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COMMENTS OF PEK IRRIGATORS, INC. AND THE SOUTHWEST KANSAS NON-PROFIT UTILITIES IN SUPPORT OF SENATE BILL 325

February 20, 2007

Good morning. My name is Frank Caro, and I am a shareholder at the law firm of Polsinelli Shalton Flanigan Suelthaus, located in Overland Park. In that capacity, I have practiced energy law for over twenty years and have directed the energy and telecommunications practice at the firm. I am also the former general counsel of the Kansas Corporation Commission. I appreciate the opportunity to present testimony in support of S.B. 325 on behalf of two of my clients, PEK Irrigators, Inc. and the Southwest Kansas Non-Profit Utilities.

PEK Irrigators is a non-profit public utility in Kansas that was formed to provide natural gas service only to its member/owners. PEK provides natural gas services to its members in southwestern Kansas for agricultural uses, including irrigation engines, pumping fuel, grain drying, and other agricultural uses. The Southwest Kansas Non-Profit Utilities is an informal coalition of non-profit utilities that also provide natural gas services to their respective members.

PEK Irrigators and the Southwest Kansas NPUs wish to demonstrate and explain their support of Senate Bill 325, which, if passed, would enact legislation concerning natural gas gathering activities, and which would amend several current Kansas statutes in order to clarify the regulation of gas gathering systems.

My comments today will focus on four main issues.

First, I will provide a brief history of issues surrounding gas gathering systems. Second, I will discuss the interplay between previously enacted legislation regarding gas gathering systems and SB 325. Third, I will discuss the Kansas Corporation Commission's recent investigation and Order regarding the legal and policy issues that exist regarding gas gathering regulation. Finally, I will briefly discuss why the Kansas Legislature's enactment of SB 325 is necessary to remedy issues regarding the regulation and oversight of gas gathering systems, and will discuss why the KCC is the appropriate agency to regulate and oversee these issues.

BACKGROUND

As a brief background to this issue, the Commission noted in 1998 that the Hugoton Natural Gas Field, as well as several other natural gas fields located in southwest Kansas, has been a tremendous asset to the economy of the State of Kansas for many decades. Expansive gathering systems are present throughout these southwest Kansas gas fields, and are primarily used to collect natural gas from numerous wells and deliver it to one or more points for transportation on intrastate and interstate pipelines to markets and end users.

Many rural Kansas citizens and businesses use the gas from the fields by tapping directly into the miles of gathering system pipe throughout the region. The gas is primarily used for irrigation, feedlot operation, and residential consumption, but is also used for other commercial and institutional purposes. Customers take gas from points along the gathering systems, referred to as "exit taps", prior to the final delivery point of the system. The final delivery point is the physical end of the gathering system, usually a processing plant or point of sale to another pipeline.

Because of the sale of parts of what was once an interstate pipeline to different gathering companies wholly located within the State of Kansas, there is no longer federal jurisdiction over these pipelines. Therefore, under K.S.A. 55-1,101, the Kansas Legislature authorized the Commission to regulate gas gathering services rendered on these lines.

The Legislature further responded to rural customers' gas supply needs by adopting the Kansas Self-Help Gas Act to ensure that rural consumers could arrange gas supply when the franchised utility refused to provide service on reasonable terms. Likewise, the non-profit public utility statutes were also enacted to assist rural customers. The Self-Help Gas Act provides a means by which rural consumers can join together to help themselves with their gas supply needs. The Self-Help Act provides that any rural gas user, defined as a person using gas from a wellhead or gathering facility for agricultural purposes on property they own, lease or operate, may construct its own pipeline connection to a gas supply system and will not be considered a public utility.

However, despite these statutory protections, many rural end use customers have been denied access to gathering lines in order to transport their gas requirements, and, in some cases, have lost access to existing distribution and transportation services. Without access to these gathering lines, the Self-Help Act and the non-profit utility provisions are rendered meaningless.

As the Commission has recently noted, declining pressure in the field poses significant challenges for those consuming gas through exit taps, as well as for the utilities and gathering system operators that serve them. Declining wellhead pressure poses particularly complicated legal and policy questions due to the differing circumstances in which the service is provided and the ambiguities of the relevant statutes. Therefore, in an effort to address these issues, on October 19, 2005, the Kansas Corporation Commission issued an Order initiating an investigation to determine a policy regarding customers served directly or indirectly with natural gas service by means of a gas gathering system.

KANSAS CORPORATION COMMISSION INVESTIGATION AND ORDERS

The Commission's investigation highlighted the necessity for the Legislature to enact S.B. 325. The Commission's investigation into these issues was contained in Commission Docket No. 06-GIMG-400-GIG, and eventually resulted in a Final Order by the Commission on November 22, 2006. The parties to this docket included non-profit public utilities, gas gatherers, producers and public utilities. Many of these parties or their representatives are here today.

In this Order, the Commission made several findings, and stated how it would likely interpret the various legal issues presented in future proceedings before it, as depletion of gas reserves in the Hugoton field continues to require consideration of various important policy issues.

1. First, the Commission found that it lacks jurisdiction under the gas gathering statutes to require open access to remove gas from a gas gathering system.
2. Second, the Commission found that it has varying jurisdiction over the numerous exit taps on gathering systems that supply gas to homes, businesses, irrigation engines and public utilities.
3. If exit taps are provided under right-of-way agreements between the landowner and the gas gatherer, then they fall within the purview of K.S.A. 55-1,101 and are therefore exempt from public utility jurisdiction under Chapter 66.
4. Finally, the KCC found that all other exit taps are not exempt from public utility jurisdiction under K.S.A. 66-105a. The Commission then found that its jurisdiction over this category of exit taps varies depending on the use of the tap.

Subsequent to this Order, numerous parties filed petitions for reconsideration, requesting that the Commission clarify, expand, or rethink its analysis and findings contained in its Order.

On January 17, 2007, the Commission issued an Order Denying Reconsideration. The Commission noted that complicated issues and legal matters remain unresolved, and reiterated that the complicated legal analysis that results from attempting to read all statutory provisions together could benefit from legislative clarification. Although the Commission intended for the docket to clarify issues surrounding gas gathering systems for the various parties, the Commission's January 17, 2007 Order Denying Reconsideration stated that complicated and issues and legal matters remain unresolved.

Therefore, the Commission concluded that reconsidering or further articulating its previous conclusions would not present the best solution to this problem. The Commission affirmed its previous conclusion that the "Legislature may be the best equipped to resolve such issues," and urged the parties involved in the docket to "participate in any related legislative process in a manner that is open to compromise and committed to pragmatic approaches to an undeniably complicated set of policy problems."

EXPLANATION OF S.B. 325

The next section of my testimony will briefly address how S.B. 325 remedies these issues.

PEK Irrigators, Inc. and the Southwest Kansas Non-Profit Utilities desire to preserve the Commission's findings in Docket No. 06-GIMG-400-GIG, regarding Commission authority and jurisdiction over certain types of exit tap service from gas gathering systems.

S.B. 325 will provide various amendments to certain statutory provisions to: (i) clarify under what circumstances consumers will have access to the gas gathering systems; (ii) clarify the service obligations of gas gathering systems; (iii) protect existing farm tap service delivery points and permit future delivery points as needed, and (iv) clarify the obligations of public utilities providing service from a gas gathering system with respect to abandonment and cessation of service.

S.B. 325 codifies the KCC's findings of regulatory authority, resolves any potential questions of ambiguity, and fills the regulatory gaps identified by the KCC. S.B. 325 also remedies the inequity of regulatory protection by assisting rural end use customers in ensuring pipeline capacity so that they can access gas supply areas to contract for their gas requirements and, in the event of unfair denial of transportation, S.B. 325 will provide recourse through the KCC.

You may hear from several gas gatherers or producers tomorrow that are in opposition to this amendment. They will argue that K.S.A. 66-105a unequivocally states that a gas gathering system, with a primary function of delivering gas from production wells to transmission pipelines, cannot be considered a public utility or common carrier in Kansas. PEK and the Southwest Kansas NPUs agree, and S.B. 325 does not alter this. S.B. 325 does, however, make the statute consistent with current practice, and recognizes that many entities use gas gathering systems in a secondary manner: to provide transportation and distribution services of behalf of public utilities and end use customers. It is this secondary function that S.B. 325 proposes to regulate as a common carrier service.

You may also hear comments in opposition to portions of S.B. 325 in which the opponents argue against requiring owners or operators of gas gathering systems to provide new exit taps on demand. The comments may suggest that supply, technical and operational constraints will not permit full open access to the gathering system. It is important to note that S.B. 325 does not mandate full open access to the gathering system. What S.B. 325 does is provide certain procedural safeguards and a regulatory body, the KCC, to oversee and regulate issues pertaining to access, service and abandonment.

In addition, the proposed amendment to K.S.A. 66-104(a) will, consistent with the Commission's Order, exclude from the definition of public utility a pipeline that operates or utilizes a gas gathering system, to the extent the pipeline provides only gas gathering services, as defined in K.S.A. 55-1,101, and which does not provide transportation and distribution services via the gathering system.

KCC OVERSIGHT OVER GAS GATHERING

The KCC, as the agency charged with regulating the public utilities and common carriers operating within the State of Kansas, is the appropriate entity to oversee the regulation of exit taps, and will provide a forum to adjudicate complaints brought by parties who believe they are adversely affected by issues regarding access, service and abandonment. The KCC is very familiar with the history of gas gathering systems and the numerous issues facing producers, gatherers, public utilities and customers who utilize gathering systems for all or a portion of their natural gas needs.

Enactment of S.B. 325 will ensure continued and bolstered regulatory oversight of these complicated issues.

In closing, I appreciate the opportunity to present testimony in favor of S.B. 325, and welcome any questions or comments that you may have.