

Approved: March 2, 2006
Date

MINUTES OF THE HOUSE UTILITIES COMMITTEE

The meeting was called to order by Chairman Carl Holmes at 9:00 A.M. on January 11, 2005 in Room 231-N of the Capitol.

All members were present except:
Vaughn Flora- excused

Committee staff present:
Mary Galligan, Kansas Legislative Research
Dennis Hodgins, Kansas Legislative Research
Mary Torrence, Revisor's Office
Heather Klaasen, Research Intern
Renaë Hansen, Committee Secretary

Conferees appearing before the committee:
Ed Cross, KIOGA

Others attending:
See attached list.

Chairman Holmes asked if there were any more bill requests.

Representative Carl Krehbiel moved to offer a bill that would require individuals who sign up for a conference to opt in to get email from other companies or else the company would have to pay a fine. Seconded by Representative Jason Watkins. Motion passed.

Ed Cross, KIOGA, (Attachment 1), gave a power point presentation Oil and Gas: The Brave New World for Consumers and Energy Producers.

Questions were asked by Representatives: Peggy Mast, Tom Sloan, Josh Svaty, Carl Holmes, Margaret Long, Lynne Oharah, Rob Olson, Forrest Knox, Melody Miller, Jim Morrison, and Don Myers.

Representative Sloan moved to introduce a bill that would offer incentives for broadband deployment in non-urban areas. Seconded by Representative Jim Morrison. Motion Passed.

Chairman Holmes reminded members to be on time as the committee will often times work bills at the beginning of a meeting and committee members might miss a chance to add amendments or vote on a bill.

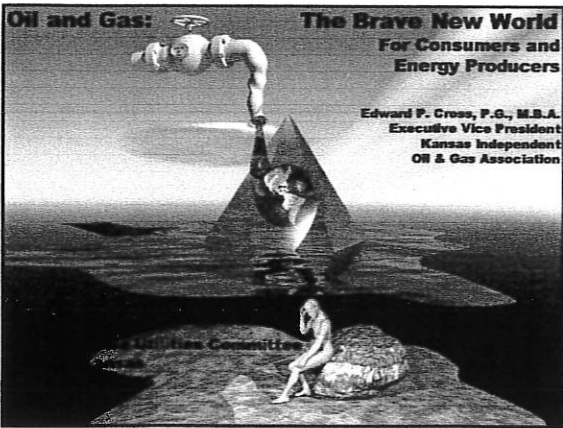
Next meeting scheduled for January 12, 2006.

Meeting Adjourned.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: January 10, 2006

NAME	REPRESENTING
Tom Day	KCC
Dave Holtzner	KEC
Tom Bruno	EILOGA
Steve Johnson	Kansas Gas Service / ONEOK
Lindsey Douglas	Hein Law Firm
Tom Pelorus	KS Petroleum Council
Ed Cross	KIOGA
Larry Berg	MIDWEST ENERGY
Jennifer Lyon	Pinegar, Smith, & Associates



Key Energy Issues

- ▶ Fossil Fuels provide over 80% of U.S. Energy Supply
- ▶ Oil & Natural Gas will provide 65% of Domestic Energy Needs for next 20-25 years
- ▶ Alternative Energy Investments will not alter U.S. Energy Mix for Decades
- ▶ Oil & Natural Gas Core Component

KIOGA

Key Energy Issues

- ▶ Independents drill 90% of wells in U.S.
- ▶ Independents provide 82% of America's natural gas supply
- ▶ Independents produce 68% of the crude oil in the lower 48 states
- ▶ 2005 John S. Herold, Inc. upstream petroleum review study said:
 - "Independent oil and natural gas producers plowed back 150% of their cash flow into new exploration and production operations nationwide."

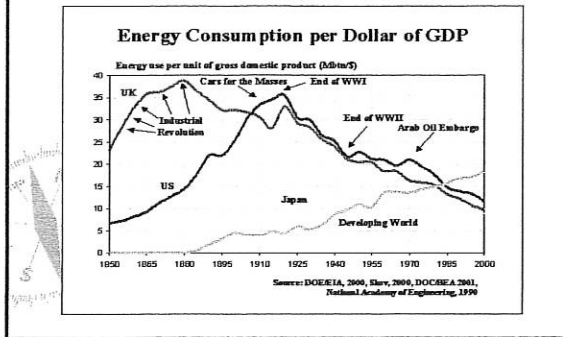
KIOGA

HOUSE UTILITIES

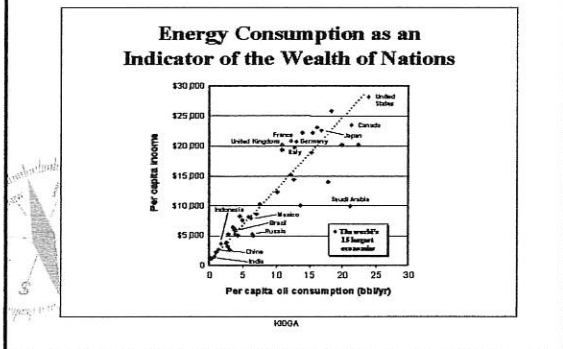
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ATTACHMENT 1

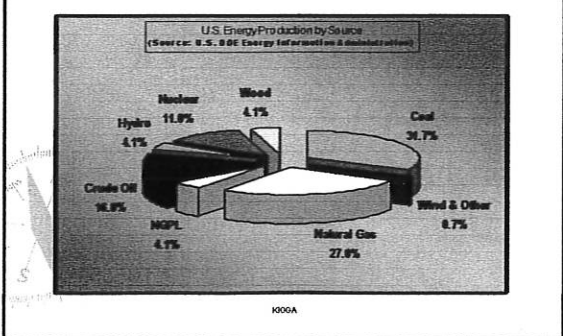
Energy Intensity



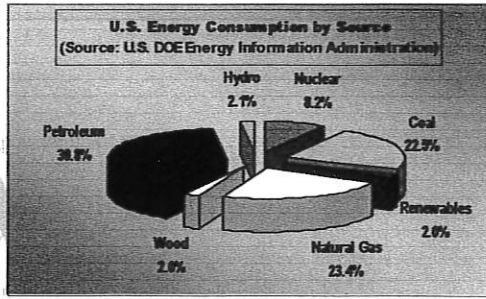
Defining National Quality



U.S. Energy Issues



U.S. Energy Issues

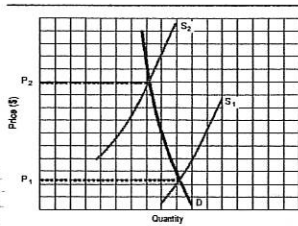


Crude Oil Market Structure

- ▶ Oligopoly
 - OPEC Cartel Collude to Influence Market Prices
- ▶ U.S. Producers are Perfect Competitors
 - Price-takers not Price-makers
 - Cost Structure Optimization Determines Profit
- ▶ OPEC Supply Leverage Diminishing

K006A

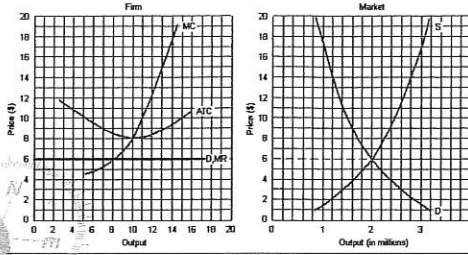
Withholding Supply to Raise Price



When supply is lowered from S₁ to S₂, price rises from P₁ to P₂

K006A

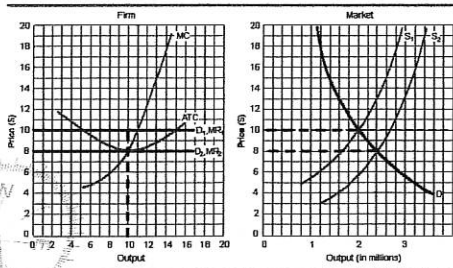
The Perfect Competitor



U.S. Oil & Gas Producers are Perfect Competitors
 Price-takers not price-makers. Internal cost structure determines profitability.

K000A

Effect of Supply Constraints on Perfect Competitor



U.S. Oil & Gas Producers Strive to Improve Operating Efficiencies

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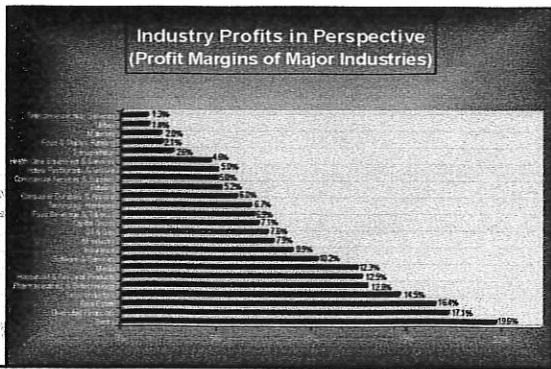


Capital Intensive Industry



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Industry Profit Margin Comparisons



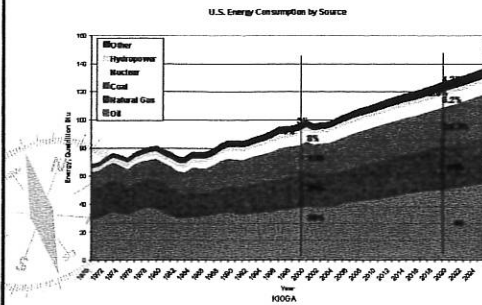
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New World Realities

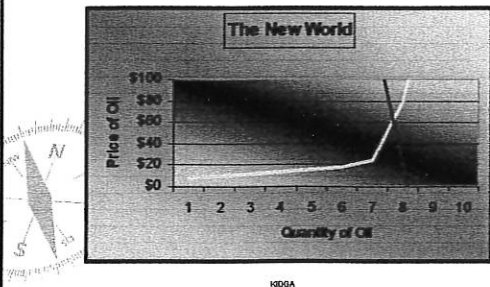
- ▶ OPEC and non-OPEC Nations have Reached Productive Capacities
- ▶ OPEC can Maintain Productive Capacity for 30-40 years
- ▶ Oil Prices will be Driven by Demand
 - EIA projects 1.6% Demand Growth through 2025
 - Chinese Oil Demand up 35% in 2004
- ▶ Future Oil Prices will be Demand Driven
- ▶ World Oil Demand Remains Inelastic
- ▶ World Oil Supply will become Increasingly Inelastic
- ▶ E&P Costs up more than 64% over last 4 years

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US ENERGY CONSUMPTION



OPEC Supply Leverage Diminishing



New World Realities

- ▶ Demand and Supply Inelasticities Mean
 - When Demand Rises, Prices Rise Very High and Very Fast
 - When Demand Declines, Prices Fall Very Hard and Very Fast

▶ Oil price fluctuations could occur very quickly and vary over a wide range

New World Realities

- ▶ Energy security has emerged as the Strategic Driver.
- ▶ US presence in Iraq and avowed goal to "democratize" the region raises issue of the stability of a number of regimes in the Gulf.
- ▶ Terrorists attacks heighten perception of oil facilities being at risk.
- ▶ Emergence of China and India as large crude oil importers.
- ▶ Energy security issues add bullish factor to crude oil prices.

KODIA

New World Realities for Gasoline

- ▶ Much Higher Prices will need to be seen before Demand Destruction becomes a Reality
- ▶ Consumer Conservation
 - 1970's = 5% of Total Household Income Spent on Gasoline
 - Today = 2% of Total Household Income Spent on Gasoline
- ▶ Alternative Fuels

KODIA



Kansas Oil & Gas Industry Statistics

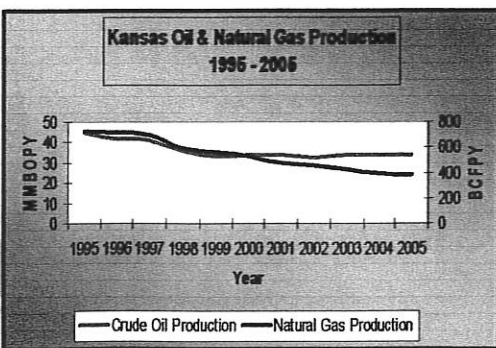
- ▶ First Oil Well = 1860
 - Miami County
- ▶ First Natural Gas Well = 1873
 - Montgomery County
- ▶ Current # of Oil Wells = 40,850
- ▶ Current # of Gas Wells = 18,376
- ▶ Current # of Injection Wells = 15,428
- ▶ Current Total # of Wells = 74,654
- ▶ Current # of Operators = 2,113
- ▶ Current Oil Production
 - 33.842 Million Barrels Annually
 - 92,718 Barrels per Day
 - Ranked 8th Among 31 Oil Producing States
- ▶ Current Natural Gas Production
 - 399.158 Billion Cubic Feet Annually
 - 1.09 Billion Cubic Feet per Day
 - Ranked 7th Among the 31 Natural Gas Producing States
- ▶ Drilling Permits Issued in 2005 = 3,704
- ▶ Drilling Rate = 92%
- ▶ Number of Active Drilling Rigs = 78

KDGA

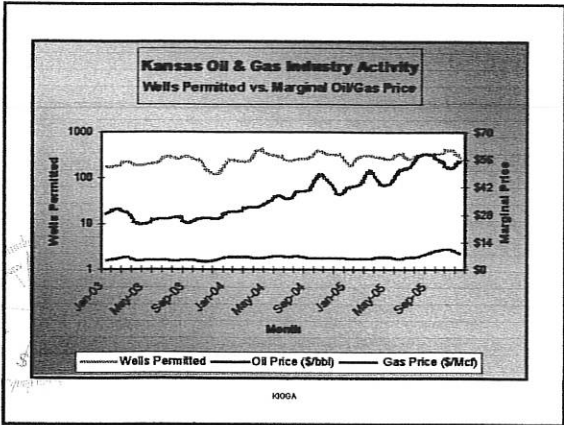
Kansas Oil & Gas Industry Statistics

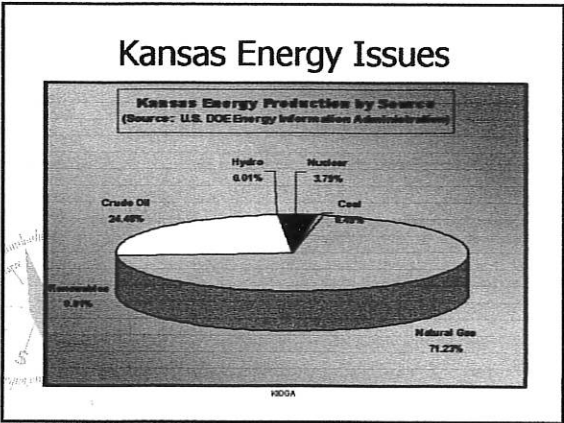
- ▶ \$4.7 Billion Industry
- ▶ 2nd Largest Kansas Industry
- ▶ Average Daily Oil Well Production = 2.09 BOPD
 - 74% of Total Kansas Oil Production from Stripper Wells
 - 80% of Total Oil Wells
- ▶ Average Daily Natural Gas Well Production = 32.8 Mcf/Day
 - < 1% of Total Kansas Natural Gas Production from stripper wells
 - 54% of Total Natural Gas Wells

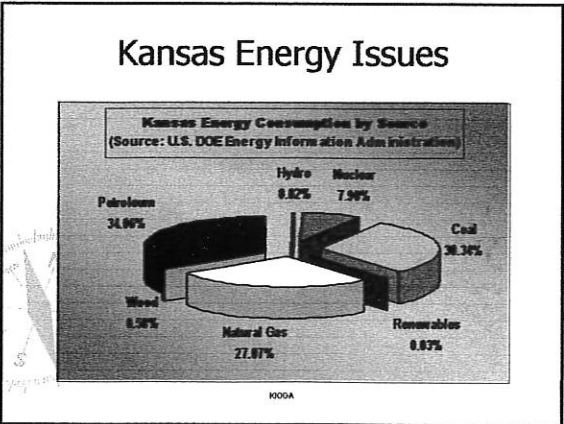
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Kansas Oil & Gas Industry Taxation

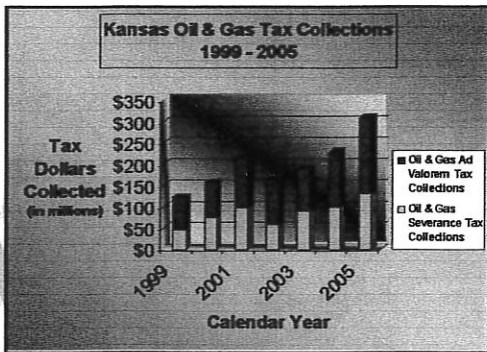
- ▶ Contributed over \$230 million in taxes to State of Kansas in 2004 and an estimated \$310 million in 2005
 - 2005 collections up over 34% from 2004
 - 2005 collections up over 151% from 1999
- ▶ Support Families/Fund Schools/Build Roads
- ▶ Kansas oil & gas producer taxed 5 times on each barrel of oil or Mcf of natural gas produced

KOOGA

Kansas Oil & Gas Industry Taxation

- ▶ Severance Tax
 - 4.33%
 - \$99.7 million collected in 2004
 - \$130 million estimated for 2005
 - ▶ Up over 30% from 2004
 - ▶ Up over 177% from 1999
- ▶ Ad Valorem Tax
 - Equipment
 - Reserves
 - \$131 million collected in 2004
 - \$180 million estimated for 2005
 - ▶ Up over 37% from 2004
 - ▶ Up nearly 136% from 1999

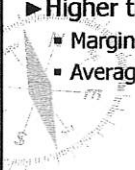
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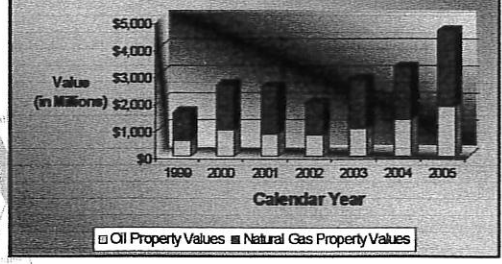
Kansas Oil & Gas Industry Taxation

- ▶ Reduce ROI on E&P Investments by 26.5%
- ▶ Higher than 6 surrounding states
 - Marginal Tax Rate
 - Average Effective Tax Rate



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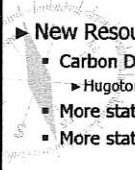
**Kansas Oil & Gas Value
1999 - 2005**



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Kansas Oil & Gas Industry Taxation

- ▶ Need Policies to Enhance Access to Capital
 - Develop & Maintain Production
 - Raise Capital Through Production
 - Oil & Gas Industry Workforce Development
- ▶ New Resources & Economic Development for Kansas
 - Carbon Dioxide (CO₂) Sequestration Potential in Kansas
 - ▶ Hugoton Field, Central Kansas Uplift, CBM Production Efficiency
 - More state, county, & local tax dollars
 - More state, county, local economic development



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Brave New World Conclusions

- ▶ Episode of higher and more volatile prices than anything witnessed in past two decades.
- ▶ New price episode likely to last several years, or until cyclical or structural price trends are impacted by higher prices.
- ▶ Higher prices will change the oil and gas industry as profoundly as lower prices did after 1986.

KDDA

A Brave New World

Kansas oil and gas is good for Kansas, the economy, and the nation. Energy policy focusing on energy value growth will result in economic growth and demonstrate leadership in formulating sound energy policy.

Thank You

KDDA

Kansas Independent Oil & Gas Association (KIOGA)

Founded in 1937, the Kansas Independent Oil & Gas Association (KIOGA) is a nonprofit member organization representing oil and gas producers in Kansas, as well as allied service and supply companies. The purpose of KIOGA, as stated in the original articles of incorporation, is “. . . to improve the market for oil and gas produced in Kansas and to promote the welfare of the oil and gas industry in the State of Kansas.”

With over 860 members, KIOGA is the lead state and national advocate for independent oil and gas producers in Kansas. The challenges facing the Kansas oil and gas industry continue to increase, in both number and complexity. Because of the efforts of KIOGA members, voters and policymakers in Kansas are learning that the oil and gas industry is working for them, the economy, and the environment.

Kansas Oil & Gas Industry Statistics

The Kansas oil and gas industry is a \$4.7 billion industry that puts tens of thousands of people to work each day and pumps hundreds of millions of dollars into the state's economy each year, money that helps support families, fund schools, and build roads. The average oil and gas producer in Kansas employs 3 people and spends nearly \$2 per barrel of oil produced on environmental protection. Oil and gas is produced in 89 of Kansas' 105 counties and the average well depth is about 3,500 feet. The Kansas oil and gas industry does more than fuel Kansas and help the Kansas economy. The industry fuels America and makes significant positive contributions to our way of life.

Date First Oil Well Drilled: 1860 in Miami County

Date First Gas Well Drilled: 1873 in Montgomery County

Date of First Oil Production: 1889

Date of First Natural Gas Production: 1882

Current Number of Oil Wells: 40,850

Average daily oil well production = 2.27 bbls.

Current Number of Natural Gas Wells: 18,376

Average daily natural gas well production = 63 Mcf

Current Number of Class II Injection Wells: 15,428

Current Number of Licensed Operators (Oil &/or Gas Producers): 2,113

Current Oil Production Level: 33.842 million barrels of oil per year
92,718 barrels of oil per day
Ranked 8th among the 31 oil producing states

Current Natural Gas Production Level: 399.158 billion cubic feet per year
1.09 billion cubic feet per day
Ranked 7th among 31 gas producing states

Number of Permits to Drill in 2005: 3,704 (2004 = 3,596, 2003 = 2,626, 2002 = 1,716)

Drilling Rate (Percentage of drilling permits actually drilled): 92%

Current Number of Wells being Drilled: 78

2nd largest industry in Kansas in terms of Gross State Product
Employs approximately 6,000 Kansans in the production process
Employs an additional 17,000 Kansans in related services

Contributed over \$230 million in taxes during calendar year 2004

Contributed an estimated \$310 million in taxes during calendar year 2005

Severance tax collections increased over 179% from 1999 to 2005

Ad valorem tax collections increased over 131% from 1999 to 2005

Kansas crude oil production declining by an annual average of 2.9%

Kansas natural gas production declining by an annual average of 6.4%

Information About Oil

What is oil? Oil, commonly referred to as petroleum, is a naturally occurring substance made up a mixture of hydrogen and carbon compounds. Hydrocarbons occur as liquids, gases or solids.

How is petroleum created? Petroleum originated from marine plants and animals that decayed over time under ocean silt, sand or other materials. Millions of years, extreme pressure and heat transformed the biotic material into petroleum.

When was the first oil well discovered? In August of 1859, at Titusville, Pennsylvania, Col. Edwin Drake drilled the first oil well. The discovery at 69.5 feet in the Oil Creek formation was significant in that it demonstrated the practicality in drilling. Oil was first discovered in Kansas in 1860 in Miami County.

Are we running out of oil? Fossil fuels supply almost 95% of the world's energy and nearly 86% of the U.S. energy, even though hydro, nuclear and geothermal energy use has tripled since 1970. According to API statistics, world proven oil reserves are estimated at well over one trillion barrels, enough to last almost fifty years at current rates of consumption.

What about the environment? The oil and natural gas industry spends more than \$10 billion annually to protect the environment worldwide—as much as the top 300 oil and natural gas companies earn in profits and more than the entire industry spends searching for oil and natural gas in the United States. Kansas' oil and natural gas industry has traditionally produced oil and natural gas to help meet the energy needs of society. Today's committed Kansas oil and natural gas producer continues to exercise their traditional service while still meeting their responsibility to protect the environment.

How is petroleum used? Oil and natural gas are an integral part of our society. Much of our high standard of living can be traced to the use of petroleum. Today, an estimated 6,000 products are produced from petroleum. Among these products are the many types of transportation fuels, industrial fuels and chemicals, residential fuels, lubricants, waxes, asphalt, fertilizers, pesticides, photographic film, plastics and medicine.

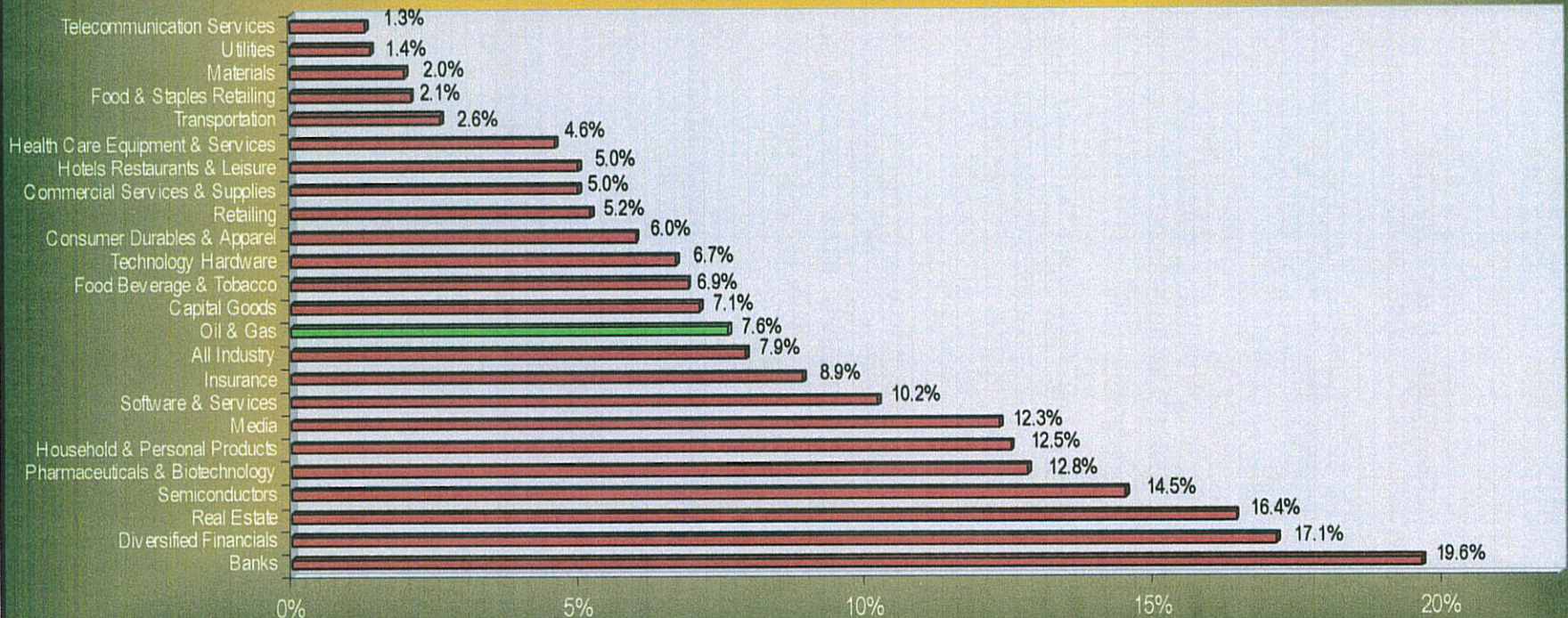
Oil & Natural Gas Industry Profit Margins Compared to all U.S. Industry

9/1-1

The oil & natural gas industry is one of the world's largest industries. The industry's revenues are large, but so too are the costs of providing consumers with the energy they need. The cost of finding and producing oil and natural gas and the costs of refining, distributing, and marketing the oil and natural gas have increased dramatically in the last few years. As a result, the oil & natural gas industry's earnings are very much in line with other industries and often are lower. This fact is not well understood, in part, because many reports focus on profits earned and not profit margin. Profits earned reflect the size of an industry and are not necessarily a good reflection of financial performance. Profit margins, on the other hand, provide a more relevant and accurate measure of an industry's financial health.

Profit margin measures financial performance as earnings per dollar of sale and is measured as net income divided by sales. Profit margin analyses provide a useful way of comparing financial performance between industries of varying sizes. The latest published data covering the period from the third quarter of 2003 through the second quarter of 2005 shows the oil & natural gas industry's profit margin at 7.6% compared to an average of 7.9% for all U.S. industry. Over the last five years, the oil & natural gas industry's profit margin averaged 5.7% compared to an average for all U.S. industry of 5.5%. The following graph illustrates this point. The source for the graph is "Profit Profile" from *Oil Daily* for oil and natural gas companies, and "Corporate Scoreboard" from *Business Week* for all other industries.

Industry Profits in Perspective (Profit Margins of Major Industries)



9/1-1

Comparative Product Prices versus Crude Oil

The following is a list of average prices of commonly purchased goods in the U.S.

Product	Price	Normal Size	Volume Ounces	Price \$/Gallon	Price \$/Barrel
Crude Oil – Kansas Common	\$58.00	1 Barrel	5376	\$1.38	\$58.00
Regular Unleaded Gas (pre tax)	\$2.35	1 Gallon	128	\$2.35	\$98.95
Regular Unleaded Gas (after tax)	\$2.79	1 Gallon	128	\$2.79	\$117.18
Coca Cola	\$1.19	2 Liter	67.6	\$2.25	\$94.50
Poland Spring Water	\$1.39	1.5 Liter	50.7	\$2.63	\$110.46
Milk – 2%	\$2.59	1 Gallon	128	\$2.59	\$108.78
Evian (Bottled Water)	\$1.79	1.5 Liter	50.7	\$4.52	\$189.80
Orange Juice	\$2.69	.5 Gallon	64	\$5.38	\$225.96
Snapple	\$1.50	1 Quart	32	\$6.00	\$252.00
Perrier (Bottled Water)	\$2.79	4 Pack	44	\$8.12	\$340.89
Budweiser	\$4.79	6 Pack	72	\$8.52	\$357.65
Crisco Cooking Oil	\$2.19	1 Quart	32	\$8.76	\$367.92
Lemon Oil	\$3.49	48 Ounces	48	\$9.31	\$390.88
Scope Mouthwash	\$3.69	24 Ounces	24	\$19.68	\$826.56
Sunflower Oil	\$2.89	16 Ounces	16	\$23.12	\$971.04
Ben & Jerry's Ice Cream	\$3.29	16	16	\$26.31	\$1,105.44
Olive Oil	\$10.99	1.5 Liter	50.7	\$27.75	\$1,165.33
Pinot Grigio (Italian White Wine)	\$12.99	1.5 Liter	50.7	\$32.80	\$1,377.40
Head & Shoulders Shampoo	\$4.59	15.2 Ounces	15.2	\$38.65	\$1,623.41
Real Maple Syrup	\$4.59	12 Ounces	12	\$48.96	\$2,056.32
Sesame Oil	\$5.99	12.7 Ounces	12.7	\$60.37	\$2,535.61
Tabasco Sauce	\$0.99	2 Ounces	2	\$63.36	\$2,661.12
Jack Daniels	\$19.49	.75 Liter	25.3	\$98.61	\$4,141.43
Tanning Oil	\$4.99	5 Ounces	5	\$127.74	\$5,365.25
Remy Martin Champagne	\$36.99	.75 Liter	25.3	\$187.14	\$7,860.01
Visine	\$5.99	1 Ounce	1	\$766.72	\$32,202.24
Flonase (Prescription Nasal Spray)	\$64.59	16 Grams	.56	\$14,763.45	\$620,064.00

Gasoline Taxes

A federal tax of **18.4** cents per gallon is collected in all states in addition to any state or local taxes on gasoline sales.

State	State & Local Tax (Cents/Gallon)	State	State & Local Tax (Cents/Gallon)
Alabama	21	Montana	27.8
Alaska	8	Nebraska	25.5
Arizona	19	Nevada	33.2
Arkansas	21.5	New Hampshire	20.6
California	32.4	New Jersey	14.5
Colorado	22	New Mexico	18
Connecticut	30.1	New York	32.95
Delaware	23	North Carolina	24.55
DC	20	North Dakota	21
Florida	30.2	Ohio	24
Georgia	12.7	Oklahoma	17
Hawaii	36.3	Oregon	24
Idaho	25	Pennsylvania	27.3
Illinois	26.7	Rhode Island	31
Indiana	23.3	South Carolina	16.75
Iowa	21.30	South Dakota	24
Kansas	25	Tennessee	21.4
Kentucky	21.4	Texas	20
Louisiana	20	Utah	24.5
Maine	26.1	Vermont	20
Maryland	23.5	Virginia	18.1
Massachusetts	23.5	Washington	28
Michigan	27.2	West Virginia	25.35
Minnesota	22	Wisconsin	31.5
Mississippi	18.8	Wyoming	14
Missouri	17	Federal Tax	18.4

Why gasoline prices are going up

1 High crude oil prices

2 Restricted world supplies

5 Strong global demand

3 OPEC

6 China

4 Political instability in oil-rich nations

7 US



8 Tight gasoline markets

9 Supply growth not keeping up with demand

19 Strong demand growth

10 US gasoline imports down sharply

15 Record refinery production but constrained capacity growth

20 SUV growth

11 New US fuel specifications

21 Growing US economy

12 High transport rates

Environmental 16
New government-mandated fuel specifications

13 Low European inventories

Political 17
'Not in my backyard'

14 Political instability: Venezuela

Economic 18
Low rates of return for refiners



Where does your gasoline \$ go?

.44	.24	.32
Crude oil	Taxes	Refining/marketing

Sources: EIA, API

TRY TO Imagine Life Without Oil & Gas

Products of Oil & Gas



GASOLINE

Gasoline is the most important petroleum product. It is used to fuel automobiles, motorcycles, trucks, golf carts, lawn mowers and edgers.



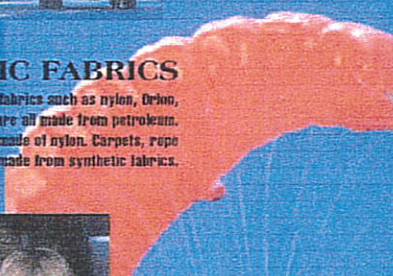
SYNTHETIC RUBBER

Synthetic rubber was developed during World War II. Today we see it in gloves, tennis shoes, boots, swimming floats, balls, hoses, stoppers, tires, rubber bands, belts, skate wheels, shoe heels and balloons.



SYNTHETIC FABRICS

Synthetic fabrics such as nylon, Orlon, Dacron and Dynel are all made from petroleum. Parachutes are made of nylon. Carpets, rope and Astro-Turf are made from synthetic fabrics.



PLASTICS

Plastics come in a large variety. Everything from bowling balls to camera film to garbage cans.



WAXES

Waxes are used to make waxed paper, candy, gum, candies, soap and crayons.

MEDICINES

Medicines such as aspirin, antihistamines, Vaseline, alcohol, ammonia, antibiotics and antiseptics all contain petrochemicals.



CARBON BLACK

Carbon black goes into paints and inks, rubber and cement, batteries and radio and television tubes.



NATURAL GAS & PROPANE

Natural gas and propane cook our food, heat our homes and workplaces, and make petrochemicals and plastic products we use every day.



COSMETICS

Today, soap, cleansing creams, toothpaste, toothbrushes, combs, curlers, shampoos, hair spray, lotion, cologne, baby oil, lipstick, eyebrow pencil, nail polish, hand cream, shaving cream and suntan lotion all come from oil.



Voice of the Kansas
Independent Petroleum Industry

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