storage field, which then migrates outside of the previously approved storage field boundaries, does not lose title to that gas. For the reasons that I have already mentioned, Section 4c (1) and (2) contained in House Bill 2045 should not be deleted.

III. CONCLUSION

In conclusion, Atmos Energy Corporation believes that the existing law addressing ownership of migrated storage gas is consistent with case law and public policy. House Bill 2045 which would change existing law is not in the public interest and is unnecessary. Atmos Energy Corporation believes that House Bill 2045 should be rejected in its entirety.

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HOUSE BILL 2045

Committee on Utilities
February 5, 1999

My name is Ann Rider. I am an attorney with the Wichita firm of Martin, Pringle, Oliver, Wallace & Swartz, L.L.P. I represent Northern Natural Gas Company and am here today to testify on Northern's behalf in opposition to HB 2045.

Northern is a public utility pipeline company which transports gas in interstate commerce. Northern operates three underground natural gas storage facilities. Two of these facilities are located in Kansas and one in Iowa. These storage facilities allow Northern to provide large sources of deliverability of natural gas during periods of peak demand for the benefit of millions of residential, commercial and industrial consumers. Northern's largest storage facility, located near Cunningham, Kansas, has a storage volume of approximately 51 billion cubic feet (BCF). Northern is able to cycle approximately 25 BCF from the facility on an annual basis. Northern's storage facilities are extremely important to both Northern and its customers.

The Kansas legislature has recognized for many years the benefit of building natural gas reserves for periods of peak demand. There is no question that the underground storage of natural gas promotes the public interest and welfare of this state.

HB 2045 is identical to HB 2522 which was introduced during the 1998 session in the House Judiciary Committee. The Judiciary Committee held one hearing and several subcommittee meetings, but no further action was taken.

HB 2045 amends and repeals 55-1201, 55-1204, 55-1205 and 55-1210. These statutes, with the exception of 55-1210, have been in place, with limited amendments, for nearly 50 years. Article 12 of Chapter 55 deals specifically with the underground storage of natural gas in Kansas and provides the method by which a public utility, such as Northern Natural Gas Company may acquire property suitable for the underground storage of natural gas.

55-1201

The first amendment is to 55-1201, which has been the law since 1951, without change. HB 2045 presents two significant changes to this statute. First, the

deletion of the definition of "native gas" and second, the addition of a definition of "suitable for the underground storage of natural gas."

When a natural gas public utility is seeking to acquire property for the purpose of establishing an underground natural gas storage facility, the utility will look for an underground stratum or formation that is depleted or nearly depleted of natural gas as well as one that will adequately contain the natural gas to be injected into the formation for storage.

Any natural gas remaining in the formation to be acquired would be considered "native gas," defined by the legislature in 1951 as "gas which has not been previously withdrawn from the earth." If a utility were to acquire an underground formation for storage which still had native gas reserves remaining, the appraisers in an eminent domain proceeding would take those reserve amounts into consideration when determining what compensation is due the property owners of that formation. The distinction between "native gas" and any other natural gas is significant when dealing with the underground storage of natural gas. The legislature, knowing the great value storage gas has to consumers and the public interest, rightfully chose to protect both the interests of the property owner by requiring the public utility to compensate the property owner for native gas which was left in the formation and had never been withdrawn and the public utility by not requiring the public utility to compensate the property owner for gas which had been previously withdrawn from the earth and then injected back into the earth at the injector's expense. An amendment to delete all reference to "native gas" and to provide no distinction between native gas and any other natural gas undermines the obvious value the legislature places on the underground storage of natural gas.

The addition of the definition of "suitable for the underground storage of natural gas" is beyond what the legislature should attempt to define. Currently, 55-1204(a)(1) provides that in order for a public utility to exercise its right of eminent domain, the Kansas Corporation Commission (KCC) must, after a public hearing, determine that the underground formation is suitable for the storage of natural gas. The KCC, which is the state agency with expertise in oil and gas issues is best suited to evaluate evidence presented to it and determine if a formation is suitable for underground storage. But, even the KCC, with all of its technical expertise could not be expected to find that natural gas in a particular formation "cannot" migrate to another formation. The nature of natural gas is such that, even with a vast amount of information, drilling and production history in a particular area, no person, company or state body can guarantee that gas "cannot" migrate to another

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formation. The KCC can only be asked to do its best, based upon its expertise and the information presented to it, to determine whether a formation is suitable for underground storage. Of course, it is not the desire of any underground storage operator for its storage gas to migrate to another formation or outside the storage area, so a potential storage operator will strive to determine with as much certainty as possible whether injected gas will be contained in the storage formation.

55-1204

55-1204 contains the steps a public utility and the KCC must follow prior to an eminent domain proceeding.

HB 2045 amends 55-1204 at (a)(2) to delete reference to "native" as a description of the gas remaining in the formation sought to be acquired. As stated earlier, Northern objects to the failure to distinguish between "native gas" and previously withdrawn gas. Failure to make that distinction would unfairly require the storage operator to pay for the value of natural gas previously withdrawn and injected into the storage field.

55-1204(b) currently requires a public hearing on any application for the underground storage of natural gas. The amendment to (b) adds the requirement that the KCC direct an independent study be made to assist the KCC in determining whether underground storage should be certified. The amendment would also authorize the KCC to assess the entire cost of the independent study to the applicant which would also undertake its own study for presentation at the public hearing.

Northern is opposed to this amendment. The public utility and any party in support or in opposition are the best and only sources of expert testimony that are needed to allow the KCC to make an informed and sound decision regarding underground storage. Any party contemplating gas storage activities will most certainly conduct a detailed study of the affected reservoir and related lands. To require the KCC to conduct an independent study is both expensive and unnecessary. The KCC, as always, has the ability to weigh the evidence presented to it by each and every applicant and party in interest, and determine whether the evidence supports approval or denial of their application. This amendment would be financially burdensome to both the KCC and the applicant. The KCC may not be in a financial position to undertake an independent study. The applicant, who may spend hundreds of thousands of dollars on its own study, should not be required to pay for another study.

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55-1205

55-1205 is the eminent domain procedure statute which references the eminent domain procedure act found in Article 5 of Chapter 26. 55-1205 provides that the KCC certificate and petition be filed with the district court and that the appraisers, in awarding damages to the property owners, take into consideration the amounts of recoverable oil and native gas remaining in the property as previously determined by the KCC.

New subsection (c), to which Northern objects, sets up the interest condemned in an eminent domain proceeding as a leasehold interest. The damages to be awarded for this leasehold interest include the value of recoverable oil and natural gas in place, in addition to seven other categories of compensation. Although several of these categories appear to be factors that an appraiser would consider under Chapter 26, the requirement of payment for royalties and annual payments based upon the annual leased value of the storage formation appear to require the storage operator to make annual payments to the property owners after the eminent domain proceeding is complete. That scenario will undoubtedly discourage gas storage operators from establishing facilities in Kansas. Such a requirement is also contrary to eminent domain procedure wherein a total sum for damages is determined by the appraisers at the time of the taking and paid out to the property owners. An individual or corporation or public utility that acquires rights through an eminent domain proceeding is not seeking a leasehold interest but something more - a fee or an easement.

Northern objects to all of the new categories presented in this subsection. The law of eminent domain and proceedings related thereto are well established in Kansas. The factors to be considered by appraisers in any eminent domain proceeding are adequately set out in Chapter 26. There is no need to complicate the responsibilities of the appraisers in an underground storage matter when sufficient guidance regarding compensation is already provided in the eminent domain procedure act.

New subsection (d) includes the authority of the appraisers to value prior use of the property for the underground storage of gas if the use was uncompensated or unauthorized. Such a provision has no place in an eminent domain statute. Condemnation awards do not contemplate past or prior value but rather the value of the property at the time immediately prior to and after the taking. Likewise, the

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district court cannot be expected under subsection (f) to include or require a prior use value in an eminent domain award.

55-1210

Most important to Northern is its opposition to the amendment of 55-1210. 55-1210 was enacted in July 1993. The effect of the current statute is to provide that gas that is reduced to possession and injected for storage shall at all times be the property of the injector and not subject to the rights of either the surface or mineral owner to produce such gas under the law of capture.

HB 2045 makes no amendment to subsections (a), (b) and (d). However, subsection (c) of the statute is completely gutted.

Current subsection (c) deals specifically with natural gas that has migrated to an adjoining property or stratum not otherwise condemned or purchased by the injector, and (c)(1) makes clear that the injector does not lose title or possession to the gas if it can prove that the gas was originally injected into the underground storage. Subsection (c)(2) grants the injector the right to conduct well tests to determine ownership of the migrating gas, at the injector's expense. Current subsection (c)(3) deals with the rights of the surface and stratum owners upon whose property gas has migrated.

HB 2045 completely deletes current subsections (c)(1) and (c)(2) and contrary to the current statute, provides that the owner of the adjoining property or stratum retains title and possession of storage gas that has migrated until the property is condemned or purchased. The effect of this statutory language would be absolutely devastating to underground storage operators as well as the public.

If natural gas were in fact migrating outside a certified storage formation or area without a storage operator's knowledge, a landowner would in effect be able to legally drill a well and drain large quantities of storage gas from the storage facility until such property is either condemned or purchased. Such a situation is exactly what the legislature was seeking to avoid in 1993 with the passage of 55-1210. HB 2045 not only allows a property owner to retain possession of migrating storage gas, but gives the injector no statutory authority to test the migrating gas to verify if it is in fact storage gas. The passage of HB 2045 and specifically the deletion of 55-1210(c)(1) and (c)(2) have the potential of destroying the integrity of underground

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storage facilities which a public utility might have spent decades and millions of dollars building for the benefit of thousands of consumers of natural gas.

Northern respectfully objects to the passage of HB 2045.

MID CONTINENT MARKET CENTER

A ONEOK COMPANY

To: The Honorable Carl Holmes and Members of the House Utilities Committee

From: Steve Luthye
Manager, Gas Control
Mid Continent Market Center

Subject: House Bill 2045

Date: February 5, 1999

Good morning. My name is Steve Luthye and I represent the Mid Continent Market Center. The Market Center is a Kansas Corporation engaging in the intrastate transportation and storage of natural gas. We are regulated as a utility by the Kansas Corporation Commission. We serve native Kansas markets including Kansas Gas Service and the major towns of Pratt, Great Bend, Hutchinson, Salina and Manhattan. We are also interconnected with several interstate pipelines and transport and store gas for shippers served from these pipelines. We have two natural gas storage fields currently operating in the State of Kansas, the Brehm Storage Field located outside the city of Pratt and the Yaggy Storage Field located outside of the city of Hutchinson.

The supply and demand for natural gas fluctuates seasonally, daily and even hourly. The underground storage of natural gas provides a balancing mechanism between the available supply of natural gas and the demand in the marketplace. The vast majority of natural gas storage facilities in the United States are in underground strata or formations, usually a depleted oil and/or gas field, which is geologically suitable for that purpose. Underground storage facilities often cover hundreds or thousands of subsurface acres and contain billions of cubic feet of natural gas; therefore, it is not feasible to build above ground containers capable of storing the volumes of gas necessary to meet peak demand requirements. Such storage facilities are absolutely essential to supply customer peak demand and are a vital component of the natural gas supply system.

When a reservoir is considered for use as an underground storage facility, the storage operator must make a thorough study of all available geologic and reservoir engineering data to determine that the reservoir is suitable for underground gas storage. The results of such a study provides the basis for predicting the performance of the facility and economic viability of the project. The storage operator has a huge financial risk if they attempt to develop an unsuitable reservoir, particularly if gas containment becomes a problem. Unfortunately, geology is not an exact science. Consequently, there will be a possibility that gas injected into underground storage may migrate to a location which was not anticipated

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by the storage operator, and which is not only outside the limits projected by the original study but also outside the originally certified storage boundaries. We have attached a diagram of a hypothetical underground reservoir situation to help illustrate how such a situation might occur. The operator will make their best conscientious effort to include the acreage that they reasonable believe will be included in the underground storage operation.

Given this background, HB 2045 presents several concerns to the Market Center.

First, if gas migration beyond the storage boundaries occurs, we agree that the surface owner of the property trespassed upon is entitled to reasonable compensation; however, we feel that the injected storage gas remains the rightful possession of the storage operator. Let's look at a parallel example. What if someone leases a pasture from a farmer for the purposes of raising cattle. He fences off the leased part of the pasture and puts his cattle in it. As long as his cattle stay within the confines of the fenced area, they remain his possession. However, what if something happens to the fence and a cow wanders from the fenced area to the adjoining property. Does the cattleman lose ownership of that cow? No. In addition, it is reasonable to expect that the cattleman has the rights to retrieve his cow. Will he need to get the permission of the owner on whose land the cow has wandered and will he need to pay for any damages to the property in the retrieval process. Yes, that would be fair and reasonable. But the key here is that the wandering cow does not become the property of the adjoining land owner just because it did not stay within the fenced area. This same parallel applies here. If natural gas which is owned by a storage field operator migrates from the certified storage area, it should not become the property of the adjoining land owner. The storage operator should pay for any damages incurred to the adjoining property owner during the retrieval of the migrated gas, but should not be required to purchase that gas a second time. Injected storage gas has already been reduced to a possession and giving that possession to another party would be wrong.

Second, we feel that the important distinction between "native" gas and injected storage gas needs to be preserved. Native gas is pre-existing natural gas prior to the creation of a storage field and as such belongs to the land or mineral right owner. The Market Center agrees with this and believes the owner is entitled to fair and reasonable compensation for that gas. However, gas that is owned by a storage operator and injected into a storage field, is and should remain, the property of the storage operator. There is a definite and distinct difference between the two that must be maintained.

Third, it is impossible to conclude prior to developing a storage field that "natural gas cannot migrate to another stratum or formation." Certainly it is the intent of the storage operator to keep the gas confined to the desired formation, but to say it cannot migrate elsewhere is impossible. As such, no formation or stratum would meet these requirements and would therefore jeopardize the existing storage operations within the State of Kansas as well as eliminate any potential new operations.

Fourth, in the determination of recoverable "native" hydrocarbons, we feel that the parties should be allowed a reasonable opportunity to settle on the amount of appropriate compensation. We feel it would be unfair to conduct an open ended study with the applicant to bear the entire cost and essentially ignore the study already developed by the applicant.

Fifth, the proposed bill, by providing that the storage operator pay "all costs and expenses, including reasonable attorney fees, if litigation is necessary ..." would give the landowner a free shot at litigation rather than encouraging them to settle out of court. They would be at no financial risk to take the matter to court, therefore, it would be very rare that a landowner would ever settle out of court.

Sixth, the methodology of evaluating the award to the landowner in a condemnation is flawed. The enumeration of the separate pieces when totaled will yield a greater value than the land itself. An analogy would be buying each separate part of a car instead of the whole car itself.

Finally, the 1998 House Judiciary Subcommittee reviewed HB 2522 which dealt with this same issue. The Market Center submitted written response to a Request for Comment by Subcommittee Chairman Tim Carmody. As a matter of information, we have attached a copy of those comments to our written testimony.

In summary, this bill as written, has six key concerns. First is the ownership of migrated gas, second is the elimination of the native gas term, third is the definition of a suitable formation, fourth and fifth is the open-ended financial liability for the certification and the litigation process and sixth is damage award process..

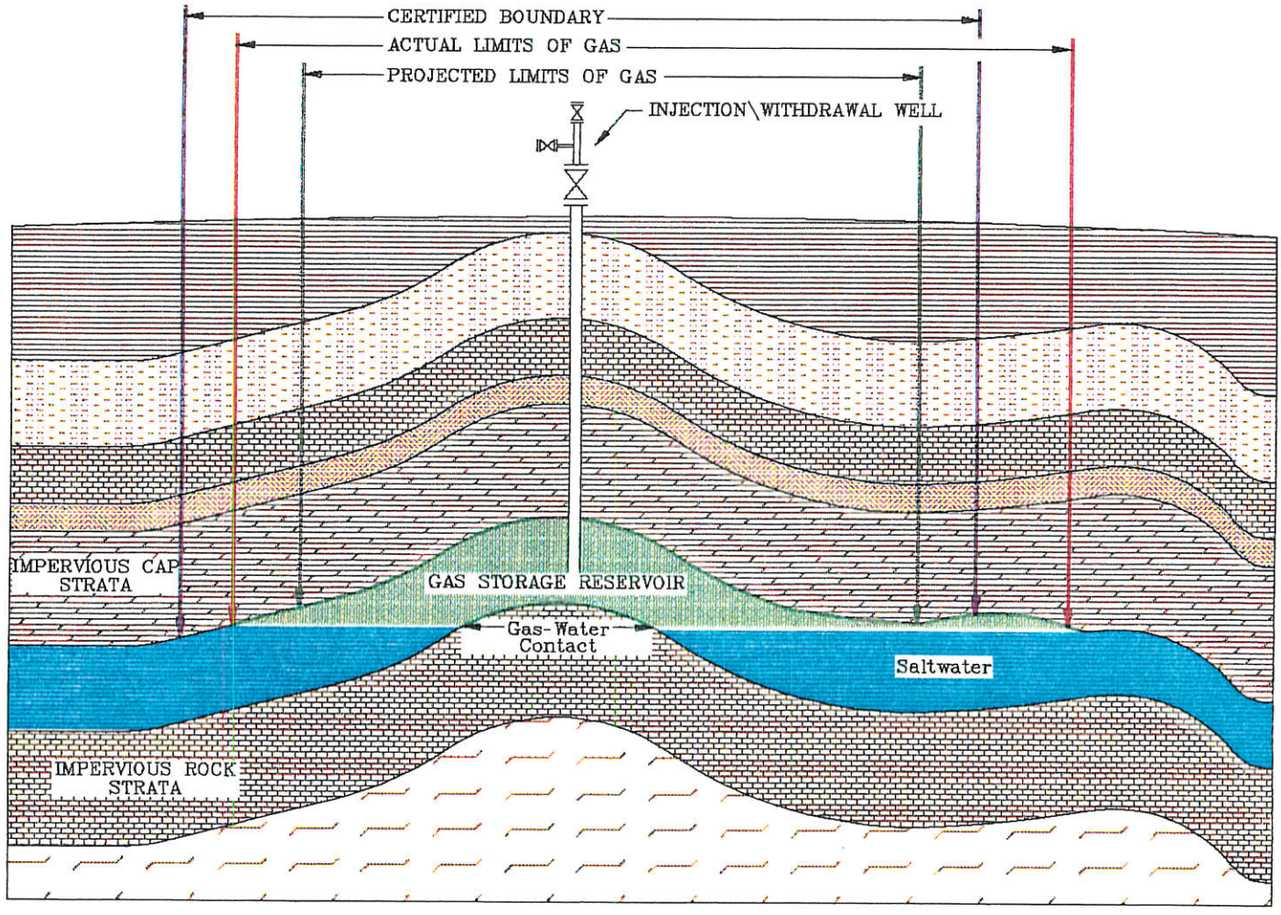
The Market Center is not opposed to fair and reasonable compensation for the rights to store gas and any native gas that may have existed prior to that storage operation. However, in the event that gas should migrate from the intended storage formation, the Market Center also believes they should not lose possession of that gas and should have the right to claim that gas, subject to fair and reasonable damages to the adjoining landowner. Whatever added financial burden that this bill causes could ultimately be born by the rate payers since storage costs are passed on to consumers.

If this committee feels the need to revise the existing law, the Market Center would welcome the opportunity to work with the committee to address the committee concerns and yet have a fair and reasonable bill.

Thank you.

PLAT DEPICTING UNDERGROUND STORAGE

Cross-Section Depicting Underground Storage



CERTIFIED BOUNDARY
PROJECTED LIMITS
ACTUAL LIMITS

MID CONTINENT MARKET CENTER

A ONEOK COMPANY

Memorandum

To: *Members of the House Judiciary Subcommittee on HB 2522*

From: *Mid Continent Market Center, Inc.*
By John L. Sommer, President

Date: *03/20/1998*

Subject: *Request for Comment made by Subcommittee Chair Tim Carmody*

In response to the four questions raised at the March 13 House Judiciary Subcommittee on HB 2522, Mid Continent Market Center would like to offer the following comments:

"1. Should the owner of mineral interests that are taken through condemnation be compensated for oil and gas which is recoverable through normal production or should they be compensated for additional production resulting from injection and removal of storage gas? (native gas and condensates)"

Under normal condemnation procedures, the value of the property is to be determined exclusive of the proposed facility. Applying this procedure, if the property is capable of economically producing hydrocarbons without the proposed storage facility in place, then that should be considered in determining the property value for purposes of the condemnation.

If, however, the property in question is depleted and is not capable of economically producing native natural gas, the owner of the mineral interest should not receive any compensation for the native gas. Any residual volume of unrecoverable native gas that is present in the reservoir will also be unrecoverable by the storage operator and therefore, should not require any compensation.

If the right reservoir conditions exist, the energy introduced by a storage operation could cause some native liquid hydrocarbon (condensates and oil) to be recovered during storage withdrawals that would not otherwise be recoverable (secondary recovery). This recovery could be handled like any other production unit, with the mineral owner receiving a privately negotiated royalty (typically 1/8) of the net proceeds (value of the hydrocarbons recovered less handling costs) based on their acreage.

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"2. Should storage facility owners and operators be liable to prior royalty owners for past production of native gas and condensates?"

This should be subject to how the native gas and condensates were originally negotiated for, but generally speaking, no. New procedures governing royalty owners should not be made retroactive. Additionally, it could become difficult to determine who the prior royalty owners were or how to locate them if and when the property has changed hands multiple times. Also depending on records available, the amount of post native production could be difficult to determine.

"3. Advantages and disadvantages of paying royalty owners on a 'going forward' basis. It has been discussed that storage field operators would prefer to pay for all mineral interests 'up front' at time of condemnation rather than being liable for future payments, including for native gas and condensates. At issue is also whether an upfront or future payment(s) for production of native gas and condensates would be appropriate, practical or should be required."

As for "up front" payment of royalties with respect to economically recoverable native gas, this method would work well. The volume of native gas can be reasonably estimated by standard engineering methods and the quality of that estimate will not improve after storage operations commence. The advantages are that it would be more convenient from an administrative perspective and both parties would know what the payment is from the start. The disadvantages would be coming to agreement on the volume of native gas and the pricing mechanism for determining the value. Additionally, either party could be hurt or benefit from this method, depending on whether the original volume estimate is overstated or understated.

As for "up front " payment of royalties with respect to native hydrocarbon liquids, this method would be difficult to implement. The estimate of recoverable hydrocarbon liquids will probably improve as the storage develops some operational history, therefore attempting to determine the volume up front would be difficult. Instead of using an estimated recovery factor up front, the volume actually recovered can be measured which would be fairer to all parties and allow for a pricing mechanism which pays today's price for today's production.

With regard to whether either method should be required, depending on the individual circumstances involved, either method could be appropriate and should be part of an negotiation between the two parties involved and should not be mandated by legislation.

"4. Should royalty owners be entitled to attorney fees when their property is condemned? Should attorney fees be allowed/mandated in other instances related to siting and operation of a storage facility as well as enforcement of contractual obligation?"

The initial phases of a condemnation procedure is an administrative procedure and the services of an attorney are not required by a land owner. If a land owner chooses to hire an attorney, then he should be held liable for that cost. The mandatory inclusion of attorney fees would seem to be an inducement for the land owner to take every case to condemnation as he would be in a "no risk" situation. This would undermine the Right Of Way negotiating process and bog the court system down needlessly. In cases where the storage operator has been abusive or grossly negligent, inclusion of attorney fees may be appropriate, but that should be determined by the case and not made mandatory.

In summary, it is our belief that each of these points should be a part of the negotiating process and should not be governed by legislation. In the event that agreement can not be reached through the negotiating process, condemnation procedures are already in place that should be utilized. An attempt to rewrite condemnation procedure into this legislation is not desirable. If specific concerns about storage facilities are not addressed by the present condemnation procedures, those concerns should be amended into the existing condemnation procedure statutes (K.S.A. 26-500).

STATEMENT OF PAN GAS STORAGE IN OPPOSITION TO HOUSE BILL 2045 BY JACK GLAVES - FEBRUARY 5, 1999 BEFORE THE HOUSE UTILITIES COMMITTEE

I. I represent Pan Gas Storage, a subsidiary of Panhandle Eastern Pipe Line Company, in turn a subsidiary of Duke Energy Corp. Pan Gas Storage owns and operates a gas storage field, known as the Borchers Field, in Meade County, Kansas. Space in the storage field is leased to Panhandle Eastern Pipe Line customers and to the pipeline which transports gas from the Texas, Oklahoma, Kansas, Hugoton and other areas across Kansas to the upper midwest. Panhandle Eastern has utilized eminent domain statutes and will no doubt be required to do so in the future.

II. This Bill is either a lawyer's dream or a lawyer's nightmare depending upon whether you represent the condemnor or the condemnee. First of all there is a serious issue concerning jurisdiction over the granting of a certificate to operate or develop a storage field. My clients storage facility is certificated and regulated by the FERC, and can utilize the right of eminent domain under federal law. Although Kansas law, as to eminent domain procedure, is applied in obtaining federally granted rights, it appears that there could be a serious issue of preemption given the restrictions contained in H.B. 2485 limiting the right condemned to that of a leasehold interest and specifying numerous items of damages involved in arriving at fair market value of the rights taken. Indeed, those provisions and

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the condition precedent established by this Bill of requiring compensation for contended prior use of the property (Sec. 3(c)(d)(e) and (f)), are substantive in nature as contrasted to procedural, and thus in conflict with and frustrate the right to utilize eminent domain under the Natural Gas Act. (15USC 717f(h).

III. A second major problem is the restoration of the law of capture by virtue of the striking of the language in Section 4(c)(1) and (2)(page 4 of the Bill). Section 1(e) defines "suitable for the underground storage of natural gas", as a separate and distinct stratum or formation from which natural gas cannot migrate to another stratum or formation, which is a finding that the KCC would be required to make under this Bill. That is an extremely difficult, if not impossible, determination for engineers to conclude with any degree of finality. They simply can't guarantee that formations won't allow migration. Migration does result and litigation ensues. Given the proposed stricken language on page 4 of the Bill, open season would be declared on all adjacent property to storage reservoirs. There is a history of producers tapping into storage reservoirs. It occurred in my client's field, which resulted in a lawyer's dream realized.

IV. The providing of attorney fees for litigating over migrating gas, even if the injector prevails, is a novel and dangerous concept that encourages interminable litigation. Likewise, the required independent study for purposes of the KCC hearing, is another unnecessary, time consuming and expensive

process, that is a deterrent to locating a storage field in Kansas. Interstate pipeline companies have choices in locating their facilities between the various states in which they operate. There are accessible depleted reservoirs in the numerous states that the pipelines traverse.

V. The existing storage fields are important not only for employment, but for tax base in numerous counties. Our Borchers facility in Meade County contains over $75 million of gas owned by Panhandle Eastern. This is assessed as a public utility and paid over $1 million in tax in 1998 just on the storage gas. Additionally, Pan Gas Storage facilities have a valuation of over $9 million with 1998 taxes of $713,000.00. In all Panhandle and subsidiaries paid Meade County over $2 million dollars in ad valorem taxes in 1998. These facilities serve a public need in supplying gas for Kansas and other states. The barriers erected by this legislation, to the operation of these facilities and the location of future storage fields are so serious as to jeopardize the economic benefits of these facilities to our State.

VI. We are not only concerned about the particular provisions proposed to be made applicable to proceedings to acquire gas storage rights, but we are also concerned about the precedential effect, should this Bill be enacted, on the eminent domain procedure generally in Kansas. Sec. 3 of House Bill 2045 directs the use of the eminent domain procedure act (K.S.A. 26-501 et seq), "<u>except</u> as otherwise provided by this section". This Bill would create a new methodology for calculating damages

in an eminent domain proceeding departing from historic statutory and case law directives. The award provided in Section 3 (c). would apparently be comprised of the sum of eight specified potential damages and values, stating that, ".... the appraisers shall assign the fair market value of all rights taken." (lines 15 and 16 on page 3.) This, we believe, is a total departure from existing Kansas law, which generally does not permit utilizing a "summation method" for calculating damages. In Union Gas system, Inc. v. Carnahan, 245 Kan. 80, 774 P.2d 962 (1989), the Kansas Supreme Court held that the value of property condemned for an underground gas storage reservoir is the fair market value of the entire property before the taking, including existing reserves of recoverable native gas less the cost of production, minus the fair market value of the entire tract after the taking. 245 Kan. at 81, Syl. 10. This opinion provides for using the "unit" method of valuation, whereby the property to be appropriated is valued as a whole, rather than as the sum of the values of the various constituent interests therein (the "summation" method.)

VII. H.B. 2045 is virtually identical to H.B. 2522 of last session. It was assigned to the Judiciary Committee, hearings were had and a Subcommittee was appointed, and although the Subcommittee struggled with the issue, a consensus was never arrived at.

VIII. The departure from existing law is made paramount by the provisions of H.B. 2140 that is pending in the Judiciary

Committee, which proposes to amend the Eminent Domain Procedures Act by defining "fair market value" as,

> "The amount in terms of money that a well informed buyer is justified in paying, and a well informed seller is justified in accepting for property in an open and competitive market.... The fair market value shall be determined by use of the comparable sales, cost or capitalization of income, appraisal methods or any combination of such methods." (Section 3(e))

Obviously, applying this definition to the elements spelled out for the damage award in H.B. 2485 would be difficult and confusing. There are obviously heavy legal issues at stake, and it would seem logical that this Bill should be considered in connection with the pending Bill in the Judiciary Committee, given the great divergence in philosophy in the application of the Eminent Domain Procedures Act.

H.B. 2045 combines an eminent domain action employing the proscribed "summation method" with a suit for damages for "prior use". To say the least, it is unique. We are plowing new ground with uncertain results. We urge defeat of this legislation, which has many ramifications and is in need, at least, of very extended study. It is certainly not something to be adopted out of pique or intuition. We believe that it could be a very bad precedent, with serious implications for every corporate entity or body authorized to utilize eminent domain. A very comprehensive study should be required, we believe, before adopting the radical concepts proposed by this Bill.

Respectfully submitted,

Jack Glaves
Pan Gas Storage

12-5

Kansas Corporation Commission

Bill Graves, Governor John Wine, Chair Cynthia L. Claus, Commissioner Brian J. Moline, Commissioner

MEMORANDUM

TO: Mr. Jim Langford, Legislative Budget Analyst
Mr. Tom Day, SCC Legislative Liaison

FROM: William J. Wix, Assistant General Counsel

DATE: February 1, 1999

RE: **House Bill No. 2045 Fiscal Impact**

House Bill No. 2045 is a two part approach to changing the certification of stratums and/or geologic formations for the storage of natural gas and secondly to change the procedures for an eminent domain proceeding following certification by the Commission.

Therefore, this fiscal impact statement only pertains to those provisions which affect the State Corporation Commission, specifically Section 2. Currently an applicant initiates a proceeding to obtain certification from the Commission that an underground stratum formation is suitable for the storage of natural gas and that its use is in the public's interest. In addition, the Commission must make a finding as to the amount of remaining recoverable oil and native gas in place. The proceeding utilizes the Rules of Practice and Procedure of the Commission and the Kansas Administrative Procedures Act.

House Bill No. 2045 imposes an additional duty upon the commission to make an independent study to assist the Commission in making the findings required under K.S.A. 55-1204 and to hold the required hearing under KAPA. Subsection (c) of Section 2 states that "the applicant shall be assessed an amount equal to all or any part of the costs of any study and any proceedings conducted pursuant to this section and the applicant shall pay the amount so assessed before the commission issues a certificate..." The Commission will be placed in a somewhat odd position of having its own expert witnesses and then taking evidence from expert witnesses on behalf of the applicant and possibly the protesters/intervenors.

Currently there are twenty-one known gas storage fields within the State of Kansas. The Conservation Division anticipates this number will grow due to the centralized location and appropriateness of fields in the State of Kansas and the need for utilities to have reliable stock piles of natural gas on hand. Existing fields which have been depleted are especially conducive to storage because they have existing wellbores. Before any storage

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reservoir can be developed, it is necessary to pursue an analysis of all existing wellbores whether they are abandoned or plugged to ensure that there is integrity and no migration between different formations.

These storage fields may be relatively small to fields covering up to thirty-five sections. We estimate a typical study would cost $100,000 to $150,000. During one certification proceeding, fees for expert witnesses on behalf of the applicant were approximately $600,000.00. Such experts would include geologists, reservoir engineers, hydrologists, landmen, etc. Although the Legislation allows for reimbursement from the applicant, the Commission believes that there could be foreseeable problems in collecting the monies on a timely basis and a possible adverse impact on the division's budgetary process.

kdd
cc: John Wine, Chair
Cynthia L. Claus, Comm.
Brian J. Moline, Comm.
M.L. Korphage
Diana Edmiston