

**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 succeed 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,

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