

MINUTES OF THE SENATE UTILITIES COMMITTEE.

The meeting was called to order by Chairperson Senator Stan Clark at 9:30 a.m. on February 22, 2002 in Room 231-N of the Capitol.

All members were present except:

Committee staff present: Emalene Correll, Legislative Research
 Bruce Kinzie, Revisor of Statutes
 Ann McMorris, Secretary

Conferees appearing before the committee:

 Gary Dawdy, KCC
 Leo Haynos, KCC
 Steve Johnson, Kansas Gas Service
 Jim Flaherty, Legal Counsel, Utilicorp United, Overland Park

Others attending: See attached list

The committee viewed a video entitled "The Safe Shipment of Used Nuclear Fuel" and received a handout entitled "What State and Local Officials are saying about Transporting Used Nuclear Fuel". (Attachment 1)

A memo reporting contact with the Kansas Department of Emergency Management in response to a question in relation to **SCR 1617** was distributed. (Attachment 2)

The chairman closed the hearing on **SCR 1617**.

Moved by Senator Wagle, seconded by Senator Brownlee, SCR 1617 be passed out favorably. Motion carried.

The chairman continued the hearing on:

SB 547 - Rural Kansas self-help gas act.

Opponents:

 Gary Dawdy, Kansas Corporation Commission (Attachment 3) Mr. Dawdy provided a Kansas map (approximately 24" x 48") with color coded legends to show the certified areas of natural gas public utilities in Kansas. Certificates for cities and transmission lines only were not shown. This map was prepared by the KCC Information Resources-GIS Section - Draft 1-17-2002 and is not attached to these minutes due to its size.

 Leo Haynos, Kansas Corporation Commission (Attachment 4)

 Steve Johnson, Kansas Gas Service (Attachment 5)

 Jim Flaherty, Legal Counsel, Utilicorp United, Overland Park (Attachment 6) In addition to his testimony, Mr. Flaherty responded to various comments in testimony presented by the proponents on February 20, 2002 regarding service provided by natural gas utilities.

Due to lack of time, the committee members were able to ask only a few of the many questions they had regarding the testimony given by the opponents.

The next meeting of the committee will be on February 25, 2002.

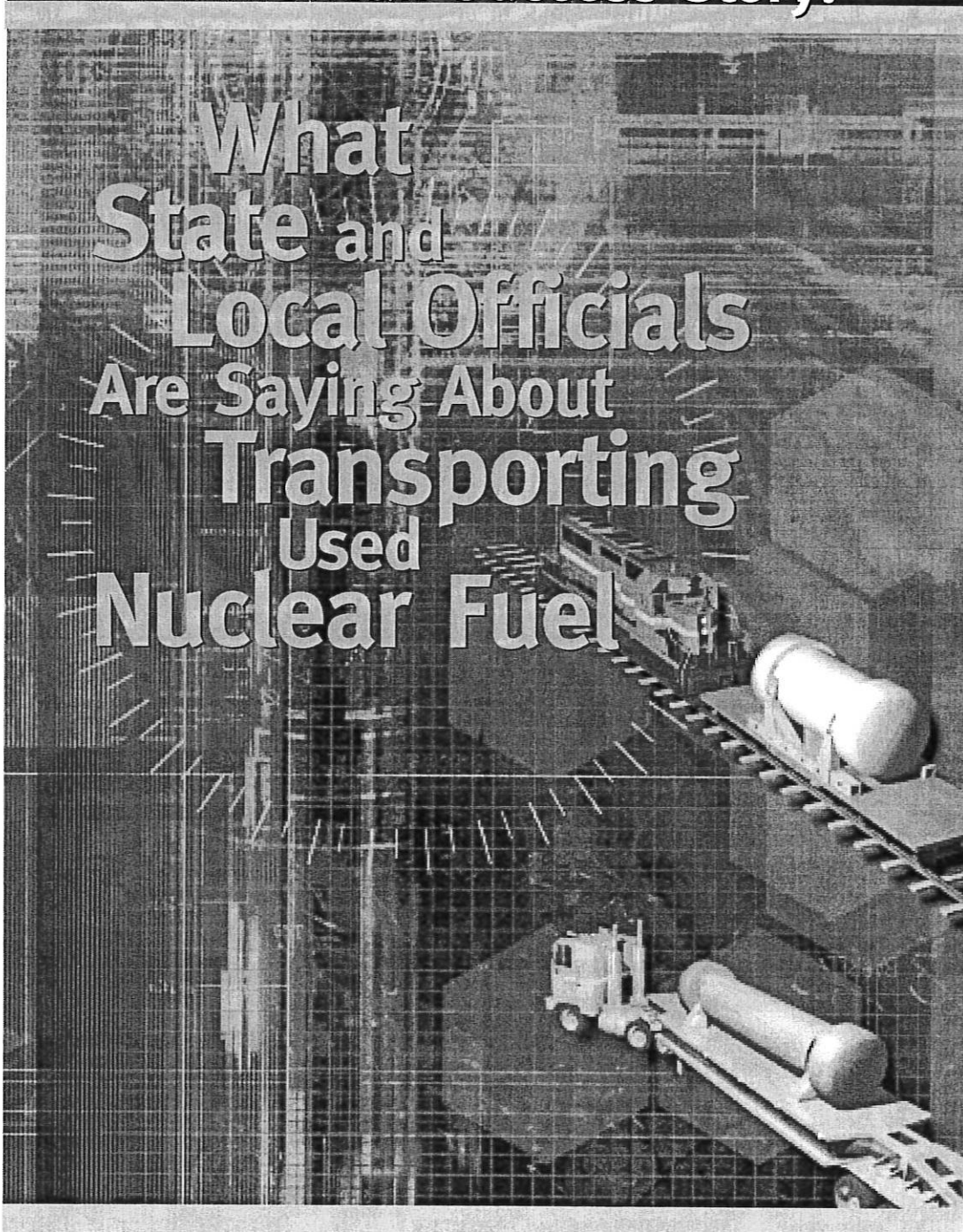
Adjournment.

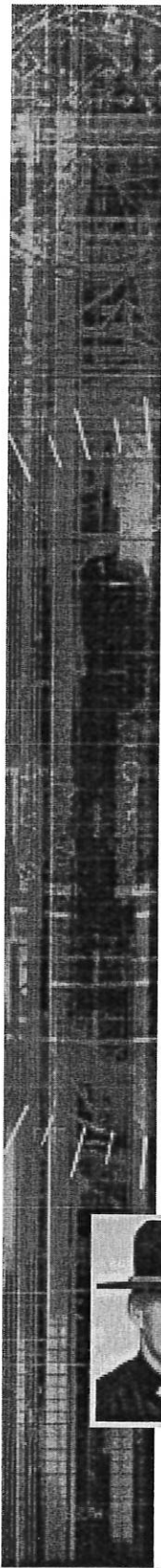
Respectfully submitted,
Ann McMorris, Secretary

Attachments - 6

An American Success Story:

**What
State and
Local Officials
Are Saying About
Transporting
Used
Nuclear Fuel**





Spotless Record of Safety

States have a vital role in ensuring that used nuclear fuel moves safely through their jurisdictions. They work with local governments and federal agencies to make shipments as safe as possible and provide emergency response if an accident does occur.

State programs for the transportation of used nuclear fuel include:

- routing designations
- the permitting of shipments bearing placards
- inspections of vehicles, drivers and cargo
- notification requirements
- emergency response preparedness, including training.

Officials like Bill Keller, coordinator of the Emergency Services and Disaster Agency for Champaign County, Ill., have extensive experience in safely transferring used nuclear fuel.

Keller says the trains that will carry used nuclear fuel through Illinois "will probably be the safest trains that'll go through the county. In the event of an emergency, our agency would coordinate with the state police, the state department of nuclear safety and hazardous materials experts."

Here is what other officials are saying about the safe transportation of used fuel.

Major Bryan Tuma Nebraska State Patrol



"We haven't had any problems with the coordination of radioactive material shipments. The effort to develop transportation plans with the involvement of state representatives has been beneficial. Nebraska could see up to 80 percent of all the rail shipments of nuclear waste, including used nuclear fuel, and 60 percent of all the highway shipments of nuclear waste coming through the state in the years to come. The continued emphasis on the planning and development of transportation protocol is critical for states to be adequately prepared."

Thomas Hughes
Radiological Officer
Pennsylvania Emergency Management Agency



“The Pennsylvania Emergency Management Agency coordinates the shipment of high-level radioactive waste—including spent nuclear fuel—with several state agencies, the state police, county emergency management offices and local enforcement agencies. All spent fuel shipments are escorted from border to border by the Pennsylvania State Police. Each Pennsylvania county is required to have radiation detection equipment, dosimetry and trained individuals to deal with the first response to an accident. In addition, individuals certified by the Commercial Vehicle Safety Alliance carry out pre-shipment inspections. Federal and state rail inspectors and radiation specialists inspect rail shipments.”

Don Flater
Chief, Bureau of Radiological Health
Iowa Department of Public Health



“A hazardous materials officer of the Iowa Department of Public Health escorts every spent fuel shipment by truck from border to border. The department’s officers have law enforcement authority. In addition, they are qualified by training to respond to a radiation incident or accident. Iowa has a minimum of six fully equipped radiological response teams that can respond to any point in the state within two hours.”

Captain Timothy Lockett
Kansas Highway Patrol



“The Kansas Highway Patrol is primarily responsible for the enforcement of laws regulating traffic upon our highways. An additional responsibility is that of public safety. Concerning the shipment of spent fuel, the Patrol has actively participated in the planning of both rail and roadway shipments. Numerous shipments have been made through Kansas the last few years, all without a safety-related incident. The Patrol is confident that the continued partnership with custodians, shippers and the emergency response community will allow us to continue this spotless record.”

Tim Runyon
Chief, Division of Environmental Monitoring
Office of Environmental Safety
Illinois Department of Nuclear Safety



“Spent nuclear fuel transportation is not a particularly new issue for the Illinois Department of Nuclear Safety. During the past 18 years, we’ve inspected and escorted over 480 highway and rail shipments. Our port of entry inspections keep shippers and carriers on their toes, and our immediate on-scene presence—in the event of an accident—helps alleviate the concerns of local emergency responders.”

Bob Fronczak
Assistant Vice President, Environment
and Hazardous Materials
Association of American Railroads



“Since 1953, there have been more than 900 rail shipments of spent nuclear fuel in the United States without injury or environmental consequences as a result of the radioactive nature of the cargo. There has never been a release of nuclear material from a rail transport vehicle. In anticipation of the increase of spent nuclear fuel shipments in the future, the rail industry has taken steps to assure this performance continues.

“The rail industry has developed a performance standard for the transportation of spent nuclear fuel that calls for cars carrying this fuel to have on-board defect detection, electropneumatic brakes, and performance characteristics that exceed that of any other freight car in service today. This best available rail technology is all designed to further reduce the probability of rail accidents as spent nuclear fuel shipments are anticipated to ramp up in the future.”

Christopher Wells
Senior Policy Analyst
Southern States Energy Board



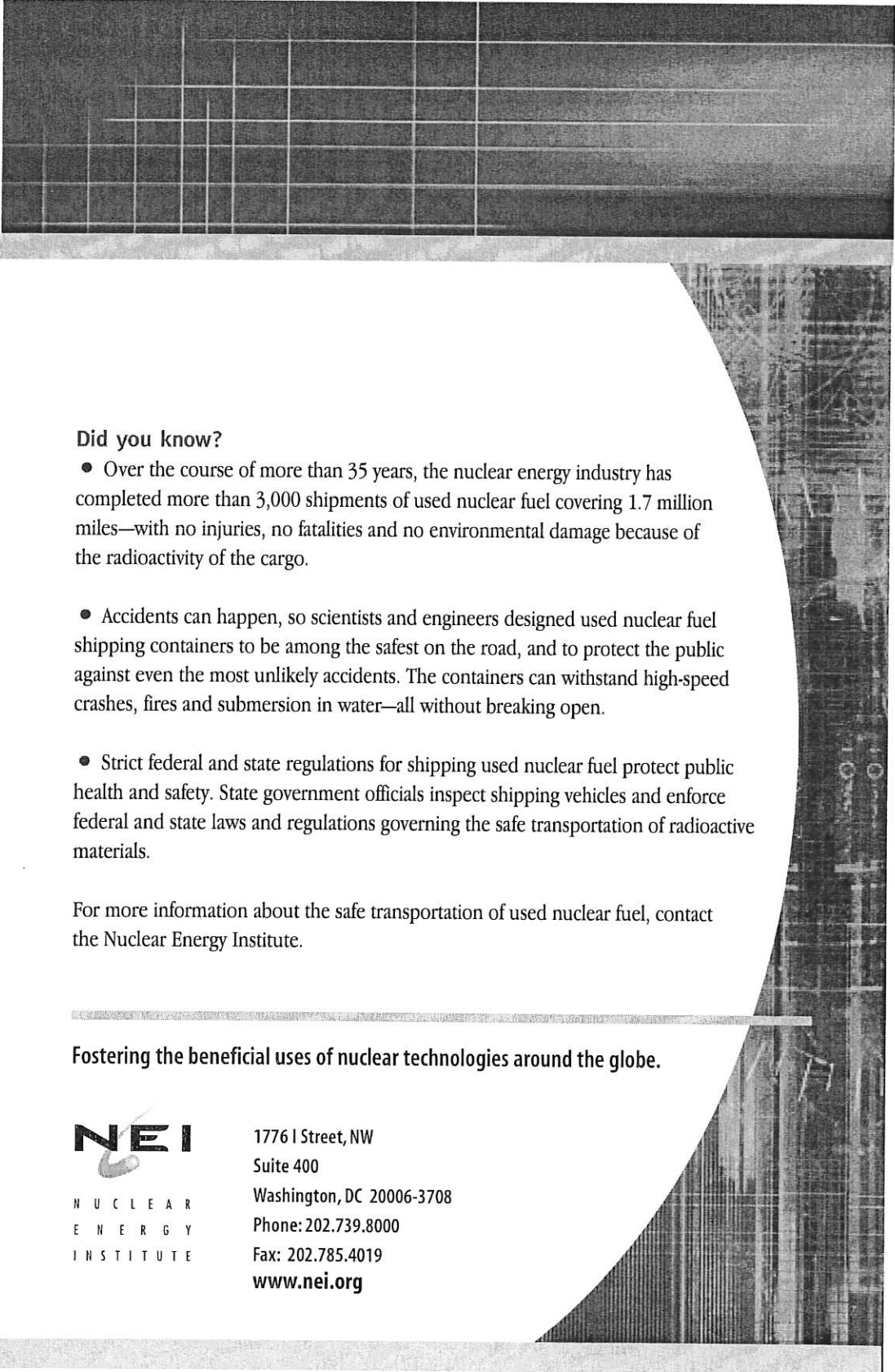
"I am responsible for staffing the board's four radioactive materials committees—including the radioactive materials transportation committee—which gives me the opportunity to work closely with state emergency response planners, health physicists and transportation planners. Our aim is to devise policies and procedures for the safe transport of radioactive materials, including spent fuel, through the southern region of the United States.

"I work with the board's member states and Energy Department officials to develop protocols for transportation campaigns that include the distribution of safety equipment, first responder training, public outreach programs and other activities along potential shipment corridors."

Jon Schwarz
Radiological Officer
Nebraska Emergency Management Agency



"The Governor's Nuclear Waste Transportation Working Group—which consists of the Nebraska Emergency Management Agency (NEMA), other state agencies and the Nebraska State Patrol—oversees the transportation of radioactive materials, including spent fuel, through the state. NEMA has trained emergency first responder agencies along the 450-plus miles of Interstate 80 and along the Union Pacific Railroad. To date, Nebraska has handled three shipments of foreign research reactor spent fuel without incident."



Did you know?

- Over the course of more than 35 years, the nuclear energy industry has completed more than 3,000 shipments of used nuclear fuel covering 1.7 million miles—with no injuries, no fatalities and no environmental damage because of the radioactivity of the cargo.
- Accidents can happen, so scientists and engineers designed used nuclear fuel shipping containers to be among the safest on the road, and to protect the public against even the most unlikely accidents. The containers can withstand high-speed crashes, fires and submersion in water—all without breaking open.
- Strict federal and state regulations for shipping used nuclear fuel protect public health and safety. State government officials inspect shipping vehicles and enforce federal and state laws and regulations governing the safe transportation of radioactive materials.

For more information about the safe transportation of used nuclear fuel, contact the Nuclear Energy Institute.

Fostering the beneficial uses of nuclear technologies around the globe.



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February 19, 2002

MEMO

RE; SCR 1617

In response to Senator Barone's concern about the responsibilities of various state and federal departments in transporting radio active materials across Kansas, I phoned Gene Krase at 274 1401. After explaining the purpose of the call, he recommended Frank Moussa of the Department of Emergency Management as the expert in this area and contacted Mr. Moussa.

Mr. Frank Moussa phoned me and explained the steps in transporting of radio active materials. These materials will be transported on special trucks, shadowed by Federal agents and tracked on a program called Transcom so that every minute the truck is in Kansas its whereabouts is known. Also, KDEM will be notified when such trucks even approach Kansas from any other state.

Since President Bush has signed the approval of Yucca Mt., the State of Nevada has filed a lawsuit against the Department of Energy to keep the site out of Nevada. The legal process could take till 2010 - and there are various routes this lawsuit could take - through Congress who could override, through the Nuclear Regulatory Commission and back to Congress and to the President for signing.

Mr. Moussa would be glad to arrange for General Gregory Gardner to appear before the Senate Utilities committee and provide this reassurance of the program in place for transporting radioactive materials.

He requested copies of the testimony presented to the Committee on SCR 1617.

Phone # 274-1408
Frank Moussa
Kansas Department of Emergency Management
2800 SW Topeka Blvd., Room 15
Topeka, KS 66611

Senate Utilities Committee
February 22, 2002
Attachment 2-1

Before the Senate Utilities Committee
Comments by the
Staff of the Kansas Corporation Commission
February 20, 2002

Senate Bill 547

Chairman Clark and members of the Committee.

Good morning, I'm Gary Dawdy, with the KCC, I'm here to make a few brief comments about Senate Bill 547. I brought along a natural gas certified area map of Kansas and would like to begin by telling you about natural gas certificates in general. As you view the map you can quickly see that there are certificated areas, and that unlike electric certification, some of the natural gas areas overlap. In addition, there are open areas in the state where there is no certificated natural gas utility.

KCC Staff does not intend for certificates to become an impediment to customers securing natural gas service. To the contrary, certified areas are intended to provide for the orderly development of the industry and to insure that utilities have a continuing obligation under the law to provide natural gas service. Without certificates and public utility status, history has shown us that some utilities would cut corners when it comes to service quality and we would experience less rate stability. But worse yet, utilities could simply make decisions to quit the utility business during hard times and invest their resources in other business ventures. Being financially fit and technically able to meet the needs of customers are things which a certificated utility must prove before they can become a utility under current law.

Staff has worked closely with the proponents of this bill to address the declining pressure problems in Southwest Kansas. This Committee is probably already familiar with the current nonprofit public utility law under KSA 66-104c. I would like to provide a quick summary of the efforts of nonprofit gas public utilities or (NPU's), regulated gas public utilities and the KCC to address the declining pressure problems as well as the need for gas generally.

Between January 1, 1998 and July 31, 2001, there were 36 certificates issued in dockets which addressed the needs of customers in the counties of Comanche, Edwards, Finney, Grant, Haskell, Kearny, Meade, Seward, Stafford and Stevens. Twenty-six of these dockets were initiated by regulated gas public utilities, while the remaining ten were initiated by NPU's. Does this solve the problem? I would say no, we still have work ahead of us. However, together these dockets benefitted a considerable geographic area extending additional gas service to portions of ten Southwestern Kansas counties.

Next, I would like to briefly address a few parts of Senate Bill 547.

1. The first comment is to provide a slightly different perspective to one of the points raised in the proposed law. There is a reference under part (c) of the bill which refers to a utility "that merely owns, operates, maintains or is responsible for a meter or meter station and incidental pipeline connections." I believe this is a reference to utilities which are serving from gathering facilities where they do not own the lines. I would point out that this is the exception rather than the rule

and that most customers of natural gas suppliers are served from facilities owned by the utility themselves.

2. The current NPU law, K.S.A. 66-104c, has operated to provide solutions to customers in rural areas where natural gas has not been heretofore available. Certificates issued thus far have been requested primarily in areas away from existing facilities and certificated areas. If enacted, Section 3 of the proposed law could result in conflict with existing suppliers which have already made investment in facilities designed to serve the areas being sought and could result in duplication of facilities. Existing utilities design facilities with capacity sufficient to extend beyond current customers requesting service so as to be able to provide for future customers.

3. It is important to note that while some certificates cover geographic areas, we encourage utilities, and they often do, to exchange existing territories to better accommodate customers. An example of this would be Midwest Energy and Greeley Gas, which recently traded areas so as to be able to better serve rural customers.

4. A final suggestion is that in Sections (a) and (i) of the bill there are references to “public utility.” I would suggest that these should be corrected to read “natural gas public utility.”

I appreciate the opportunity to provide comments to you this morning. Leo Haynos, our Chief of Pipeline Safety, will now address additional concerns raised by this bill. When he has finished, we will both be available to stand for questions.

**Before the Senate Utilities Committee
Comments by the
Staff of the Kansas Corporation Commission
February 20, 2002**

Senate Bill 547

Thank you, Mr. Chair, and members of the Committee. I am Leo Haynos, chief of pipeline safety. In addition to the policy concerns addressed by Mr. Dawdy, Commission Staff has several concerns with the current bill that can best be described as unintended operational problems that could occur under the definitions of the proposed bill.

On page 1, lines 28 through 31, SB 547 defines the term "firm gas service" as a level of service that obligates the public utility to provide unlimited supply of gas except for reasons of force majeure. This definition is used to define an existing gas customer. Staff believes this definition is too broad. Many large customers currently served by public utilities allow their service to be curtailed by the utility in exchange for some rate considerations. As written, this definition would allow many existing large volume gas customers outside of a city's boundaries to abandon their current service with a public utility for more economic service as an intrastate direct sales customer or as a non-profit utility.

Staff believes the definition of "rural gas user" on page 2, lines 4 through 6 also poses operational problems because it is too broad. With no limitations on the definition of a

rural gas user, there is the potential for a myriad of gas pipeline operators on the outskirts of large cities. It would allow for individual home owners or any other entity not currently using gas to construct piping to the LDC in front of their house or to construct piping to any other source that can provide gas. This could lead to a spider web network of pipelines serving various customers with multiple operators.

The owner of any gas piping that leaves the property controlled by the owner becomes an “operator” as defined in pipeline safety code and in the One Call law we discussed earlier today. Typically, small operators who do not depend on providing gas service as their main source of income do not have the expertise or qualifications necessary to operate a gas distribution system.

Among other things, pipeline safety code requires:

- Use of approved construction practices and materials;
- Participation in a drug testing program;
- Providing utility locates upon request; and
- The ability to demonstrate they are qualified to perform a variety of operations and maintenance tasks including gas odorization, leak surveys, and emergency response on a 24/7 basis.

Staff believes that assuring compliance with pipeline safety regulations for what could be hundreds of pipeline distribution system operators who are not in the primary business of operating a gas distribution system would be problematic.

It appears to Staff that the intent of SB 547 is to provide those entities currently obtaining service from gas gathering systems the opportunity to seek reliable, if not firm, gas service within reasonable time constraints. The definition would be much more manageable from an operational viewpoint and particularly from a pipeline safety viewpoint if the definition of rural gas service was restricted to include only those entities that are served from gathering systems.

As I have noted earlier, the definition of rural gas service does not include any guarantees for firm service to the customer. With this in mind, a host of policy questions with implications in reducing pipeline safety come to mind. These include:

- If property is annexed into a city, will the rural gas user no longer be allowed to operate?**
- If a rural gas user builds a pipeline to property that is leased and then loses the lease, would he be obligated to serve the new tenant?**
- If a rural gas operator/user becomes financially insolvent, who is obliged to maintain the facility or insure public safety?**
- Should eminent domain be considered for this type of operator?**
- Can an individual cancel service with an existing gas service utility, and then build their own pipeline to another source?**
- Should the public utility be given the right of first refusal to serve the rural gas user?**
- Does the public utility have any right to stranded costs?**

While some of these problems may seem rhetorical, the possibility exists for customers that have invested large sums of money being abandoned, insolvent companies no longer able to afford proper maintenance for gas lines, or the failure of public utilities to upgrade their systems because of potential bypasses occurring. All of these potential issues may lead to a deterioration in pipeline safety.

As Mr. Dawdy mentioned, there is a mechanism in place under K.S.A. 66-104c that allows for the organization of non profit utilities, subject to Commission approval. Furthermore, the requirements of 66-104c at the very least provide the customer with a vote in the decisions of the gas system operator. The requirements of 66-104c also allow the Commission to determine the impact the proposed NPU will have on public utilities certificated in the area. The NPU mechanism, when considered with public utility certificated areas and the availability of existing gas piping, allows for a more systematic development of a gas distribution infrastructure than what is proposed in this bill.



KANSAS GAS SERVICE

A DIVISION OF ONEOK

TESTIMONY

Before the Senate Utilities Committee
Steve Johnson
Executive Director, Corporate Relations
Kansas Gas Service
SB 547
February 22, 2002

Dear Chairman Clark and members of the Committee,

Kansas Gas Service is interested in this bill because we are firm believers in the regulated system now in place to economically serve the natural gas customers in the State. We are certificated throughout the State in many counties providing service to over 630,000 natural gas customers in 340 communities. The vast majority of these customers are served in an urban setting and a few are served through a mainline tap or from wellheads and gathering lines. We take, very seriously, our responsibility and obligation to serve and expend many dollars, manhours and expertise to make sure we provide gas to all of our customers, when they need it, in the quantities they require and at a reasonable price.

We are aware of the several customers in rural Kansas that are losing service because their wellhead gas or gathering lines have lost pressure or gas altogether. We have not experienced the proliferation of this problem as other utility companies, but we are in agreement with them, that this is an economic situation that should be taken care of through an analysis that makes sure other customers of the Utility are not subsidizing the facilities that need to be installed. Without the benefit of new revenue to gain a return on such investment the new facilities would be paid for entirely by the existing customer, since little if any new load is realized. Additionally, those captive customers left on the system, will eventually bear the burden of higher rates if these few customers were allowed to bypass the Utility.

Senate Utilities Committee
February 22, 2002
Attachment 5-1

In some isolated cases, after all options had been exhausted, we have relinquished our certificate on a customer specific basis, so the customer has the freedom to make any other type of arrangement needed with another service provider. Again, I would stress that even that entity needs to economically justify this new service and be held to safety standards as high as the Utility that is giving up their certificate. In other words, we believe that an "even playing field" requires the Kansas Corporation Commission regulate these new utilities.

Kansas Gas Service is in opposition to SB 547 and support the other utilities and the KCC that have expressed these same concerns before this committee. I will be happy to stand for questions at the appropriate time.

**TESTIMONY OF JAMES G. FLAHERTY
ON BEHALF OF UTILICORP UNITED INC.
BEFORE THE SENATE UTILITIES COMMITTEE
IN OPPOSITION TO SENATE BILL 547**

I. INTRODUCTION

Mr. Chairman and members of the Committee, my name is James G. Flaherty. I am an attorney from Ottawa, Kansas. I represent UtiliCorp United Inc. before the Kansas Corporation Commission. I am testifying this morning in opposition to Senate Bill 547 which advocates the replacement of traditional economies of scale regulated public utility service with a process which promotes unregulated efforts to provide natural gas service in all parts of rural Kansas not currently served by natural gas public utilities. The underlying premise of Senate Bill 547 that the problems relating to natural gas service in rural Southwest Kansas are based upon the distinction between rural and urban areas in Kansas is wrong. Because of this faulty premise, supporters of Senate Bill 547 reach the wrong conclusion in regards to their proposed legislative solution to the problems facing natural gas customers in rural Southwest Kansas. The correct solution to those problems is not to regulate service in urban areas and deregulate service in rural areas. There are several problems caused by that structure and the proposed legislation. Instead, the correct solution is to promote the same type of economies of scale which have successfully worked throughout the other areas of Kansas.

II. THE REAL FACTS ABOUT THE HISTORY OF NATURAL GAS SERVICE IN SOUTHWEST KANSAS

To understand the problems facing natural gas customers in rural Southwest Kansas it is important to know the history of natural gas service in that area. Once the problems are placed in the historical context, the solutions to those problems will become more evident.

Under the typical scenario, a natural gas distribution company will buy a tap on an interstate or intrastate natural gas pipeline to obtain a natural gas supply. The distribution company then distributes that gas to retail customers through a distribution system. For example, in Lawrence, Kansas, Kansas Public Service (KPS) has a tap on an interstate pipeline owned by Williams Pipeline. KPS distributes the gas that it obtains from the Williams pipeline and distributes it to retail customers in Lawrence through its distribution system. This typical scenario not only takes place in urban areas in Kansas, it takes place in rural areas in Kansas as well. In fact, all of the major local distribution companies in Kansas effectively serve rural areas in Kansas using economies of scale to provide efficient service to customers in those areas.

What makes the rural Southwest Kansas situation atypical, is not the fact that the area is rural, as opposed to urban, as suggested by the proponents of Senate Bill 547. Those proponents' suggestion that customers in Southwest Kansas have been unable to obtain natural gas because they are located in a rural area of Kansas misses the mark when considering the history of natural gas usage in Southwest Kansas. In fact, the thing that makes the rural Southwest Kansas situation different is the fact that it sits on what was the largest natural gas field in the world. Accordingly, the proponents' premise as to what is causing the problem in Southwest Kansas is wrong and their proposal for so-called self-help unregulated action for all rural areas in Kansas is incorrect.¹

In Southwest Kansas there was no need for an interstate pipeline or distribution company to deliver the gas to the customers since the customers were sitting on top of a large natural gas field.

¹The "self-help" label placed on the proposed legislation is somewhat of a misnomer because what is likely to occur if the proposed legislation is passed is that certain individuals and companies (referred to in the bill as "any gas provider assisting the rural gas user") will be serving rural Kansas on an unregulated basis.

Historically, customers in rural Southwest Kansas received their natural gas from one of two sources. The first source was from a natural gas producer, either directly from the wellhead or from the producer's own gas gathering system. Typically the producer agreed to provide gas to the customers as part of the oil and gas lease or other agreement with the landowner. The second source of gas was from a interstate pipeline company's gas gathering system. Again, typically, the interstate pipeline agreed to provide gas to the customer as part of a right of way or other agreement. Although the gathering systems were designed to "gather" gas rather than "distribute" gas, as long as the field pressures were sufficient, the gathering system could effectively serve a dual role. Hundreds of customers were attached to these gathering systems.

Interstate pipelines which owned the gathering systems used to serve some of the customers did not want to be regulated by the Kansas Corporation Commission (Commission). They, therefore, allowed distribution companies to take ownership of the customer meter and to become responsible for service to the customers in order to avoid being regulated by the Commission.

Over the past several years wellhead pressures in the two fields have declined to the point where producers and companies, which now control the interstate pipeline gathering systems, are having difficulty in delivering a reliable supply of gas to the hundreds of customers that have been served off of these gathering systems for several decades. The problems facing these customers are not caused because they live in rural Kansas as suggested by the proponents of this legislation. The problems are caused because the gathering systems can no longer service a dual role.

Customers in Southwest Kansas, who currently receive their gas from a producer, either directly from the wellhead or the producer's own gas gathering system are in a different position than the customers who currently receive their gas supply from a gas gathering system that is owned by

the pipeline. This is because the producers currently have a huge incentive to assist these customers in finding another way in which to obtain delivery of natural gas. It is that incentive that is providing a solution (based upon traditional public utility regulation principles instead of unregulated self help—every man for himself—processes) to at least some of the problems in the area.

Because of declining wellhead pressures, and the necessity of installing compression (including vacuum operations) and/or lowering pressures in their gathering systems, it is in the self interest of the producers that are currently serving customers in Southwest Kansas directly from the wellhead or off of their gathering system to find another way in which to deliver natural gas to customers. Producers need to add compression (including vacuum operations) and/or lower pressures in their gathering systems in order to maintain production levels. It is becoming more and more difficult for producers to make these necessary changes and continue to serve customers from the wellhead or their gathering systems. At least two major producers (Vastar and Pioneer Natural Resources USA, Inc.) have worked with the regulated utility that is certificated in the area where their wells and/or gathering systems are located, to contribute funds to allow the utility to take advantage of economies of scale and to build a new distribution system to serve the customers formerly served by the producer. The new distribution systems are or will be connected to pipeline quality gas supplies, will resemble the typical distribution set-up found throughout the state, and the rates and service provided to these customers will be regulated by the Commission. Other major producers who currently serve customers directly from their wells or gathering system are also considering similar plans with the distribution company certificated in the area where their wells and gathering system are located.

The producers were willing to contribute funds for the construction of the new distribution

system because they were able to maintain the obligation they had under their oil and gas leases and other agreements to make sure these customers had a supply of natural gas, while moving the customers off of the wellhead and gathering systems so they could make the necessary additions to add compression and lower pressures in their gathering systems in order to maintain production. An additional benefit to the producers, was the producers, themselves, were able to obtain pipeline quality gas through the new distribution system to fuel their new compressors.

The agreements which have led to the construction and operation of these new distribution systems in rural Southwest Kansas may not have been possible if there had been twelve different unregulated projects going on in competition with the certificated utility in the area. The certificated utility was able to use economies of scale created by the fact that it had an existing certificate to serve the area, and the partial contribution from the producer to construct a new distribution system to serve all customers, including any new customers in the area.

Customers, who currently receive their gas off of gas gathering systems which were once owned by the interstate pipelines who purchased gas in the Hugoton and Panoma Council Grove Fields, are in a different situation than the customers who have historically been served by producers in the area. Unlike the producers, who have an incentive to move customers off of their wellhead and gathering systems so they can make changes to maintain production, the companies which now own the gas gathering systems once owned by the interstate pipelines, have little or no incentive to contribute to the construction of a new distribution system to serve customers in the area. Although the companies owning these gas gathering systems have no incentive to contribute to the construction of a new distribution system, this does not mean that the traditional regulated public utility system will not be able to provide the best solution to these customers' problems. As set forth below, the

economies of scale obtained by having one entity serve a large number of customers, instead of having several entities serving a few customers, provides the best solution to these customers' problems. Obtaining the economies of scale can best be achieved, as in the situation where the producers and the utility have worked together, by having the utility certificated in the area work with the customers to develop a plan for the construction of one large distribution system, instead of a number of small systems.

III. ECONOMIES OF SCALE INSTEAD OF INDIVIDUAL SELF-HELP PROCESSES PROVIDES THE BEST SOLUTION TO NATURAL GAS SERVICE PROBLEMS IN SOUTHWEST KANSAS

A. THE CONCEPT OF ECONOMIES OF SCALE UNDER EXISTING LAW

Contrary to the conclusions reached by the proponents of Senate Bill 547, the current law in Kansas, as it is in most states, grants natural gas distribution companies certificates of convenience and authority to serve specific portions of the state on a regulated basis because the public interest is best served by having one distribution system serve an area instead of multiple systems. Certificated areas are established by Kansas state law to protect the public interest, not to protect the interest of the local distribution company. In order for a company to obtain a certificate to provide natural gas service to anyone in Kansas, that company must prove to the Commission that it has the financial ability and the expertise to provide natural gas to customers. The Commission uses the certification process, which the proponents unfairly degrade, in order to assure that customers in Kansas receive service from a company which has the ability to serve those customers on a long term basis. The conclusion that "with respect to public utilities, significant (permanent) economies of scale indicating large-scale, monopolistic operations appear to be found in the ... distribution of natural gas..." goes

to the basic core of public utility regulation. *The Economic Concepts of Regulation, Charles F. Phillips, Jr., page 47.*

Consider the following example from Professor Phillips which explains why economies of scale are important to achieve:

The pipeline industry is illustrative. Unit costs of crude oil pipeline transport decline rapidly with increases in the designated capacity (throughput) per day and the diameter of the pipeline. Thus, a throughput of 25,000 barrels per day in a 10 3/4 inch line costs 0.237 cents per ton-mile as compared with a cost of .0513 cents per ton-mile for a daily throughput of 400,000 barrels in a 32-inch line. The second cost is approximately 22 percent of the first.

Id. at page 47.

The concept of economies of scale, and why it provides the best long term solution to the problems to natural gas customers in Southwest Kansas is simple and straight-forward. Under the concept of economies of scale, one natural gas distribution company can achieve lower costs if placed in the position of a monopolist in a market and if regulated by the state. *Id. at 45.* Lower costs are achieved in several ways. First, as in the above example, once an investment in facilities is made, output can be increased with unit costs declining until the physical capacity of the facilities are reached. *Id. 46.* Second, at any point in time, the unit cost of adding capacity declines as the size of the additional facility increases. *Id. 46.* Third, as technology changes, the real unit costs of adding capacity decline. *Id. 46.*

Competition on the other hand, which is really what the proponents of Senate Bill 547 are promoting for natural gas service in rural areas of Kansas, may provide some benefit in the short run, but in the long run competition will be self-destructive and result in a waste of scarce resources. This is because in the long run what Kansas would end up with under the proposed deregulation of the

natural gas distribution business in rural areas in Kansas are a number of firms that would be high cost producers and a larger number of consumers who will have been denied the benefits derived from economies of scale.

B. REGULATED UTILITIES AND CUSTOMERS WORKING TOGETHER TO FIND SOLUTION TO PROBLEMS IN SOUTHWEST KANSAS WILL BEST SERVE THE PUBLIC INTEREST

As indicated above, in areas where producers and the certificated utility have worked together to develop and implement a plan to solve problems of natural gas customers in Southwest Kansas, success is being achieved as a result of economies of scale. Similar plans are being discussed and should also prove to provide a long term solution.

In areas where customers are served off of gas gathering systems owned or previously owned by interstate pipelines, developing and implementing a plan is taking longer than in the other areas because the owners of the gas gathering systems have little incentive to assist the certificated utility and the customers. However, this does not mean that the certificated utilities and there customers are not pursuing long term solutions. It also certainly does not mean that it is time to change the law to promote short term fixes and give up on traditional and proven economies of scale to provide a solution to the problems faced by natural gas customers in Southwest Kansas.

There are a number of things which UtiliCorp is currently doing to take advantage of economies of scale to implement a long term solution, which is to move customers off of the gas gathering systems and onto a distribution system which is connected to a source of processed, pipeline- quality gas supply. For example, in July of 2000, UtiliCorp installed 66,000 feet of new main to move 2 feed yards and 13 irrigation customers (23 irrigation engines) off of the old gas

gathering system and onto the new distribution system. In the spring of 2001, UtiliCorp installed an additional 7,920 feet to the new distribution system to supply gas to 3 other irrigation engines and one oil well heater treater. In the summer of 2001, UtiliCorp added another extension to supply gas to serve another 6 irrigation engines. In January of 2002, another extension to the new distribution system was added to supply gas to 4 irrigation engines. UtiliCorp is working on another extension of this new distribution system and will be able to serve another 5 irrigation engines in early spring of 2002.

UtiliCorp is looking into the feasibility of constructing a new distribution system that would be connected to Northern Natural pipeline to serve south of Sublette and is looking at another distribution system off of Williams' interstate pipeline to serve customers in the southwest portion of Haskell County. UtiliCorp is also looking at the possibility of acquiring and converting some of the existing gas gathering lines between Tice and Copeland into a distribution system which could be hooked up to an interstate pipeline owned by Williams that it is in the area. This is a rural distribution system, which will serve an additional 37 customers, and which will be set up just like the distribution service is set up in Lawrence.

Again, the problems in Southwest Kansas are not caused by the fact that it is a rural area as suggested by the proponents of Senate Bill 547. Rather, the problems are caused by the continued use of a delivery system that was reliable and cost effective during the glory years of the Hugoton and Panoma Council Grove gas fields, but is no longer a reliable method of delivery natural gas. There is going to have to be this type of transition over the next few years to move customers off of wellhead and gathering systems and onto new distribution systems served by interstate pipelines in the area. What drives the time frame on how soon these projects are completed depends on how quickly the

customers want to leave the relatively low cost supply provided by the gathering system and move onto a new distribution system. This transition can best be accomplished through the use of economies of scale implemented by regulated utilities, instead of the use of higher cost individual projects by multiple unregulated firms or individuals. The key to successfully solve the problems facing natural gas customers in Southwest Kansas is for the utility and the customers to work together to develop a plan and to implement that plan. Multiple plans and multiple unregulated firms will only distract from getting a cost effective long term solution in place.

IV. OTHER ISSUES RAISED BY PROPONENTS TO SENATE BILL 547

A. *UNITED CITIES GAS COMPANY V. BROCK EXPLORATION COMPANY*

In support of their argument for the deregulation of natural gas service in rural Kansas, proponents of Senate Bill 547 have referred to *United Cities Gas Company v. Brock*, 995 F.Supp.284 (D.Kan. 1998). They state that the *Brock* case shows how utilities use the certification process to deter the self-help efforts of customers. The *Brock* case does not stand for that proposition.

The *Brock* case involved a situation where an unregulated non-utility company from Texas began serving several large industrial customers in Olathe, Kansas which had previously been served by United Cities Gas Company (United Cities). United Cities is a regulated utility which provides service to Olathe, Kansas under a certificate of convenience and authority from the Commission. Brock did not attempt to obtain a certificate from the Commission to serve the industrial customers. United Cities filed a complaint with the Commission claiming that Brock was operating without a certificate. The Commission found that Brock's operations, which had the effect of bypassing the utility to serve large industrial customers who were previously served by the utility, were not in the

public interest. The Commission found that the bypass by Brock was not in the public interest because the bypass would likely result in higher rates to United Cities' residential and small commercial customers. The Commission did not want to promote unregulated providers entering the market and "cherry-picking" large customers served by the regulated utility. The Commission stated as follows:

The Commission has a long established policy prohibiting bypass of LDC facilities (citations omitted). In general, bypass occurs when an end user in a LDC's certificated service area obtains natural gas in a manner that circumvents the existing LDC. The Commission's policy is based on the economics of cost of service. The cost of service is spread among all the customers of the utility. When only certain customers are able to leave the system and obtain service from another utility, the cost of idle facilities is then shifted to those "captive" customers that do not have the option to leave the system, resulting in increased rates to remaining customers.

KCC Docket No. 193,478-U (96-GIMG-199-COM), Order dated May 29, 1996, ¶133, pages 12-13.

V. PROBLEMS WITH PROPOSED LEGISLATION

There are several problems with Senate Bill 547. As indicated above, the bill's premise that problems faced by customers in Southwest Kansas are caused by the fact that they live in rural Kansas is wrong. The fact that the bill's premise is incorrect, also makes the bill's proposed solution of creating a two-tier system that provides regulated natural gas service to urban areas in Kansas and unregulated natural gas service to rural areas in Kansas wrong.

The fact that the customers in Southwest Kansas live in a rural area has nothing to do with their problems. Their problems are caused by having to go through a transition period which has them moving from receiving gas from a wellhead or gas gathering system which can no longer provide reliable service because of declining wellhead pressures in the Hugoton and Panoma Council Grove

gas fields, to a more typical distribution system which is connected to an interstate pipeline or processing plant in the area.

There are many customers currently living in rural areas in Kansas, including areas in Southwest Kansas, that are able to obtain natural gas service from regulated natural gas distribution companies. The quality of service and rates are regulated by the Commission in these areas. This traditional method of providing natural gas service to customers in both rural and urban areas in Kansas is well tested and supported by long standing and proven regulatory principles. There is simply no need to set up a different system to govern natural gas distribution in the rural areas of Kansas.

The proposed legislation calls for continued regulation of service and rates for customers located in urban areas, and for customers located outside the rural areas that are already served by a regulated local distribution company. However, for all customers, who are located in a rural area (outside the city limits and not presently receiving gas service from an existing gas service utility) their quality of service and rates will no longer be regulated by the Commission. In addition, any individual, firm or company, regardless of their financial ability and qualifications to provide natural gas service, (referred to in the proposed legislation as a gas provider and defined as "any person that provides natural gas, transportation, supply management or other gas services and any related facilities associated with delivering natural gas) will be allowed on an unregulated basis to provide natural gas service to rural gas users. All facilities installed by these unregulated firms must comply with pipeline safety requirements, but these unregulated firms will not be subject to any other type of regulation under the proposed legislation. These unregulated firms will be allowed to charge their customers any rate that they can obtain from the customers and they will not be required to charge each customer the

same rate.

In addition to not providing a long term solution to the problems faced by natural gas customers in Southwest Kansas, the proposed legislation is simply contrary to good public policy. It is contrary to public policy because it would change the current law so that all future natural gas distribution service to rural users in Kansas (including areas just outside major urban areas) would be provided by unregulated firms, regardless of their financial ability to provide long term service, and regardless of their expertise to provide natural gas distribution service, at whatever price they could get each customer to pay. These unregulated firms would even be allowed to charge each customer a different rate. It is also contrary to public policy because the proposed law allows for multiple natural gas suppliers to provide service in the same area, thus eliminating any economies of scale. As indicated above, the elimination of economies of scale will lead to firms who are high cost providers and a large number of customers who will be denied the benefits derived by the economies of scale. Because there is no screening by the state of financial ability, and because the bill promotes competition, it is likely that some firms will face bankruptcy and customers will be faced with uncertainty.

VI. CONCLUSION

For the reasons set forth herein, it is our opinion that Senate Bill 547's premise that the problems in Southwest Kansas are caused by the fact that those customers live in a rural area is wrong. Furthermore, it is our opinion that the bill's proposed solution to the problems in Southwest Kansas is also wrong. The correct solution is to rely upon certificated utilities to continue to work with customers to take advantage of economies of scale to develop and implement a long term solution.

Finally, Senate Bill 547 not only fails to provide the correct solution to the problems faced by natural gas customers in Southwest Kansas, it is contrary to good public policy and should not be enacted by the legislature.

6-15

TS - 28 R - 34 Haskell COUNTY						TS - 28 R - 33 Haskell COUNTY						TS - 28 R - 32 Haskell COUNTY					
6	5	4	3	2	1	6	5	4	3	2	1	6	5	4	3	2	1
7	8	9	10	11	12	7	8	9	10	11	12	7	8	9	10	11	12
18	17	16	15	14	13	18	17	16	15	14	13	18	17	16	15	14	13
19	20	21	22	23	24	19	20	21	22	23	24	19	20	21	22	23	24
30	29	28	27	26	25	30	29	28	27	26	25	30	29	28	27	26	25
31	32	33	34	35	36	31	32	33	34	35	36	31	32	33	34	35	36
TS - 29 R - 34 Haskell COUNTY						TS - 29 R - 33 Haskell COUNTY						TS - 29 R - 32 Haskell COUNTY					
6	5	4	3	2	1	6	5	4	3	2	1	6	5	4	3	2	1
7	8	9	10	11	12	7	8	9	10	11	12	7	8	9	10	11	12
18	17	16	15	14	13	18	17	16	15	14	13	18	17	16	15	14	13
19	20	21	22	23	24	19	20	21	22	23	24	19	20	21	22	23	24
30	29	28	27	26	25	30	29	28	27	26	25	30	29	28	27	26	25
31	32	33	34	35	36	31	32	33	34	35	36	31	32	33	34	35	36

Dotted Red Lines
Current Main Extensions
Dotted Yellow Lines
Future main Extensions

Grey Area denoted
PWQ Certification

18-dual MW

CRS

Dark Blue Line
WVQ/Haskell System
Up and running

WVQ/Haskell TSS

WVQ/Haskell South
Project Planning Stage

1-tap

32-sublette