STATEMENT

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PANEL II: STATE OF THE PIPELINE INDUSTRY

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I would like to thank the Commission for accepting my request to speak here today. I appreciate the opportunity to share Kinder Morgan's views on the development of new pipeline infrastructure with the Commission.

As you know a great focus of this industry and the Commission is, and has been, on building new pipeline infrastructure. Today I would like to discuss the development of storage and pipeline infrastructure with the Commission.

Let me emphasize that the pipeline industry, its investors and bankers, have the capacity to build the necessary infrastructure. However, the investment element is heavily dependent upon stable regulatory policies which reflect current market requirements. The Commission must be vigilant to recognize the realities of the market as they emerge.

<u>First Storage Infrastructure.</u>

Today Kinder Morgan's Natural Gas Pipeline Company of America operates eight natural gas storage fields, consisting of aquifer and, depleted reservoir and salt type fields. In total this is approximately 240 bcf of working gas capability. We agree with various recent industry studies including the National Petroleum Council study which projects that significant additional storage capabilities will need to be constructed to meet typical peak day demand, electric generation growth and LNG balancing requirements of the marketplace. The ongoing development of LNG terminals and their ability to supply the market with significant daily supply inputs ranging from 1 to 4 bcf per terminal will provide a challenge to the existing storage and pipeline infrastructure.

Companies like Kinder Morgan are answering the challenge to develop storage. In our case, Natural Gas Pipeline Company of America in 2004 expanded their North Lansing field by ten bcf and currently has under construction a ten bcf expansion at our Sayre Storage field in Beckham County, Oklahoma. Natural has recently filed with the Commission for approval for an additional expansion of the North Lansing storage field by ten bcf in Harrison County, Texas.

However, the high price of cushion gas is hindering the development of both the expansion of existing and the development of new green field storage. Much of what I would call the low hanging fruit, or the cheaper expansions of existing fields has been picked over the last five years. Given the current high cost of development, many new storage development opportunities are not economic at the prices offered in the current market. Consequently, it is not likely that these projects will not be constructed in the short term. We believe unless the current paradigm changes the development of the low hanging fruit will not provide the level of storage development required to meet the future needs of the market.

The bottom line is that shippers are not willing to sign up today for storage services at rates that would be required to fund the development and companies are not willing to go at risk and invest significant dollars without some assurance in the future that they will be able to achieve a return on their investment. It is important to note that any significant storage development spans multiple years, so we must start the development now if we are going to meet the market needs in the future.

By allowing the presumption of market based rates for both green field and the expansion of existing storage fields we believe the Commission can provide the right foundation for storage developers to move forward today and immediately develop new storage infrastructure. The developers will take the risk and undertake the development of storage with the belief that the in the future they will be able to capture market rates on their services and achieve an overall return on their investment.

Market based rates for new storage infrastructure is appropriate. As a matter of public policy the prospect of having market based rates for both green field and the expansion of existing storage fields is imperative. We believe there is significant opportunity for existing storage providers to quickly expand their existing storage fields if market based rates were allowed. With the integrated pipeline grid and the physical storage fields residing in both the market and field areas the sale of storage services faces competition from a variety of storage providers including shippers releasing their capacity. Expanding existing storage is equally competitive with the construction of new green field storage capacity since both access the same pipeline grid to provide the storage services. At the end of the day, if incremental storage infrastructure can be constructed, customers will have greater choices than they do today versus if incremental storage was not constructed.

<u>Now I would like to move to the development of large new pipeline infrastructure.</u>

Large infrastructure projects are needed not just to address the growing needs of the market but to meet a fundamental shift in the location of supply growth within the United States. The growing supply in the Rockies and upcoming inputs from LNG will provide some of the greatest near term incremental growth in supply in the United States and we believe the existing pipeline grid is not sufficient to efficiently move that supply to the market. We need to not only connect that supply but to build pipeline projects that alleviate the bottlenecks and not just move the bottlenecks from for example the Rockies to the Mid-continent.

Kinder Morgan has recently announced an open season on $490 million dollar 137 mile LNG pipeline in the state of Louisiana and has obtained conditional agreements from multiple shippers for the combined 3.4 bcf of initial project capacity. Additionally, we are developing a project in conjunction with Sempra to move gas out of the Rockies to the east coast. As designed, the 42-inch diameter pipeline will have capacity of up to 2 billion cubic feet per day and cost an estimated $3 billion dollars. The preliminary route of the 1,500-mile pipeline originates at the Wamsutter Hub in Wyoming and extends to eastern Ohio.

These are examples of a few major pipeline infrastructure projects which will be needed to allow new gas supplies to access the market but will require significant investment by developers. Pipeline developers need long term contracts to support an investment of five hundred million to three billion dollars. At the same time these pipeline projects are supply driven and need to be flexible enough to accommodate the underpinning economic assumptions of the supply developers who are also making a significant investment in the basin or upstream of the LNG terminal.

These large infrastructure projects typically have a few large shippers who commit early to the project, usually prior to an open season and provide the underpinnings to allow the much needed infrastructure to be developed. Typically these are the producers in the region that are investing significant dollars in production development or in the case of LNG these are the throughput holders at the LNG terminal. I will refer to these shippers as “foundation” shippers. These foundation shippers share the early risk of project development with the pipeline and typically hold a major portion of the project capacity.

The current open season and negotiated rate policies are appropriate for more conventional projects of a smaller scale not requiring the same capital commitments and therefore typically supported by multiple shippers with shorter term contracts and smaller increments of capacity commitments. We encourage the Commission to be flexible in working with the pipeline on these larger projects as the pipeline negotiates with foundation shippers to develop this much needed infrastructure. We understand the Commission must be vigilante that they are not unduly discriminatory, however where variations from current policy can be demonstrated to be a reasonable accommodation to the needs of a project insuring it moves forward we would suggest that does not constitute undue discrimination and should be permitted. For example…

1. The ability to insure foundation shippers that they will be awarded a minimum level of capacity on a project. This may require the pipeline to construct a larger project to meet the open season requests and/or allow the foundation shippers prior to any prorating to match other bids that occurred after their pre open season bids. In some situations, based on the benefits a foundation shipper brings to a large project, the open season may simply provide that the foundation shippers will not be prorated.

2. Allowing foundation shippers in the future to have the ability to trigger an economic expansion of the pipeline system and potentially have an option on that capacity.

3. Ability to differentiate between shippers based on their level of capacity commitment to the project.

4. Ability for foundation shippers to have step down rights on their capacity commitment if a minimum project subscription is achieved. If, in the early stages of project development, the pipeline company is assured a minimum volume by a foundation shipper the pipeline will immediately move forward in committing millions of dollars on preliminary engineering and environmental work thereby significantly shortening the overall project development timeline to in-service. However the foundation shipper may not have wanted to take the risk of the full minimum commitment but is willing to do so to move the project along. A key incentive for the foundation shippers to make that commitment is providing them the ability to step down if additional shippers commit during later development stages. However, a pipeline should not be obligated to make that same right available to other shippers that come along at a much later point in time.

5. Continue to allow the utilization of flexible negotiated rate authority.

Finally we believe that new concepts and ideas will be needed to insure the large pipeline infrastructure gets built. I would like to discuss one such idea we have which I will refer to as our aggregator proposal.

As part of our project out of the Rockies we have recently announced entering into exclusive negotiations regarding a Memorandum of Understanding that will result in the Wyoming Natural Gas Pipeline Authority contract for up to 200 million cubic feet per day (MMcf/day) of firm capacity on the proposed pipeline, explore use of its $1 billion in bonding authority to provide debt financing for the project and provide support for the extension of the project to the Opal Hub in Wyoming. The WNGPA is an instrumentality of the State of Wyoming formed by the legislature to facilitate production and transportation of Wyoming natural gas. We are encouraged by the state of Wyoming's willingness to work with us to develop this infrastructure.

Small producers do not typically commit long term to pipeline capacity due to their need to invest their resources into drilling and limited credit capabilities. As part of this project we intend to develop and propose a new supply aggregator concept which would allow entities like the WNGPA to assist small producers who would not typically take capacity on a large pipeline projects. Additionally the State of Wyoming is exploring in working with the WNGPA whether they can aggregate their royalty in kind gas with the production of small producers into one pool or commitment.

Under this concept an aggregator would hold the pipeline capacity under a long term commitment and provide the credit support for that capacity commitment.

The aggregator would gather or “aggregate” various production to fill the pipeline capacity. These small producers could commit their production to the aggregator under a variety of scenarios that fits their production profile. For example the aggregator may have a commitment from one producer for a couple of years with reducing mdq and another longer term with increasing mdq, or the aggregator may only have a volumetric commitment from the producer which may be backed up by a dedication of reserves. This would allow the aggregator to combine various small production or volumetric commitments into support for the construction of the pipeline project.

The aggregator would not necessarily buy the gas or hold title to the gas. To alleviate any concerns with the shipper must have title rule the pipeline would set up on their electronic bulletin board a posting where the aggregator would publicly disclose after the fact the entities they are aggregating gas for and their volumes they flowed over a period of time. We believe this aggregator concept will help provide the support to get the large pipeline projects built and we look forward to working with the commission on its development and implementation. We believe if the shipper must have title rule is sufficiently addressed this concept could move forward under the current regulations since the aggregators agreement with third party producers is properly a non regulated contractual matter.

That concludes my comments here today, again I appreciate the opportunity to speak and will answer any questions you may have.