

## MINUTES OF THE SENATE UTILITIES COMMITTEE

The meeting was called to order by Chairman Jay Emler at 9:30 A.M. on March 8, 2007 in Room 526-S of the Capitol.

Committee members absent:

Committee staff present: Raney Gilliland, Kansas Legislative Research Department  
Mike Corrigan, Revisor of Statutes  
Tatiana Lin, Legislative Fellow  
Ann McMorris, Committee Secretary

Conferees appearing before the committee:

Leo Haynos, Kansas Corporation Commission  
Alan Degood, American Energies Corporation  
David Scharf, ONEOK Field Services  
David Bleakley, Eastern Kansas Oil & Gas  
Bill McKean, American Pipeline Company

Others in attendance: See attached list

Chair continued the hearing on

**SB 325 - State corporation commission jurisdiction over gas gathering systems**

Opponents:

Alan DeGood, President, American Energies Corporation, reviewed the makeup of his company and their operations. He felt **SB 325** would create problems for the small gas gathering company. Safety is a big factor in raw gas useage. (Attachment 1)

David Scharf, Vice President, Gathering and Processing, ONEOK Partners, testified that ONEOK Field Services Company, LLC believes **SB 325** is inappropriate, unnecessary and would be unduly burdensome to both gas gatherers and to state offices charged with interpreting and enforcing the law. **SB 325** moves the gas gathering industry of Kansas away from its existing structure and intended function. (Attachment 2)

David Bleakley, Eastern Kansas Oil and Gas, voiced their concerns that **SB 325** would change gas gatherers to distributors. EKOGA strongly urged the committee to vote against **SB 325**. (Attachment 3)

Bill McLean, manager of business development, American Pipeline Company, Wichita, listed three issues for the committee to consider: (1) How often do the primary function and the secondary function of a gathering system conflict with each other?; (2) Is it possible for KCC to determine a fair and reasonable transportation rate for the secondary function to transport gas to irrigation taps?; and (3) How may NPUs will be created throughout Kansas? (Attachment 4)

Neutral

Leo Haynos, Chief of Gas Operations and Pipeline Safety for the Kansas Corporation Commission, provided an Overview of KCC Final Order in Docket 06-GIMG-400-GIG regarding gas gathering systems. He presented a power point program on gas gathering progression. (Attachment 5)

Chair closed the hearing on **SB 325**.

Dick Brewster, BP, presented a memorandum setting forth proposed language to be drafted into a substitute bill **SB 325**. These concepts have been reviewed with representatives of those supporting **SB 325** that agree these concepts can be workable and while there is not unanimity of those supporting or opposing **SB 325**, there is a consensus that believes a bill with these concepts can be workable. (Attachment 6)

CONTINUATION SHEET

MINUTES OF THE Senate Utilities Committee at 9:30 A.M. on March 8, 2007 in Room 526-S of the Capitol.

Moved by Senator Lee, seconded by Senator Pine, the revisor be directed to draft **Substitute Bill 325** with the provisions set forth in the March 8, 2007 Memorandum for review and consideration by the Senate Utilities committee on Tuesday, March 13, 2007. Motion carried.

Adjournment.

Respectfully submitted,

Ann McMorris, Secretary

Attachments - 6

# SENATE UTILITIES COMMITTEE GUEST LIST

DATE: MARCH 8, 2007

Name	Representing
TOM DAY	KCC
BOB ANDERSON	AQUICA
James G. Flaherty	Pioneer
Charlie Sizemore	Pioneer
Leo Haynos	KCC
HARRY BIRG	MIDWEST ENERGY
STEVE JOHNSON	ONEOK
DAVE SCHARF	ONEOK FIELD SERVICES
Lon STANTON	NORTHERN NATURAL GAS
Tom Bruno	ERGGA
David Blakely	Cott Energy
STHELBY SMITH	—
Frank Cox	PER Irrigators
DON LOW	KCC
Alvin H. Best	American Energy Corp.

# SENATE UTILITIES COMMITTEE GUEST LIST

DATE: MARCH 8, 2007

Name	Representing
Dennis Stell	DCP Midstream
Tack Graves	" "
<del>Allic</del>	<del>Ks. Livestock Assoc.</del>
Mike Beam	Ks. Livestock Assn.
Matt Tomc	KCC
Whitney Jaman	ON EOC, Inc.
<del>Ken Peters</del>	<del>KC Petroleum Council</del>
Ed Cross	KIOGA
Ron Seiber	Oxy
Jon Callen	KIOGA
Doug Smith	SWKROA
Bill Melkun	WOOLSEY
Wes Ashton	Aquila



**Testimony for Public Hearing on S.B. 325  
Before the Senate Utilities Committee  
Kansas Senate  
February 21, 2007**

American Energies Corporation operates approximately 400 wells in Kansas and has two limited liability corporations. American Energies Gas Service, LLC (AEGS) is a rural utility which has approximately 240 customers, including irrigators. It operates under the Kansas Corporation Commission's rules and regulations, as a Class B Utility. American Energies Pipeline, LLC (AEPL) operates six small gas gathering systems with 147 miles of pipelines, all smaller than 6 inches in diameter. AEGS has 90 miles of pipeline, all smaller than 6 inches in diameter.

With our current AEPL gas gathering system and our production capabilities, S.B. 325 would cause a real problem, if passed. Each system, is sized for a minimum daily pressure and deliverability according to the compressor's capabilities. The average well volume delivering into the AEPL gathering system, is approximately 13 MCF/D. I am sure, that this number is average for many small gathering systems operated by Kansas operators.

Should a Non-Profit Utility (NPU) request an exit tap on many of our AEPL systems, we could not provide a stable flow of gas to both the NPU and the AEPL compressor. For example, one 150 HP irrigation engine will use approximately 36 MCF/D. If the NPU has 10 customers, that would equal 360 MCF/D on their demand. The NPU will not need our gas if it rains. Their market is very unreliable, and would force our gas to be sold on the spot market, at lower prices during the months they would require our gas.

AEPL owns and leases equipment and pipelines, with over \$5 million dollars invested in

these assets. AEPL pays transportation fees for 2,000 MCF per day to get the gas to AEGS. This assures AEGS and its customers, that we will have gas at their burner tip, and that these customers will be able to heat their homes and businesses. I find it strange that the NPU is requesting the ability for an exit tap into our gas gathering system, only then to request that the Kansas Corporation Commission regulate us and they, (NPU) remain exempt and non-regulated.

AEC has invested and is investing in the economy of Kansas by developing a sound business plan, which involves discovering new oil and gas reserves, marketing these reserves, thus benefiting the Kansas economy. AEC drilled or participated in the drilling of 48 new wells in 2006. AEPL laid approximately 20 miles of new gathering lines, and invested over \$200,000 in new line taps and meters. AEC paid nearly \$100,000 in firm transportation fees. AEGS expanded and is selling gas to the cities of Moundridge and Hesston, Kansas. We are also providing gas to three manufacturing companies in McPherson and Moundridge.

Liability and pipeline compliance is yet another concern which will create additional cost if exit taps are allowed. Insurance to transport gas is nothing compared to the insurance necessary for running a utility company with gas meters. Liability insurance would certainly be increased should a gathering system becomes a gas utility and begin selling to an NPU. Since the NPU is not regulated, the problems would be compounded if an accident should occur. The lawsuit would probably involve the gas utility which sold the gas.

The gas which goes thru our AEPL and AEGS lines has a dedicated market, which provides gas to our residential and manufacturing customers. We are strictly monitored under current gas contracts, nominations, and the Kansas Corporation Commission's rules and regulations.

Alan L. DeGood, President  
American Energies Corporation



Before the Senate Utilities Committee  
SB 325  
Testimony of David Scharf, Vice-President  
ONEOK Partners  
100 W. Fifth Street, Tulsa, Oklahoma  
918-588-7976  
February 21, 2007

Chairman Emler and Members of the Committee,

My name is Dave Scharf. I am the commercial Vice-President of the Gathering and Processing segment of ONEOK Partners, the owner of ONEOK Field Services Company, LLC ("OFS"). OFS owns and operates more than 5,100 miles of natural gas gathering pipelines in the State of Kansas from which it gathers gas from more than 5,700 wells. I appear before you today in opposition to Senate Bill 325.

OFS believes this bill is inappropriate, unnecessary, and would be unduly burdensome to both gas gatherers and to state offices charged with interpreting and enforcing the law. It is such a radical departure from existing practices that the consequences of its implementation can't be adequately foreseen. However, at a minimum, it would result in pointless effort and expense, and it would likely cause the premature abandonment of wells and loss of associated reserves – either directly, via higher line pressures that facilitate tap deliveries but inhibit production, or indirectly, through lower wellhead netback values.

Our gathering systems were built and are operated to efficiently move the maximum amount of gas practical to processing plants where the value of the gas and its components can be enhanced and delivered to markets. Declining pressures, reduced

volumes, underutilized processing facilities, and aging equipment put considerable pressure on this business, and gatherers have had to be nimble and resourceful to maintain efficient and profitable operations. Common carrier or public utility status, even for limited agricultural use, would be an additional impediment to effectiveness that this industry, and the state, can ill-afford.

OFS and other gatherers are sympathetic to the needs of agricultural users, but passage of this bill will not solve the underlying problems of the decline in Hugoton field volumes and pressures, or remedy the issues encountered when delivering raw natural gas to an end-use customer. This is not to say that there is no situation where gas can be used for agricultural purposes. We have offered, individually and as an industry, to consider specific applications – for instance, consolidating taps on low pressure lines so they could be fed from a more secure and reliable source of gas. However, we believe declaring gas gathering systems to be common carriers and public utilities for certain uses will impede, rather than encourage progress on finding such accommodations.

OFS has affiliates that are fully regulated utilities and/or common carriers, with attendant tariffs, rate-making procedures, gas control facilities, regulatory personnel, and so on. These are good businesses, but I respectfully submit to the Committee, they are fundamentally different businesses than gas gathering and processing. Reaction times are much slower, and expenses per unit tend to be much higher. Despite significant quality issues in our raw gas systems, agricultural users prefer to get gas from gathering systems rather than interstate pipelines, precisely because tap costs are much less, and gatherers can move more quickly and are more responsive to operational problems. SB 325 would move the gas gathering industry of Kansas away from its existing structure and intended

function (that it performs well), to a hybrid structure and mixed function that OFS believes would be inefficient and ultimately ineffective in addressing the needs of both the producing and agricultural industries.

OFS urges a Do Not Pass recommendation for this bill.

**SENATE UTILITY COMMITTEE**  
**February 21, 2007**

**RE: SB 325 - An Act concerning Natural Gas; relating to gas gathering facilities amending K.S.A 55-1,102, 55-1,104, 55-1,109, 66-104c and 66-2101 and K.S.A. 2006 Supp. 66-104 and 66-105a and repealing the existing sections.**

Legislative Chairman	Testimony of David Bleakley -
Association	Eastern Kansas Oil and Gas
Management	& Director of Acquisitions & Land Colt Energy, Inc.

The Eastern Kansas Oil and Gas Association (EKOGA) strongly opposes amending K.S.A 55-1,102, 55-1,104, 55-1,109, 66-104c and 66-2101 and K.S.A. 2006 Supp. 66-104 and 66-105a and repealing the existing sections.

Our association represents and supports eastern Kansas oil and gas producers, gas gatherers, service companies, royalty owners and associated businesses along with the overall welfare of the Kansas oil and gas industry in this state.

**BACK GROUND ON EASTERN KANSAS**

Eastern Kansas and in particular Southeastern Kansas has been experiencing a boom in shallow gas production thru the major development of coalbed methane gas (CBM) over the last nine years. Several hundred miles of new gas gathering pipeline has been installed to bring this gas to market. This gas production has generated millions of dollars in severance tax and conservation fee fund tax going to the state general fund and the Kansas Corporation Commission, not to mention the millions of dollars the counties have derived from the new personal property taxes being assessed on all of these new wells, pipelines and assets. Numerous Gas Companies collectively have invested several hundred million dollars to bring this boom to fruition. Most of these companies have drilled their own wells in one company, operated their wells in another and have an affiliate company build the gas gathering systems and compression to move their gas to the market. Some of the companies gather third party gas, but none of them consider themselves a public Utility and what's more they don't want to be.

**OUR CONCERNS**

1. This appears to be a regional battle between the Southwest Kansas Corn Growers association and the southwest Kansas gas gatherers and to a

Senate Utilities Committee  
March 8, 2007  
Attachment 3-1

smaller extent the gas producers. Our question is, why should the rest of the gas producers and gas gatherers in the state be pulled into this regional battle thru legislation and a bill that sets up the KCC as court and the policeman to monitor, referee and enforce; access to a gathering lines, fees charged for selling and transporting gas, and when a gas gatherer would be allowed to abandon a segment of their own pipeline?

2. Who is going to pay for the additional KCC manpower necessary to accomplish the above requirements if this bill would pass? The answer is the entire oil and gas industry across the State thru an increase in the KCC conservation assessment. This assessment was just recently raised 41% on December 22, 2006 do the fact that the oil and gas division of the KCC needed additional funding to operate. Additional manpower means additional cost which means additional KCC conservation assessments to the oil and gas industry.
3. What obligations do any gas gatherers have to give open access to anyone who wants it, just because they want a cheaper energy source than they can find anywhere else in their area? Doesn't a private pipeline have a choice to sell or not sell gas to anyone they want to under private negotiations based on economics and a business decision.
4. Most gas gatherers are not Public Utilities and don't want to be because they were organize to drill, develop, produce and gather gas to deliver into major pipelines and not for the purpose of distributing gas to individuals.
5. This bill would not encourage the drilling, development and new pipelines being laid to bring this gas to market and we believe would actually discourage and make companies rethink their investing in gas in Kansas that has been such a windfall for the state and counties.

## **CONCLUSION**

The Hugoton gas field has been producing gas since 1928 (79 years) and has been a major revenue source for the state and has supplied gas not only to this state, but to the county over those years. It has also provide royalty owners and mineral owners with hundreds of millions of dollars of royalty income and landowners, irrigators and other rural consumers with cheap natural gas for a very long time period outlasting most gas fields many times over. Now as the old adage goes "all good things come to an end" and the Hugoton gas field is no exception and although it is not yet finished producing, it is in a very mature stage of it production life. Many landowners, irrigators and rural customers in southwest Kansas have come to look at the gas from the Hugoton field as almost a birthright having free gas taps and cheap gas passed down from grandfather to father to son, but as the proponents said themselves yesterday



they do have irrigation pumps running on electricity and other energy sources besides natural gas. This begs the question, why are we here trying to pass a bill and legislate gas gatherers state wide over a dwindling resource of natural gas specifically located in southwest Kansas and in particular for relative small group of beneficiaries instead of the landowners, irrigators and rural customers looking for long term solutions to their energy needs in that part of the state. Why aren't energy sources such as ethanol (based on corn), propane, diesel, electricity, solar (although not as cheap as natural gas) being planned for and implemented for the future. We understand this is not an easy transition period both financially or for the sake that it has been this way for so long for the landowners, irrigators and rural customers, but a prudent business person must agree legislation is not the long term answer to this problem only securing other energy sources for the future will be the real answer.

Therefore, Mr. Chairman and members of this Committee, **EKOGA WOULD STRONGLY URGE YOU TO VOTE AGAINST SB 325** and let the gas gatherers do what they were setup in business to do and that is move gas from producing wells in the fields to the major gas transmission lines greatly benefiting the State, the counties and all the citizens of Kansas.

Thank you for your time.

David P. Bleakley

**TESTIMONY IN OPPOSITION TO SENATE BILL 325  
BY BILL MCKEAN - MANAGER OF BUSINESS DEVELOPMENT  
AMERICAN PIPELINE COMPANY, LLC , A SUBSIDIARY OF WOOLSEY  
ENERGY CORPORATION – WICHITA, KANSAS**

Woolsey Energy Corporation is a small, independent oil & gas producer with integrated operations in South Central Kansas. We operate 300 wells that are connected to the gathering systems owned by Lumen, ONEOK and our subsidiary, American Pipeline Company. Our system gathers 9,000 Mcf per day from 120 meters operated by Woolsey and 70 meters operated by 31 other producers. The gathering system also supplies a small amount of gas (10 Mcf per day) to 6 regulated farm taps that are owned by Kansas Gas Service. The 6 farm tap meters are not used for irrigation..

American Pipeline Company has two customers or shippers: an affiliate, Bluestem Gas Marketing, which purchases gas from 178 meters and Kansas Gas Services which purchases gas from the other 12 meters. Both customers have identical percentage of proceeds contracts with American Pipeline Company. Bluestem offers it 31 party producers the identical gas purchase contract that it made with its affiliate, Woolsey Energy Corporation. Bluestem passes the American Pipeline Company gathering & processing charges back to producer. The contract terms for the 31 producers have not changed in 9 years. The producers can make long-term plans to develop their reserves because every one producer receives the same gathering-processing deal for every meter whether the well produces 20 Mcf or 500 Mcf per day.

From our perspective as a small producer being served by ONOEK, a large gathering system operator, and as a small gathering system operator serving 31 producers, there are 3 main sets of issues that we hope that the committee will carefully consider:

1. How often do the primary function and the secondary function of a gathering system conflict with each other? How many years should the gathering systems be expected to supply gas to rural customers? Does it make sense for the irrigators and NPUs to invest in infrastructure, irrigation wells and farm equipment if the gathering system operator can not commit to supplying gas for more than a 3 year period?
2. Is it possible for the KCC to determine a fair & reasonable transportation rate for the secondary function to transport gas to irrigation taps? Are the small gathering system operators able to negotiate supply contracts with an NPU with out the threat of KCC intervention?
3. How many NPUs will be created through out Kansas? Will the KCC staff be able to handle the additional work load from small NPUs petitioning for KCC intervention?

After hearing several hours of testimony, we do not feel that the Committee needs to be

educated on pipeline or gas plant engineering. We concur that if there are no problems with gas qualities and if there substantial developed and undeveloped gas production spread through out the gathering system, a gathering system should be able to serve both the producers and the irrigators with out any conflicts. However our industry experience has proven that these two assumptions are too idealistic because gas quality, production and line pressures can vary dramatically over a short period of time in different segments of a gathering system. We would like to present the American Pipeline Company and the Rolling Thunder gathering systems as two case studies for the Committee to consider.

The most important point we would like to reiterate is that every gathering system is unique and is in its own life cycle. For example, American Pipeline was created in 1997 when Woolsey combined the unregulated gathering system purchased from a major oil company that moved out of Kansas with the regulated gathering system purchased from Westar. The American Pipeline Company processing plant was installed in 1997 when the Westar gathering system was deregulated. The classic deregulation model has worked well because we were able to extend the life of both gathering systems by finding new reserves. Two sophisticated large companies sold their marginal assets to smaller company that was more focused on providing better services (lower line pressure & line losses) and to secure a better gas market. The royalty owners, the existing producers and the ad valorem & state severance taxing authorities all benefited from deregulation because the new owner, American Pipeline Company had a greater incentive as a reserve owner to provide better service at a lower cost than its predecessor, Westar.

However despite the incentives, the decreased commodity prices caused lower drilling activity in the late 1990's resulting in system volumes declining by 47% over a 3 year period from a peak of 12,000 mmbtu per day in January 2000 down to 6,400 mmbtu per day in February 2003. We were concerned because the economic limit to operate the plant & gathering system was approximately 4,500 mmbtu/day. As the chart demonstrates, American Pipeline's profits fluctuated wildly during this 3 year period due to the swings in commodity prices for gas and natural gas liquids.

The lesson to be learned from the APC history is that deregulation works if the royalty owners, the well owners, the gathering system operators and the county & state taxing authorities have parallel interests to maximize gas production, to minimize line losses and line pressures and to have a fair long-term sharing arrangement so that every one can succeeds during both the good times and bad times. Because hind sight is 20-20, it would have been a financial disaster for every one involved if an KCC arbitrator ordered American Pipeline to provide 2,000 mmbtu/day to an NPU based on the assumption that undeveloped reserves would be drilled to replace production lost due to production declines. Bankers do not like to lend a lot of money to drill new wells when commodity prices are low. The KCC can not predict long-term commodity prices and does not have the geological or reservoir engineering expertise to predict if reservoirs will be replaced to insure a stable gas supply to an NPU. However because Woolsey Energy Corporation is in the business about making assumptions about the future commodity prices and about the potential production from undeveloped reserves, we would have considered making a firm commitment to supply gas to a credit worthy NPU on a 5 year deal if we thought that the incremental profit warranted the risk. Because there are so many unique variables to

be considered, only the producer-gatherer rather than the KCC staff is able to determine if a mutually beneficial long-term gas supply contract can be made with a NPU.

The second real life case study for the Committee to consider is the recent bankruptcy of the Rolling Thunder gathering system in Pawnee & Edwards County. A year before it went bankrupt, the owners invited our company to perform due diligence and make a bid to purchase the gathering system and the affiliated utility company. Even though our company did not have any production on the system, we took the time to study the system because we were familiar with the area and thought that we could negotiate a joint venture with the largest producer on the system if the economics were justified.

Even though the rural customers were paying fat margins above the index price to purchase substantial volumes of gas during the irrigation season, we quickly determined that the gathering system had reached a critical point in its life cycle because its volumes had declined so far that it could not simultaneously serve both the producer and the irrigators. We determined that the out of state owners of the Rolling Thunder system had purchased the system only two years earlier from the Kansas Gas Services utility (we assumed at a bargain price due to the system's marginal economics. We were also very concerned that less valuable high nitrogen, low BTU gas was plentiful, but that high BTU production that could be burned by the irrigators had declined too far. The system operator was importing processed gas from an interstate pipeline during the irrigation season. Because the gas flow was being reversed, system line pressures became too high during the summer months which further reduced the production volumes from the marginal wells. The income declined for the producer, the royalty owners, the gathering system operator and the taxing authorities. Because the system owners did not own an interest in the wells, they did not care about the production declines as long as the incremental revenues from the irrigators exceeded the lost gathering revenues from the producers.

Based on our study of the undeveloped reserves in the area, we were pessimistic that the through put volumes could ever be substantially increased. After two days of due diligence, we declined to make even a low ball offer for the system. As a sophisticated potential producer-gatherer, we knew that the system's primary and the secondary functions clearly were in conflict with each other. The Committee has heard testimony from proponents that complained that the irrigators were hurt due to the Rolling Thunder bankruptcy because the operator arbitrarily cancelled the gas supply contracts to the irrigators. Although we believe that the gathering system operator should have cancelled the contracts well in advance of planting season, the series of unfortunate events did not surprise us. We do not think that the NPU should have been surprised either. We understand that the producers and royalty owners on the system lost millions of dollars for several months of revenue that were not paid. Unlike the irrigators who could have switched to a diesel fuel, the producers were captive to the system. We understand that the gathering system is continuing to have economic difficulties problems due to the expense of processing the high nitrogen gas.

There are 3 lessons to be learned by the Rolling Thunder disaster:

Irrigators, NPUs and KCC regulators should understand that there is no guaranty that

undeveloped reserves can be developed to stop the production declines. The regulatory concept of “the obligation to serve” is foreign to the science of petroleum geology.

Due to the economics, ONEOK eventually sold the unprofitable gathering system. Unfortunately an out of state speculator rather than the largest producer on the system became the new owner. The KCC did not have the geological or engineering expertise to evaluate whether or not the system could simultaneously perform a primary and secondary obligation and to determine a fair and reasonable rate.

We predict that portions of the Rolling Thunder system will eventually be completely abandoned due to the lack of production. The irrigators and the KCC should be patient, but pro active to purchase the system at the right time before the system is abandoned. It will eventually become more valuable to the NPU as a distribution system importing processed gas from the interstate pipeline than as a gathering system for the producer-gatherer. The economics of deregulation will eventually change the systems function.

We believe that Senate Bill 325 will only benefit a few administrative attorneys and will hurt the Kansas tax payers, producers and the rural gas customers. Because it is relatively easy for a few rural customers to join together to form an NPU, we believe that the KCC will be over-whelmed by hundreds of requests by small NPUs acting pro se seeking the KCC to perform individual rate case studies. Because each scenario will be unique, the KCC will be required additional staff with oil & gas expertise. The small producer-gatherer will either be required to spend significant time at KCC hearings or will need to hire attorneys. More importantly the producer-gatherer will not be able to make any long-term plans if it has no control over the level of irrigation demand.

Assuming that there is sufficient gas to serve the initial demand of a NPU, we are concerned that there will be an increasing pent up demand for gas supply from the adjacent landowners seeking to hook up to the NPU or form a new NPU. We believe that this will result in a new allocation disputes between neighbors for the KCC to resolve. We think that a better solution for the irrigators and the Kansas taxpayers will be for the Committee to assist the irrigators in securing new sources of energy to be transported through regulated systems such as an expanded electric distribution system or extensions of the existing gas utility lines. A purely regulated solution makes the most sense because the energy demand for irrigation pumps and the infrastructure costs are more predictable over a 20 year period than the fickle undeveloped gas reserves. The state should help facilitate the financing of the new electric or gas utility infrastructure with low interest utility debt and repaid over 20 years by fees charged to the irrigators. The new utility infrastructure will permanently enhance the economy in certain parts of rural Kansas. We understand that utility economics may offer the fairest solution assuming every variable is very predictable. However the unique assumptions about a gathering system preclude every rural customer can be hooked up to a new gas utility line or a more powerful electric grid. Most potential irrigators will be required to use diesel fuel to power their engines.

However we believe that by allowing the gathering systems to be deregulated, gathering system operators and NPUs will enter into mutually beneficial contracts with firm

performance obligations whenever warranted by the geology and the projected commodity prices. We believe that the Committee and the KCC should strive to help as many irrigators as possible to secure a predictable long-term gas supply from an interstate pipeline or electricity or gas from an utility. We request that the Committee allow the defeat SB 325 so that the producer-gatherer can operate their systems in the most efficient manner to serve the parallel economic interests of the producer, the royalty owner, the ad valorem and state severance taxing agencies and the gathering system operator to maximize the gas production in the State of Kansas.

We appreciate the opportunity to express our concerns. I would be pleased to stand for questions.

Respectfully submitted,

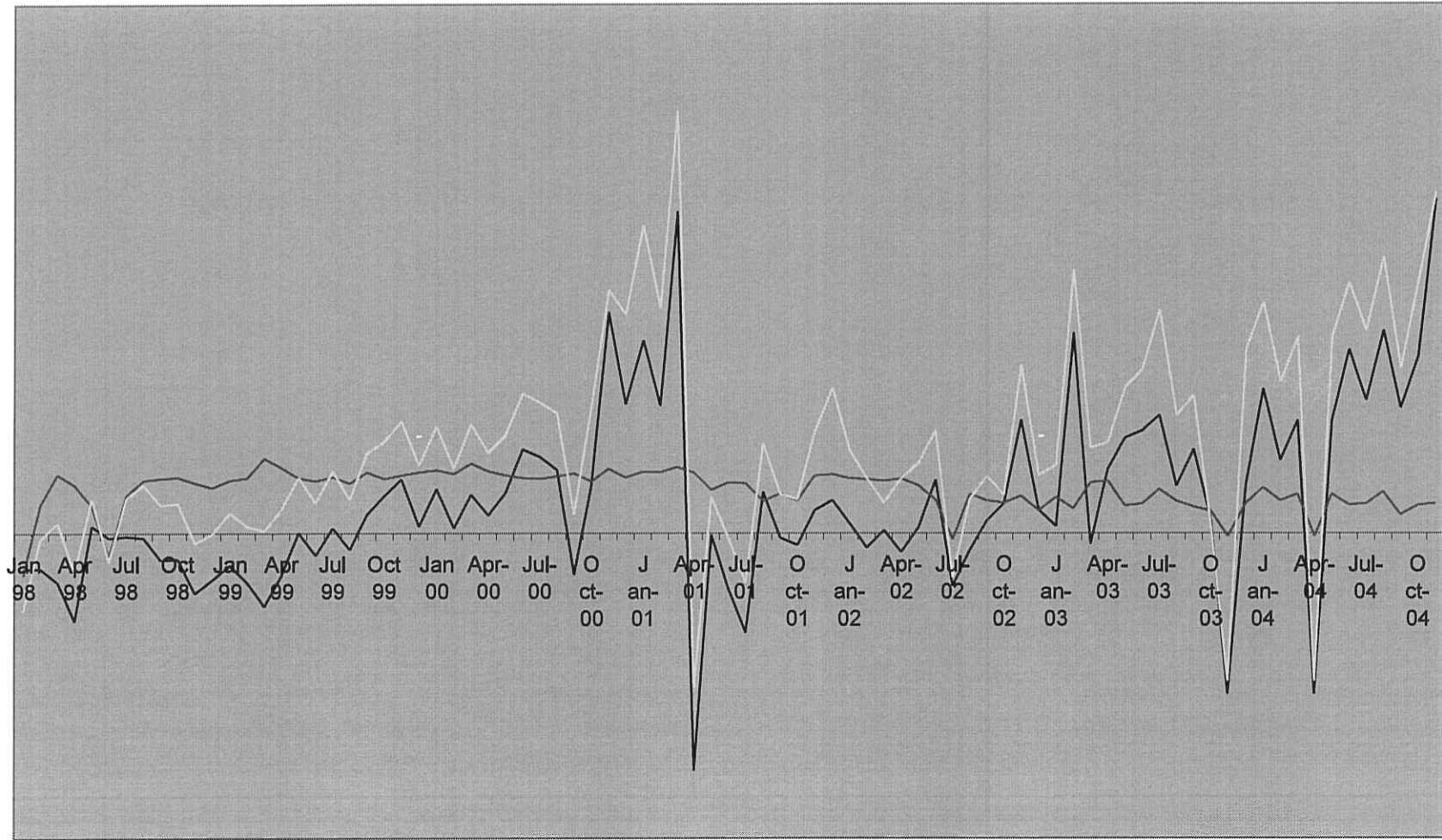
Bill McKean  
Manager of Business Development  
American Pipeline Company, LLC







### System & Plant Margin Per MMBTU



— Plant Margin / MMBTU    - - - System Margin / MMBTU    ..... Total Margin / MMBTU



# KANSAS

CORPORATION COMMISSION

KATHLEEN SEBELIUS, GOVERNOR  
BRIAN J. MOLINE, CHAIR  
ROBERT E. KREHBIEL, COMMISSIONER  
MICHAEL C. MOFFET, COMMISSIONER

**Before the Senate Utilities Committee  
Comments by the  
Staff of the Kansas Corporation Commission  
March 8, 2007**

**Senate Bill 325**

Thank you Mr. Chair and members of the Committee. I am Leo Haynos, Chief of Gas Operations and Pipeline Safety for the Kansas Corporation Commission. I am appearing today on behalf of the KCC Staff. The purpose of my testimony today is to provide an overview of the Commission order contained in docket 06-GIMG-400-GIG, also known as the "400 docket". As you have heard over the last two days of testimony on SB 325, this docket established a framework for the Commission to use when establishing policy related to end use gas consumers connected to gas gathering lines. A synopsis of the order is attached to my testimony. If you would like to review the order in its entirety, I would refer you to the KCC website [at www.kcc.state.ks.us](http://www.kcc.state.ks.us) under the tab docket filings.

Before I begin discussing the order, I think it is important to provide some background into the differences between public utilities, common carriers, and gas gatherers. In reviewing the testimony before this committee in the 1990's when the gas gathering statutes were written, it is apparent that the focus of the discussion at that time involved providing gas producers open access to gas gathering systems. Although some of the same consumers testified before you on SB 325, there is no record of any concerns being raised in the 1990's by consumers not being able to get gas off the pipeline once it was put on. Consequently, the gas gathering statutes only address getting gas on the pipeline, not getting it off. The laws which recognize public utilities, common carriers, and gas gatherers as natural monopolies and provide KCC

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Attachment 5-1

oversight are found intertwined in both Chapters 55 and 66 of the statutes. The Kansas regulatory system provides the Commission with an extremely broad jurisdictional authority with little statutory or regulatory detail directing the Commission on the exercise of this jurisdiction. In many cases, there are specialized statutes that apply to one type of common carrier such as “public motor carriers” but in many of the situations dealing with public utility natural gas, electric, or telephone service, the Commission has established customs and practices that define the regulatory requirements. An Example of these practices that are not found in the statutes is the requirement to convert gas users to alternate energy sources if their service is abandoned.

In previous testimony on SB 325, there was some discussion about the difference between a common carrier and a public utility. In a recent Commission docket, Professor David Pierce from Washburn University provided an historical perspective of Kansas Public utility law. In his treatise, he states, “Kansas public utility and common carrier statutes are a patchwork of often overlapping legislative responses to monopoly power throughout the State's history. For example, many of the early statutes regulating railroads as common carriers also address other common carriers. This is the case with, for example, K.S.A. 66-154, which was enacted in 1905, prohibiting "any railroad company or other common carrier to grant . . . any rebate or drawback”. The Kansas public utility and common carrier statutes are the product of cumulative major enactments in 1905, 1911, 1923, 1929, and 1985, with numerous laws passed on the subject from 1883 to the present”.

I would view common carriers as a specialized type or subset of public utilities. The goal of the statutes governing common carriers is to ensure that rates and terms of service are listed in a filed tariff and that the rates and practices of the carrier are not unreasonable, preferential, or unduly discriminatory. A comparison of the Chapter 55 statutes governing gas gathering practices show the gas gathering statutes are very similar to those statutes that

govern common carriers. In essence, they are designed to provide the Commission with authority to arbitrate problems that the parties are unable to resolve among themselves. One of the problems the Commission struggled with in the 400 docket is the same problem we are discussing today. That is, Kansas law would require a common carrier to also be considered as a public utility subject to cost of service rate treatment and quality of service requirements that have been developed through past Commission practices. As you have heard in recent testimony, gas gathering systems provide multiple functions in the delivery of gas yet the pipelines are not designed to operate as distribution systems.

The recent order in the 400 docket tried to reconcile the various statutes with the operational concerns of providing end use consumers from gathering lines. The order sets out a framework for four of the five categories of gathering system end use consumers. The five categories can be described as follows:

1. Consumers supplied because of a leasehold agreement with a producing company:

This type of supply arrangement was not contemplated in the 400 docket. Generally, it has been Staff's position that supply contracts associated with mineral lease agreements are part of a gas production operation and therefore not subject to gas gathering or public utility regulation.

2. Consumers supplied because of a right-of-way, (ROW) agreement with the gathering pipeline: Because ROW is necessary to operate a pipeline, the Commission concluded ROW consumers are incidental to a gas gathering service and these consumers are covered by the Chapter 55 gas gathering statutes. That is, the consumer has the right to appeal to the Commission if they believe the gas gathering company is "unduly discriminatory" in its rates and practices.

5-3

3. Consumers that are NOT rural gas user, (i.e. gas use for agricultural purposes), supplied retail gas sales from a gas gathering operator: This type of consumer such as a residence, business, or manufacturing facility would be considered a public utility customer. Therefore, the gathering system providing retail sales would be a public utility required to establish tariffs and set rates in compliance with public utility practices. The costs and obligations associated with serving this group of consumers would only apply to the public utility function of the gathering system, not to the producers using the gas gathering services.

4. Consumers that are rural gas users, (irrigators, feedlots, grain dryers, etc): Under K.S.A. 66-21012 companies providing gas service to rural gas users can not be considered as public utilities. Therefore, the Commission order considers this category of supplier exempt from public utility regulation.

5. Consumers that are customers of a certificated public utility or non profit utility that is supplied from a gas gathering system: The Commission considered the transportation of gas for retail sales to be a public utility function. Therefore, the gathering system operator providing this type of service could be considered a common carrier which is a specific type of public utility.

The Commission's order recognized the operational difficulties of providing distribution service from a supply limited gathering system. Therefore, the order established the previously discussed categories of service obligations only for existing customers and any new customers added at the discretion of the system operator. This decision is based on the fact that many of the end use customers connected to gathering systems in Kansas are former customers of federally regulated transmission systems. As such, the customer would have had recourse to the Federal Energy Regulatory Commission, (FERC), when disputes over service practices arose. When the gathering systems were unbundled from the interstate

transmission system, the end use customers were sold to a Kansas public utility or simply stranded with no ability to appeal to a jurisdictional authority. The Kansas public utilities that purchased the right to serve the consumers were also stranded in regard to resolution of disputes related to gas transportation contracts needed to serve their customers. The Commission's policy decision to apply the order's framework only to existing customers provides the customer with an avenue of regulatory recourse formerly available with the FERC while minimizing the impact on the gathering system's ability to perform its primary function of moving gas from production to transmission.

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**OVERVIEW OF KANSAS CORPORATION COMMISSION FINAL ORDER  
IN DOCKET 06-GIMG-400-GIG**

**Prepared by Leo Haynos, Kansas Corporation Commission Staff.**

**February 20, 2007**

Para 37: The statutory definition of “gas gathering system” does not indicate what should be considered part of the gathering system beyond that used for the gathering function. Therefore, with regard to Commission authority over exit taps, the question is whether the legislature intended to exempt certain specific functions of “gathering systems” or whether it intended to enact an exemption covering all uses of any facilities classifiable as a “gathering system” using the statutory definition.

Para. 40: After reviewing the statute and the various suggested interpretations by the parties, the Commission concludes that the requirements of K.S.A. 55-1,103 to provide just, reasonable and non-discriminatory access and rates do not extend to exit taps. Such requirements are imposed on “gathering services,” “facilities essential” to such services, and “practices in connection” with gathering services. Exit taps do not appear to fall within any of these three categories. Gas gathering service clearly does not directly encompass exit tap service because exit tap service does not involve transporting natural gas “to a point of entry into a main transmission line” as set out in K.S.A. 55-150. Furthermore, as suggested by Staff, exit taps do not involve transportation of natural gas but rather distribution to end users. If exit taps are not directly involved in the gathering function, it would logically follow that exit tap facilities are not essential to gathering services,

Para 40: Therefore, the Commission concludes that it is without jurisdiction to regulate exit tap service pursuant to K.S.A. 55-1,101 *et seq.*, unless the exit tap service was obtained through a ROW agreement. Stated another way, where exit tap service is obtained through a ROW agreement, the Commission has jurisdiction over such service pursuant to K.S.A. 55-1,101 *et seq.*

Para 42: Furthermore, K.S.A. 55-1,107 appears to recognize that retail sales of natural gas from a gas gathering system require a certificate of convenience and necessity from the Commission.<sup>1</sup> These statutes thus reflect the fact that the use of any facilities for the conveyance and sale of natural gas generally comes within the definition of a public utility in K.S.A. 66-104.

Para. 43: After due consideration, the Commission concludes that the legislature only intended to remove from utility regulation those functions or services which were to become subject to regulation under the gathering statutes, K.S.A. 55-1,101 *et seq.*, enacted concomitantly with K.S.A. 66-105a. Since we have found that exit taps, unless associated with a ROW agreement, are not a gathering service because they do not involve transporting natural gas to a point of

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<sup>1</sup> The statute reads, in relevant part: “In any retail natural gas service area where the commission has granted a certificate of convenience and necessity to sell natural gas at retail from a gas gathering system, the commission may issue other certificates of convenience and necessity to make such sales in such area. A person purchasing natural gas or gas gathering services from a person offering gas gathering services in a retail natural gas service area where the commission has issued more than one certificate of convenience and necessity shall not be assessed an exit fee for electing to purchase natural gas or gas gathering services from another person offering gas gathering services.”



entry into a main transmission line, this category of exit taps remains subject to regulation as a public utility service. We do not believe that other interpretations can be adequately supported.<sup>2</sup>

Para. 46: Exit taps that are provided pursuant to right-of-way agreements would appear to be integral to the operation of the gathering system. Although they are not technically gathering services, the Commission believes that they are the kind of secondary functions that the legislature intended to include within the scope of K.S.A. 55-150(d). Furthermore it would seem that such exit tap services would be subject to Commission review under K.S.A. 55-1,103 since they either involve “facilities essential” to gathering service or “practices in connection” with gathering services.

Para. 49: In a general sense, the Commission acknowledges that a gathering service could be deemed a “gas provider” pursuant to the Kansas Self-Help Gas Act. The Commission notes that for such a situation to arise, the customer served must be using the gas procured for “agricultural purposes” and must not presently be receiving gas service by an “existing gas service utility.”<sup>3</sup> Providing exit tap gas to a customer utilizing the gas for purely residential consumption would therefore not qualify a gas gatherer for the exemption contained in the Kansas Self-Help Gas Act.

Para. 50: The Commission notes that under its interpretation of the statutes, a gathering system’s transport or provision of natural gas in concert with a certificated public utility for immediate distribution to end users would be subject to regulation as a public utility service.<sup>4</sup> ... the Commission finds that the obligation to provide such transportation service should extend only to existing exit taps or exit taps that are provided at the discretion of the gas gatherer.

Para 57: The Commission finds that three key areas should be addressed: (1) curtailment of service to public utility exit tap customers, (2) curtailment of service to gathering system ROW customers, and (3) establishing a general benchmark for safe H<sub>2</sub>S thresholds in relation to the exercise of the Commission’s powers pursuant to K.S.A. 66-105a.

Para. 58: The Commission also concludes that any public utility who serves customers off of gathering systems is responsible for providing sufficient and efficient service regardless of the means by which such utility has secured its gas supply. If a utility finds that it can no longer provide service due to pending curtailment of gathering service gas, the utility must seek abandonment approval from the Commission.

Para. 59: The Commission concludes that when an exit tap customer who takes service pursuant to a ROW agreement is curtailed or denied gas service by a gathering company, the Commission is authorized to evaluate the reasonableness of the curtailment pursuant to its Chapter 55 jurisdiction over gathering services. However, the Commission should not become a forum for

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<sup>2</sup> Staff’s functionality analysis appears to be factually supportable but does not comport well with the statutory language. The Commission’s view of legislative intent better resolves some of the ambiguities in the statutes.

<sup>3</sup> “Existing gas service utility” is also defined in the Kansas Self-Help Gas Act. The term generally refers to traditional natural gas public utilities with existing natural gas infrastructure to serve end use customers.

<sup>4</sup> Additionally, when common carrier transportation service is not regulated by the FERC, it may fall under K.S.A. 66-105, and therefore allow for common carrier regulation by the Commission.

the resolution of private contractual disputes. Rather, the Commission should focus on whether curtailment of service is “just and reasonable.” The Commission will defer to the district court matters of contractual interpretation.

Para. 60: If a gas gatherer can justify its disconnection of exit tap customers by presenting substantial evidence that conditions impacting safety and/or health exist, the Commission will not disturb the decision to curtail service. As a general rule, however, the Commission adopts Staff’s recommendation that H<sub>2</sub>S concentrations in excess of 15 ppm in gas provided for residences or other confined domestic uses is not safe and any such concentrations would warrant curtailment.

Para 61: First, the Commission finds and concludes it lacks jurisdiction under the gas gathering statutes to require open access to remove gas from a gathering system. K.S.A. 55-1,101 *et seq.* The statutes do not present a clear legislative intent to mandate exit taps on gas gathering systems.

Para. 62. The Commission finds and concludes it has varying jurisdiction over existing exit taps. The category of exit tap and type of jurisdiction found herein are as follows:

- Exit taps provided under right-of-way agreements between the landowner and the gas gatherer are considered essential to the gatherer being able to provide gas gathering services. This category of exit tap falls within the purview of the gas gathering statutes K.S.A. 55-1,101 *et seq.* and is therefore exempt from public utility jurisdiction under Chapter 66. Customers served by this type of exit tap would have recourse to the KCC under the provisions of the gas gathering statutes.
- Exit taps providing gas for agricultural purposes such as operating irrigation equipment or providing fuel for feedlots are exempt from regulation under the Kansas Self-Help Gas Act, K.S.A. 66-2101 *et seq.*, depending on each specific fact situation.
- All other exit taps are not essential to the gathering system or to providing gathering services. Because these exit taps do not fall under the definition of a gas gathering system or a rural gas user, they are not exempt from utility jurisdiction under K.S.A. 66-105a. Commission jurisdiction over this category of exit taps varies depending on the use of the tap, for example:
  - Exit taps providing gas directly to a residence or business fall under public utility regulation. *(As such the gas gathering operator would be required to acquire a certificate of convenience and provide sufficient and efficient service to its customers. In this case sufficient and sufficient service would take into consideration the available supply and other competing market conditions; -- Staff)*
    - *Exit taps providing transportation service to a public utility such as Aquila, may be considered as a common carrier which is a specific type of public utility.-- Staff*

- The Commission will exercise such regulation only with regard to existing exit taps or exit taps that are provided at the discretion of the gas gatherer.

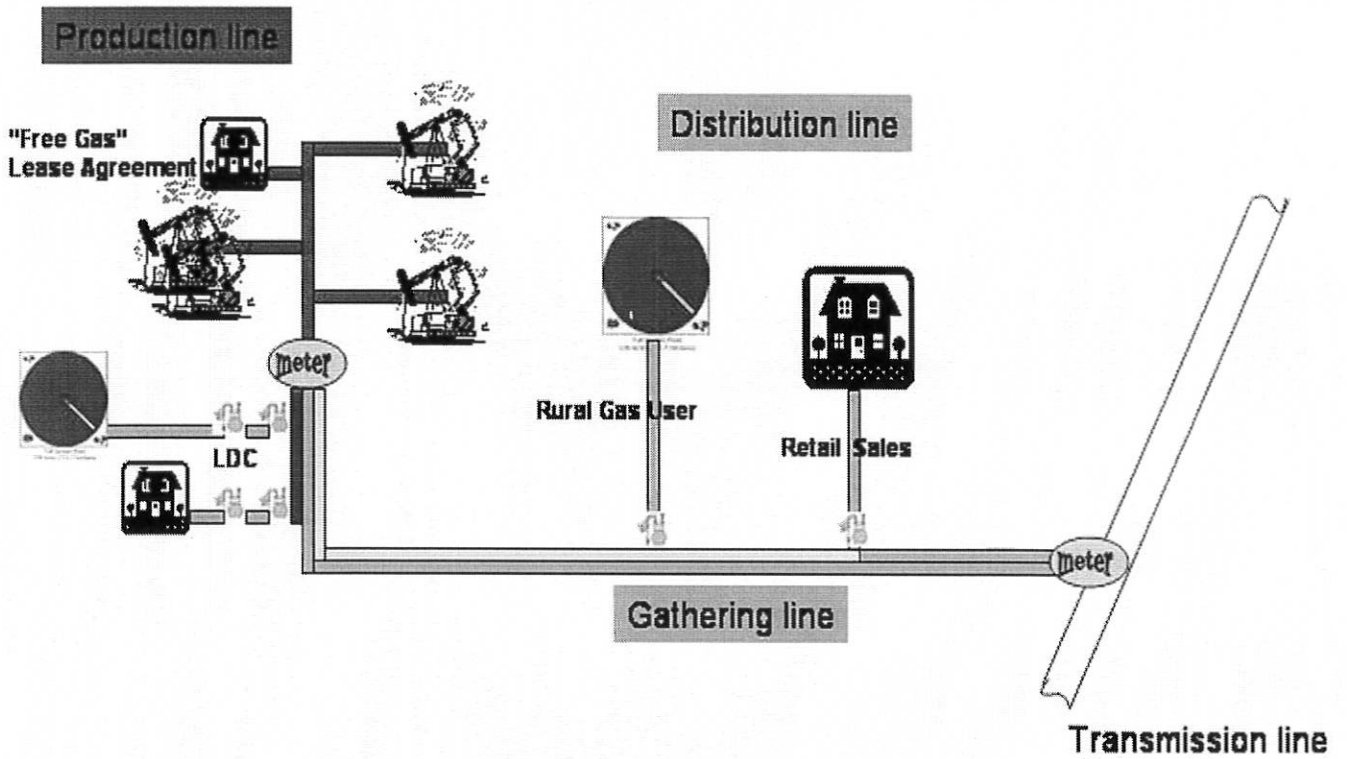
Para. 63. In addition to making jurisdictional pronouncements, the Commission investigated establishing policy in three key areas:




- curtailment of public utility exit tap customers;
- curtailment of right-of-way agreement customers; and
- a safe operational threshold for the concentration of H<sub>2</sub>S in the gas stream.

Under current law and Commission precedent, when a public utility can no longer provide service due to curtailment of its gas supply, it must seek abandonment approval from the Commission. Based on the facts of each case, the Commission will decide what conversion costs, if any, should be paid by the public utility. Next, when right-of-way agreement exit tap customers are curtailed, the Commission will evaluate the curtailment under the just, reasonable and not unduly preferential standard of K.S.A. 55-1,103. Matters involving right-of-way agreement interpretation will be deferred to District Court. Finally, as a general rule, the Commission adopts Staff's recommendation that H<sub>2</sub>S levels in excess of 15 ppm in gas provided for residential and business use are not safe. However, if a gas gatherer can justify its disconnection of exit tap customers by presenting substantial evidence that conditions impacting safety and/or health exist, the Commission will not disturb the decision to curtail service.

Para. 64. The Commission believes this Order is based on a reasonable interpretation of the statutes and gives gas gatherers and exit tap customers a framework to follow. Further, given the determinations contained herein, the Commission concludes this general investigation.

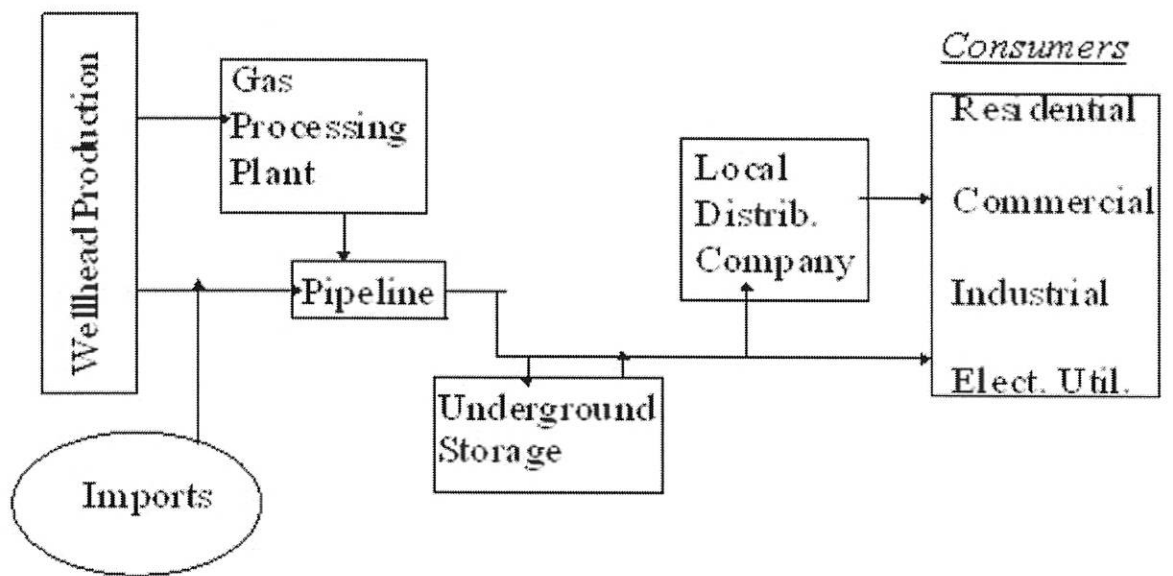
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-  Distribution Function, (Chapter 66)
  -  Transportation Function (Chapter 66)
  -  Gathering Function, (Chapter 55)
- } Gas Gathering System

5-10

Generalized Schematic **Physical Flow** of Natural Gas in U.S.



5-11

## Memorandum

**To:** Chairman and Members of the Kansas Senate Utilities Committee  
**From:** Dick Brewster, BP, Jack Glaves, DCP Midstream, Steve Johnson, OneOk, and others in the *ad hoc* gas gathering group  
**Re:** S.B. No. 325  
**Date:** March 8, 2007

What follows is a list of requirements for exit tap service sought by an NPU on a gathering system. In addition, you'll see a list of findings of fact the KCC must make before it can order a gathering system to provide an exit tap service to an NPU, or order the continuation of an existing exit tap service. It is envisioned that the KCC's involvement would be only after a complaint filed with the KCC by an NPU in the case of an exit tap serviced sought, or by a gas user in the case of an existing exit tap service, where in either case the parties could not reach agreement after a good faith attempt to do so.

It is also envisioned that this language, after being drafted in a substitute bill for S.B. No. 325, would be the only provisions in the bill, replacing the existing bill entirely.

While there is not unanimity within the group of gathering operators, owners and others opposing S.B. No. 325, there is a consensus that believes a bill with these concepts can be workable.

We have reviewed these concepts with representatives of those supporting S.B. No. 325, and understand that there is a consensus among that group that agrees these concepts can be workable as well.

We will work to draft a bill based on these concepts, and believe it can be presented to the Committee next Tuesday, March 13, for your review and consideration.

### Basic Requirements:

1. The NPU seeking an exit tap service must have acquired or be able to acquire a gas supply, either by a purchase agreement from producers who can deliver or are currently delivering gas to the gathering system, or by a purchase agreement for gas from the gathering operation if the gas belongs to the gatherer. The terms of either agreement, including price, volumes, and other terms would be subject only to the agreement between the parties and not subject to review by the KCC. Any such agreement would be voluntary between and among the parties involved. The KCC would not have the

Senate Utilities Committee  
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Attachment 6-1

authority to order any producer, gatherer or other party to sell gas to an NPU, or any other party.

2. If the NPU becomes a shipper of gas it has purchased from a party other than the gatherer, the NPU must meet the same requirements as all shippers on the gathering system, i.e. credit worthiness, etc.
3. The NPU shall pay all costs and any associated expenses for the exit tap service as imposed by the provider.
4. Existing, new or additional exit tap service added to a gas gathering system shall not cause a gas gathering system, its owner or its operator to be regulated as a public utility as that term is used in K.S.A. 66-104, and amendments thereto, or as a common carrier as that term is used in K. S.A. 66-105, and amendments thereto.
5. The provider of an exit tap service shall not be required to install, relocate or modify compression or other operational equipment or features in order to provide such service or maintain pressure in its gathering system to deliver gas to a user of an exit tap service.
6. "Exit tap service on a gas gathering system" means providing a point on a gas gathering system at which natural gas is delivered to a consumer, homeowner, business, agricultural user, person, gas marketer or public utility.

Upon proper complaint to the KCC by an NPU or other party using gas directly from an exit tap service, or seeking such service, if the above requirements are met, the KCC may order the gatherer to provide exit tap service, or continue to provide exit tap service only if the Commission makes the following "Finding of Fact:"

1. That the proposed service will not impair the ability of the gas provider to meet all existing and anticipated demands on its system.
2. That the proposed charges by the exit tap service provider are reasonable and adequate to cover the provider's administrative and operating expenses, risk and profit for the service provided.
3. That the requested service will be provided on an interruptible basis and that the provider will be indemnified from liability for and shall not be held liable for damages to human life, crops, livestock, equipment, environmental or any other damage arising from using such gas, or arising from interruption or curtailment of service.
4. That the requested service will be provided only to NPU's, and shall be used to provide gas exclusively for agricultural use and not for commercial or industrial use.



5. That such service may be terminated for failure to promptly pay billings or maintain credit worthiness, or in the event the provider determines that it can not safely continue to supply such service.
6. That such service may be terminated at any time if continued service threatens the operational stability and reliability of the providers' system, and may be interrupted for gathering system maintenance, replacement or repairs.
7. That such service will not impair nor modify existing contracts held by the gathering owner or operator.
8. That such service will not unreasonably increase the total number of exit taps on the provider's system.
9. That such service can be provided in a safe manner that does not jeopardize human life or safety or the environment.
10. That providing such services will not adversely affect service or cost to any other consumers of gas gathering services on the system.