Approved April 6, 1983
Date

MINUTES OF THE HOUSE COMMITTEE ON ASSESSMENT AND TAXATION.

The meeting was called to order by Representative Jim Braden at
Chairperson

9:00 a.m./~~p.m.~~ on March 15, 1983 in room 313-S of the Capitol.

All members were present ~~except~~:

Committee staff present:

Wayne Morris, Research Department
Tom Severn, Research Department
Don Hayward, Revisor of Statutes' Office
Nancy Wolff, Secretary to the Committee

Conferees appearing before the committee:

Richard D. Smith, Wichita, President, KIOGA
Jim Cast, Wichita, Manager, Peat, Marwick & Mitchell, CPA's
Representative Keith Farrar
Bernard Nordling, S. W. Kansas Royalty Owners Association
John Bower, former state legislator and royalty owner
Jerry Marcus, Beredco Inc.
Dennis Woolman, Vice-President, Mackie-Clemens Fuel Company
David Utermoehlen, President, Alternate Fuels Inc.
George M. Barberich, Vice-President, Alternate Fuels Inc.
Ron Pommier, Bills Coal Company, Inc.
Carlos Buckelew, Plant Manager, Lone Star Industries, Inc.
Tom McKinney, Victor Division of General Portland, Inc.
Representative Harold Guldner
Barney Sullivan, Wichita Petroleum Accountants
M. D. Keener, Manager, Independent Salt Company of Kanopolis
Gerald Rohlfsen, Profit Center Manager, Cargill Salt
Eugene C. Duffy, Vice-President & General Manager, Carey Salt
Ronald J. Nugent, Vice-President & General Manager, American Salt
Representative Richard Harper
R. D. Randall, General Counsel for Petroleum, Inc.
Ed Hughes, Consolidated Oilwell Services
Bernard Dick, Executive Vice-Presdient, GEO Churchill, Inc., Chanute
J. M. Boyd, Plant Manager, Vulcan Materials Company, Wichita
Don Bowman, Codell, Kansas
Joe Strong, President, Strong's Inc.
Eldon Phares, Royalty owner, Benton, Kansas
John V. Glades, Royalty owner, former state senator, Yates Center
Pete McGill, Legislative Policy Group
Robert A. Anderson, Gas Service Co., Oklahoma-Kansas Oil & Gas Association
Kansas-Nebraska Natural Gas Co., Inc.

The meeting was called to order by the Chairman.

Hearings were held on Senate Bill 267 which is the Severance Tax legislation.

Richard D. Smith, President of Kansas Independent Oil and Gas Association, appeared briefly to reply to questions from the Committee.

Jim Cast, Peat Marwick & Mitchell, CPA's, appeared as an opponent to Senate Bill 267. (Attachment I)

Representative Keith Farrar, appeared in opposition to Senate Bill 267. (Attachment II)

Bernard Nordling, representing the Southwest Kansas Royalty Owners Association, appeared in opposition to Senate Bill 267. (Attachment III)

John Bower, former state legislator and royalty owner, appeared to speak against Senate Bill 267. (Attachment IV)

Jerry Marcus, Beredco, Inc., a rotary drilling contractor, appeared to oppose Senate Bill 267. (Attachment V)

Dennis G. Woolman, Vice-President of the Mackie-Clemens Fueld Company, appeared in opposition to the severance tax. (Attachment VI)

David Utermoehlen, President of Alternate Fuels, Inc., a coal production company, appeared to oppose Senate Bill 267.

George M. Barberich, Vice-President of Alternate Fuels, Inc., also appeared in opposition to Senate Bill 267. Attachment VII)

Ron Pommier, Bill's Coal Company, Inc., appeared to echo the comments of the previous three conferees, and presented written testimony in opposition to the severance tax on coal. (Attachment VIII)

Carlos Buckelew, Plant Manager for Lone Star Industries, Inc., a cement and construction materials company, appeared to oppose the proposed severance tax on coal. (Attachment IX)

Tom McKinney, Victor Division of General Portland, Inc., appeared to speak against the imposition of a severance tax on coal. (Attachment X)

Representative Harold Guldner of the 122nd District, appeared to oppose Senate Bill 267. (Attachment XI)

Barney Sullivan, Wichita Petroleum Accountants, appeared in opposition to Senate Bill 267.

M. D. Keener, Manager of Independent Salt Company, Kanopolis, Kansas, appeared to oppose the inclusion of salt under the provisions of Senate Bill 267. (Attachment XII)

Gerald O. Rohlfsen, Profit Center Manager, Cargill Salt, appeared in opposition to the severance tax on salt produced in Kansas. (Attachment XIII)

Eugene C. Duffy, Vice-President and General Manager of Carey Salt Division of Processed Minerals, Inc., of Hutchinson, appeared in opposition to Senate Bill 267. (Attachment XIV)

Ronald J. Nugent, Vice-President and General Manager of American Salt Company, Kansas City, appeared to oppose the inclusion of salt in Senate Bill 267. (Attachment XV)

Representative Richard Harper, representing the 11th District, appeared to oppose Senate Bill 267.

R. D. Randall, General Counsel for Petroleum, Inc., and Chairman of the KIOGA Legislative Committee, appeared in opposition of any severance tax legislation. (Attachment XVI)

Ed Hughes, Consolidated Oilwell Services, appeared to speak against the severance tax legislation.

Bernard Dick, Executive Vice-President, GEO Churchill, Inc., of Chanute, Kansas, appeared to oppose Senate Bill 267. (Attachment XVII)

J. M. Boyd, Plant Manager, Wichita, Kansas Plant of Vulcan Materials Company, Chemicals Division, appeared to oppose the concept of a minerals severance tax. (Attachment XVIII)

Don Bowman, an oil producer from Western Kansas, appeared to speak against severance tax on oil (Attachment XIX)

Joe Strong, President of Strong's, Inc., appeared against any severance tax legislation that would unduly tax the oil industry. (Attachment XX)

Eldon Phares, a royalty owner from Benton, Kansas, appeared in opposition to Senate Bill 267. (Attachment XXI)

John Glades, Yates Center, Kansas, a royalty owner, appeared as a concerned citizen who opposes the severance tax. (Attachment XXII)

Pete McGill, representative of the Legislative Policy Group, appeared to oppose Senate Bill 267.

MINUTES OF THE HOUSE COMMITTEE ON ASSESSMENT AND TAXATION,

room 313-S, Statehouse, at 9:00 a.m./~~p.m.~~ on March 15, 1983.

Robert A. Anderson, Gas Service Company, Oklahoma-Kansas Oil & Gas Association, and Kansas-Nebraska Natural gas Co., Inc., appeared in opposition to the Severance Tax Legislation.

Several conferees were in attendance, but time did not permit them to testify. They did submit written testimony in opposition to Senate Bill 267. These were:

John W. Koepke, Associate Executive Director, Kansas Association of School Boards; (Attachment XXIII)

Robert J. Dietterich, Ransom, Kansas; (Attachment XXV)

Ronald N. Gaches, Kansas Association of Commerce and Industry; (Attachment XXVI)

Don Willoughby, Northern Natural Gas Company; (Attachment XXVII)

Paul E. Fleener, Director, Public Affairs Division, Kansas Farm Bureau; (Attachment XXVIII)

Dr. John S. Shaw, Supt., U.S.D. 395, LaCrosse, Kansas; (Attachment XXIX).

The testimony of Charles Johns, Kansas-National Education Association, proponent of the severance tax, was also distributed to the committee. (Attachment XXIV)

The meeting was adjourned.

DATE: March 15, 1983

GUEST REGISTER

HOUSE

ASSESSMENT & TAXATION
COMMITTEE

NAME	ORGANIZATION	ADDRESS
DENNIS ALLEN		SCOTT CITY, KS
Elsie Allen		Scott City
Joann Hoffner	Salina KNEA	Salina
Arden Landorff		Smith Center Ks
Ken Cohen	KAPGA	Topeka
Jim Allen	Senate	
Thomas D. McKeon		Pittsburg, KS
Terra McKeon		Pittsburg, Ks
Ed Waugh	CONSOLIDATED OIL	CHANUTE, KS
Bernard Dick	GEO Churchill, Secy.	Chanute, KS
Ed Rosenberger	Consolidated Oil Well SVC	Chanute, Ks.
Roy BOWMAN	BOWMAN OIL	Codell, Ks
LaVerne Schulte	Board Member USD 329	Maple Hill, Ks
Elizabeth Wilson		Topeka, Ks.
Brett Wilson	Self Employed	Topeka
Chip Wheelen	Leg. Policy Group	"
C.A. Buckelew	Lone Star Industries	Bonner Springs, Ks.
Barbara Buckelew		Bonner Spgs, Ks
Jon Smith	Legislative Policy Group	Topeka
Donna Waska	HANSTON HIGH SCHOOL	HANSTON, KANSAS
Kent Bass	Hanston High School	Hanston Ks
Bill Gough	Self	Topeka
Dennis Woolman	MoKan - Clemens Fuel Co	Pittsburg, Kansas

DATE: _____

GUEST REGISTER

HOUSE

ASSESSMENT & TAXATION
COMMITTEE

NAME	ORGANIZATION	ADDRESS
WILLIAM MACKIE	MACKIE-CLEMENS	PRAIRIE VILLAGE, K
Ronald L. Pommier	B. Ils Coal Co., Inc	Pittsburg, Ks.
Jeanette Lashley	Chamber of Commerce	Lyons, KS
Don Snyder	Chamber Commerce	Lyons, Kansas
Ronald J. Nugent	American Salt Co.	Kansas City, MO
Charles Stuckey	American Salt Co	Lyons Ks.
Robert C. Anderson	Mid Continent Salt Co	Olathe
M.D. KEENER	IND SALT CO	KANOPOLIS KS.
John Parks	Dept. of Revenue	Topeka
Mike Beam	KLA	Topeka
W.W. Keech	Chamber of Commerce	Winfield
JR E. Strong	STRONG'S, Inc	Nashville, Ks.
Burton Runyan	—	Kingman, Ks.
Joe Burke	Royalty owner	Topeka
Elden Phares	Benton Ks Royalty owner	Benton Ks
Wilma Phares	royalty owner	Benton, Ks
CHARLES ANDERSON	K.U.	LAWRENCE
John Boenbaugh	—	Lewis, Ks
Joanne Tate	—	Shawnee, Ks.
N. Eugene Zimmerman	Hanston H.S.	Hanston, Ks
Ronnie Wasko	Hanston High School	Hanston, Ks.
Scott J. Salbasgo	Hanston High School	Hanston Ks.
Warren Hastings	Hanston High School	Hanston, Ks

DATE: _____

GUEST REGISTER

HOUSE

ASSESSMENT & TAXATION
COMMITTEE

NAME	ORGANIZATION	ADDRESS
Barbara Neumann	Hanston High School	Hanston
Scott N. Miller	Hanston High School	Hanston,
Melanie McElroy	Hanston High School	Hanston, Ks.
Gary Salmans	Hanston High School	Hanston
Rodney J. Cure	Hanston High School	Hanston, Ks
Pamela Jo Falmans	Hanston High School	Hanston, Kansas
~~Susan L. Vogel~~	~~Hanston High School~~	~~Hanston, Ks.~~
Loretta M. Fiesch	Hanston High School	Hanston, Ks
John Swanger	Hanston High	Hanston KS
Janice Marcus	DOR	Topeka
Dan O'Hall	Legislative Research	Topeka
Belinda Kelley	Public	Boyer Spgs. Ks.
Patt Wearden	Public	"
Don Willoughby	INI	Topeka
Glenn A Evans	Evans Energy Development Inc.	Ottawa Kans
Max Thomas	Rep 117th Dist	Dighton, Kansas
Geo. Erickson	KIOGA	Topeka
Phil Martin	PVO	Topeka
Sue Ann Collins		Junction City
Wayne Lebsack.	Petroleum Geologist	Hugoton, Ks.
Bill Estes	Revenue	Topeka
Frank Buckler	Kansas Ag.	Topeka
Rick Dearne	Hovington PLC	Hovington

DATE: _____

GUEST REGISTER

HOUSE

ASSESSMENT & TAXATION
COMMITTEE

NAME	ORGANIZATION	ADDRESS
Leroy Jones	B.L.E.	Overland Park
Harry Craig	Martin Tractor Co	Topeka, Kan
Greg Martin	" "	" "
Danielle S. Burke	Jewell High School	Jewell, Kans.
Greg Schumacher	" " "	" "
Twila Meier	" " "	Jewell, Kans.
Darwin Cochraft	" "	" "
Curtis Bond	" "	Manhato Kans
Ralph Blevins	Jewell High School	Jewell Ks.
Robert Swank	" " "	" "
James Huhanna	Stevens County	Hugoton, Ks.

ATTACHMENT I
(3-15-83)

Peat, Marwick, Mitchell & Co.

Certified Public Accountants

600 Fourth Financial Center
Wichita, Kansas 67202
316-267-8341

March 14, 1983

House Committee on Assessment & Taxation
State Capitol Building
Topeka, Kansas 66601

Members:

My name is Jim Cast. I am a CPA and serve as chairman of KIOGA's tax committee. I am appearing today in opposition to the proposed Kansas severance tax on oil and gas. Today I would like to speak briefly to two issues. My concern is that the proponents of this legislation have continually overstated what they feel to be the economic impact of the windfall profit tax exemption for stripper oil which began as of January 1, 1983. In my opinion, the $100 million figure being used by the proponents is more accurately calculated as follows:

Estimated stripper production subject to exemption	$ 1.09	billion
1982 windfall tax on above (1)	95.0	million
Less: estimated current refunds due to application of 90% net income limitation - 25%	(24.0)	million
Total amount subject to exemption	71.00	million
Less: federal and state tax on reduced withholding - estimated at 50%	35.5	million
Net cash flow to Kansas oil industry	$ 35.5	million

(1) Assumes $29.00 sales price and $20.50 adjusted base price.

The sales, adjusted base prices and net income limitation figures used in the above calculations are representative of the typical oil and gas producers which I represent. It is particularly important to recognize that the reduced windfall profit tax withholding will not automatically flow to the bottom line for Kansas producers. It is totally unrealistic to assume that the $71,000,000 refund will not increase the total federal and state tax liability of Kansas producers.

ATTACHMENT I
(3-15-83)

I would also like to make one further illustration to emphasize my belief that Kansas oil and gas producers cannot afford this tax. Specifically, my calculations indicate that Kansas producers are now receiving $3.40 per barrel less than they were receiving in December 1980, even though the stripper exemption has now taken effect.

In summary, I believe the proponents have grossly overstated the industry's ability to pay this tax, specifically with respect to their estimate of the cash that will be available to Kansas producers because of the removal of the windfall profit tax on stripper oil beginning in 1983. Secondly, if you do not feel that the tax was appropriate based on a net $32.40 per barrel to the producer in 1980, how can you justify an increased tax burden in 1983 when their actual cash flow is lower than it was in 1980?

Thank you for this opportunity to present my views in opposition to the proposed severance tax.

Very truly yours,

PEAT, MARWICK, MITCHELL & CO.

James R. Cast

James R. Cast, Partner

JRC:MLW

Last 6a

Peat, Marwick, Mitchell & Co.

Certified Public Accountants

600 Fourth Financial Center
Wichita, Kansas 67202
316-267-8341

March 14, 1983

House Committee on Assessment & Taxation
State Capitol Building
Topeka, Kansas 66601

Members:

Supplement to Testimony in Opposition to
Kansas Severance Tax

I would also like to comment on the technical complexities of the proposed severance tax bills. Tax legislation is by its very nature complex. Take for example the Internal Revenue Code which now numbers over 6,000 pages, excluding the regulations. While I am totally opposed to any severance tax, it is clear to me that if in fact a tax must be enacted, it must provide certain exemptions and credits to fairly allocate the tax burden among those in the oil and gas industry. Just as we have progressive income tax rates at both the federal and state levels, it seems only fair that we should provide exemptions and credits for those producers operating the less marginal wells in our state. Likewise, a "flat rate" credit system is not acceptable due to the widely varying ad valorem taxes present across our state. If such a tax is necessary, then it must be imposed in such a way as to take into account the varying levels of ad valorem taxes and profitability of wells.

I am also concerned about the frequent comments I have overhead regarding the ability of this industry to administer anything other than a "flat rate" tax without exemptions and credits. Let me assure you that the provisions for exemptions and credits currently being considered are clearly within our administrative capabilities. The process of supplying the annual tax statements to the purchasers is a good one. The purchasers, although few in number, have the most capability for administering this process. They have already handled much more significant problems in dealing with the windfall profit tax and varying levels of crude oil pricing prior to decontrol.

In my opinion, the worst thing you could do would be to have a "flat rate" credit applied by the purchasers. The vast majority of the smaller operators in our state would have difficulty performing the reconciliation work necessary to properly pay their tax under such a system. It is quite

likely that underpayments would be unreported and, likewise, that overpayments would never be claimed. By having the purchasers undertake this task, you have by far the best chance of having the tax properly administered, the tax collected timely, and the least amount of reconciliation at year end. It appears to me that under the proposed credit system the vast majority of reconcilation differences would be in favor of the State of Kansas when varying production levels failed to utilize the full credit allowed when applied on the basis of 1/12 per month.

I remain opposed to any severance tax in Kansas primarily based on the inability of the industry to handle such a financial burden at this time. However, if you deem such a tax necessary, I urge you to leave the exemptions and credits in place so that our industry can allocate the tax to those most able to pay and further so that the tax can be administered in the least costly manner to both the industry and the State of Kansas.

Very truly yours,

PEAT, MARWICK, MITCHELL & CO.

James R. Cast

James R. Cast, Partner

JRC:MLW

STATE OF KANSAS

KEITH FARRAR
REPRESENTATIVE, 124TH DISTRICT
STEVENS, GRANT, STANTON,
MORTON, HASKELL COUNTIES
STAR ROUTE
HUGOTON, KANSAS 67951

TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
MEMBER: WAYS AND MEANS
JOINT COMMITTEE ON STATE BUILDING CONSTRUCTION
INSURANCE

STATEMENT BY REP. KEITH FARRAR
ASSESSMENT AND TAXATION COMMITTEE
OPPOSITION TO SB 267

Mr. Chairman and members of the committee, I am sorry to say there are legislators, especially those who do not have oil and natural gas production in their districts, but who want to share in the benefit of the distribution of the proposed tax, who think this is a fair tax, since in their view, it is a tax someone else pays.

I represent the southwest corner of the state, which has some oil, a lot of natural gas, irrigation, and a great livestock industry.

Now, let me tell you about the attitude of the people I represent in western Kansas. A lot of them are the "someone elses" who will pay the tax. We are located nearly 400 miles from Topeka, and to many of these people, it seems the only time the legislature notices them, is to try and take away their tax base.

Our average rainfall in western Kansas is between 15" and 17", (that is close to the definition of a desert). My constituents do not have the availability of water sports, such as boating, skiing and fishing without driving 150 miles or more. They have been helping to pay for those beautiful lakes in the eastern half of the state, without much benefit.

ATTACHMENT II
(3-15-83)

I think you can understand why western Kansas taxpayers are concerned about the proposed severance tax. It looks like here again goes more of our tax resources to Topeka and we will not receive any benefit.

Two years ago a legislative committee looked into the background of the use of Industrial Revenue Bonds in Kansas. The figures are being updated, but showed a loss of approximately 2 billion dollars to the ad valorem tax base since 1961, these properties were off the tax rolls, which means that the state, through the school finance formula subsidized the revenue bond property, and rewarded those school districts that had Industrial Revenue Bond property off the tax rolls, since they appeared poorer than they actually were. The urban school districts fared better than most, since Sedgwick, Wyandotte and Johnson Counties had nearly one half of all the industrial revenue bonds issued since 1961. Wichita has the distinction of the largest single bond issue - Boeing Aircraft for 112 million dollars in 1979. We know jobs were created but, my people question, why is it fair for urban areas and others to lower their tax base with industrial revenue bonds exempt from county ad valorem taxes then get tax dollars for education from the proposed severance tax from other areas of the state?

According to information provided by the KDED pertaining to "IRBs" issued in Kansas 1961 to 1981 and published June 1982, Wyandotte County had 195 million dollars off the tax rolls, Johnson County had 273 million off the tax rolls and Sedgwick County had 673 million dollars off the property tax rolls. The state total was 2 billion, 704 million, 956 thousand dollars.

I think you might benefit by reading an Editorial from the "Southwest Kansas Irrigator" back in 1981. He compares the oil and gas valuation in the 39th Senatorial District to valuation off the tax rolls in Wichita. Valuation from oil and gas totaled right at 600 million dollars and "surely looks like a plum worth picking." The Editor used figures available at that time to point out that Wichita alone had almost enough exemptions from the tax rolls to buy most of the wells in the 39th District, which are not tax exempt. Further, it was pointed out in reference to Wichita "No wonder they got state aid in 1981 totaling $49,869,477 in the Sedgwick County schools." He quotes a figure of 5 billion dollars exempted statewide. I am not sure where that figure came from but his point is the same - "it's time that equalization became more equal; that's all."

Another point to remember, any home, business, church, school, etc. using Kansas natural gas or LPG to heat with, or use in the process to produce a product for sale will pay more. I am sure most of you know people pay taxes - business will pass their cost on in order to make a profit, if there is no profit, pretty soon there is no business and needless to say, no jobs either.

This is the first time the legislature has considered a severance tax that included the royalty owners and I believe you should consider that action very carefully. I am sure that someone has said it is not right to tax only 7/8 of the production, after all the royalty owner doesn't have any expense.

I would point out that there is quite a difference in what the 7/8 represents and the 1/8 royalty interest represents. The royalty

owner owns all 100% of the minerals while in the ground and the oil or gas producer owns the product when it is severed from the earth, and usually pays the royalty owner for 1/8th of the proceeds of the sale of the product. The royalty owner has a property right to the minerals in place, while in the ground, and has paid for the right to own 100% of those minerals. That property right is sold, just like the property right for the surface of the land, a home, hotel or other business. If you include royalty owners in a severance tax which reduces the value of his mineral interest, what is to keep the legislature from taxing, at the same rate, the income to a landlord from property he rents to someone else, farmland, a home, hotel or a business property?

Now back to my final reasons why I appear against the proposed severance tax.

I like to think that over all, the Kansas legislature in responding to the needs of Kansas citizens has tried to use the user pay concept in taxation, however with the proposed severance tax we are singling out one industry to help offset rising property taxes. What industry will be next?

Remember, someone had to take a chance with their money to discover natural gas and oil in this state and we have all shared in some manner from that golden egg, directly or indirectly. In my area, it provided cheap fuel to run an irrigation engine and help hold our taxes down. Without irrigation, much of my districts farm land is summer fallowed, in other words we only raise a crop at <u>best</u> every two years. The rest of the state has benefitted by having lower prices for electricity - heating their homes and factories. By passing this

bill, we will slow development of new production in Kansas and become more dependent on sources outside our state. I would rather have money spent in Kansas providing Kansas jobs in searching for more oil and gas than seeing it shifted elsewhere.

The money spent in Kansas on drilling for more oil and gas is a welcome addition to the states economy. With increased drilling comes the discovery of more oil and gas which also adds to our economy. We should encourage the oil and gas industry, not discourage it.

SOUTHWEST KANSAS IRRIGATOR

Opinion/Ed Page

Wichita Exemptions Could Buy Our Wells

Editorial by John McVey

Severance tax may not be an issue directly related to groundwater use or the price of a bushel of milo. For this we apologize, to readers who feel that severance tax would have no impact on the farmer. As most of our readers surely realize how big an impact severance tax would have on agriculture in Kansas, and every other aspect of the economy of oil and gas producing areas of the state, we felt that this was an appropriate subject for an editorial.

Information from the Kansas Legislative Research Department reveals that the 39th Senatorial district, represented by Senator LeRoy Hayden of Satanta, has natural gas valuation of $523,725,297, and oil valuation of $74,237,765, for total oil and gas valuations of in excess of $600,000,000. This surely looks like a plum worthy of rapid plucking, to people in the some other parts of the state. But they overlook the fact that over five billion dollars worth of property in Kansas is exempt from taxation, through industrial revenue bonds! A huge chunk of property, comparable to a large portion of the petroleum in the 39th district, is locked up in Wichita, completely safe from the tax collectors in the "industrial revenue bond" strongbox.

Not much can be done about this, since state law provides for industrial revenue bonds. The theory is that, if industries are encouraged in this manner, people will come to work for the industries and will, in turn, pay enough taxes to offset the tax exemptions enjoyed by the companies. Whether it actually works out that way is a good question. In the light of current inflation and higher interest rates, thousands of employees cannot buy homes and other property that, in different times than these, would have gone on the tax rolls in the cities and counties issuing the industrial revenue bonds.

Regardless of the value to the city and county getting the benefit of the ad valorem tax-exempt industry, these whale-sized exemptions create a gaping hole in the tax structure of the state. Among other effects, the concentration of tax-exempt property in places like Wichita distorts the school equalization formula. While western Kansas, on the one hand, gets little or no state aid for schools, because our oil and gas wealth is NOT tax exempt, Wichita alone has enough exemptions to buy most of the wells in the 39th district. In Wichita since 1963, $474,568,500 in industrial revenue bonds have been issued. With six exceptions, amounting to payments totalling approximately $10,000 in 10 years, no taxes, no payments in lieu of taxes, and no service fee payments were required of Wichita industries for which industrial revenue bonds were issued between 1963 and 1973. But 42 industries founded in that time paid no ad valorem taxes at all, and are still required to pay no taxes. For Wichita industries for which IR bonds were issued after 1973, it is a different story. Only about half of these, including hospitals and other public facilities, paid nothing. But only about $117,737 has been paid, in fees and payments in lieu of taxes, on $474,568,500 worth of property in almost 20 years. A ratio of about one tax dollar for every $5,000 worth of property. If our houses in western Kansas were taxed at that rate, we would pay the taxes on one for what it would take to buy a carton of cigarettes. At that rate, you couldn't pay the eraser bill in the Wichita public schools. No wonder they got state aid in 1981 totalling $49,869,477 in the Sedgwick County schools!

How much aid does the so-called equalization formula provide for western Kansas public schools? Again taking the 39th district as an example, here's how it stacks up:

Greeley County: 0. Hamilton County: 0. Kearny County: 0. Finney County: $3,928,591. Stanton County: 0. Grant County: 0. Morton County: $243,674. Stevens County: 0.

Quite a parade of zeroes, when it comes to getting state money, isn't it?

Now Carlin wants to use severance tax to help everybody out. This means still more money from the petroleum industry in western Kansas, and more zeroes from the pockets of rich Wichita industries. We don't mean to pick on Wichita. The roughly 500 million dollars in exempted property in Wichita is a drop in the bucket compared with the FIVE BILLION DOLLARS exempted statewide!

It's time that equalization became more equal; that's all.

STATEMENT OF
BERNARD E. NORDLING, EXECUTIVE SECRETARY
SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION
Hugoton, Kansas 67951

March 15, 1983

To the Honorable Members of the House Committee
on Assessment and Taxation:

My name is Bernard E. Nordling of Hugoton. I am Executive Secretary of the Southwest Kansas Royalty Owners Association. Our Association was formed in 1948 for the primary purpose of protecting the rights of landowners in the Hugoton Gas Field. We presently have slightly over 2,100 landowner members.

I am appearing before your Honorable Committee on behalf of Association members and Kansas royalty owners in opposition to Substitute for Senate Bill No. 267 imposing an eight per cent severance tax on oil, gas, salt and coal production.

Several severance tax bills have been introduced in this legislative session, all of which, to my knowledge, originally exempted royalty owners from the tax with the exception of Senate Bill No. 171. Substitute for Senate Bill No. 267, as recommended by Senate Committee on Assessment and Taxation, also exempted royalty owners when it reached the Senate floor last week for debate. By Senate action, royalty owners were included in the substitute bill.

First, we feel we must clarify our position as royalty owners with relation to the lessee-producers.

ATTACHMENT III
(3-15-83)

We certainly are not here to "defend" the oil and gas industry because as we have learned many times over the years, they are quite capable of taking care of themselves. In fact, there are several bills presently pending before the legislature in which we have taken an opposite position.

A perfect example is the deep horizons bill in which we are seeking to shift the burden of proof to force the major oil and gas companies operating in the Hugoton Gas Field to develop the deeper horizons underlying the two and a half million acres in the Kansas portion of the Hugoton Gas Field.

One of the early objectives of our Association, formed in 1948, was to fight a severance tax. We have maintained that position throughout the years.

The Association has and still remains opposed to a severance tax for a number of reasons, most of which will be or have been mentioned by opponents of the severance tax in their testimony today. Among other things, we feel the tax imposed is excessive and singles out a particular industry to be taxed more than its fair share of the tax burden of the state. Also, there is no such thing as a "free lunch" and the Kansas consumers will ultimately pay the tax.

Our main concern today is the inclusion of royalty owners in the bill. We strongly feel the reason royalty owners are presently included in the substitute bill is because of pressure by oil and gas industry lobbyists to include them. Several representatives from the industry so testified before the Senate Committee on Assessment and Taxation.

Before this committee takes action to include royalty owners, we respectfully submit that serious consideration should be given to the large number of small oil and gas royalty owners in the state who will be affected by the bill. Attached to my statement is testimony given by myself and L. F. Stanley on behalf of the Southwest Kansas Royalty Owners Association before the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance in Great Bend, Kansas, on May 23, 1980. We testified that in 1980, there were over 215,000 oil royalty owners in Kansas receiving royalties from 47,000 oil wells. This number does not include gas royalty owners or coal and salt royalty owners. Of these 215,000 oil royalty owners, slightly over 142,000 were Kansas residents. It is fair to assume that many of those Kansas royalty owners are elderly persons receiving social security benefits and depend on oil royalty income to supplement their social security benefits. We feel strongly that Substitute for Senate Bill No. 267 should be amended to specifically exempt royalty owners from the severance tax.

While our Association is categorically against any form of state severance tax, nevertheless, we feel we must address the issue of the constitutionality of excluding royalty owners from any severance tax bill.

We submit that to include gas royalty owners in a severance tax bill would make the bill unconstitutional. Under the provisions of the gas royalty clause of an oil and gas lease, the instant the gas is severed from the surface, the entire ownership of the gas is in the lessee. The best proof of this

fact is that it is necessary for irrigation farmers to purchase natural gas at the wellhead to fuel irrigation engines even though they may receive gas royalties from the gas well to which they are connected.

This fact of lessee ownership of gas is confirmed in Mobil Oil Corporation v. Federal Power Commission, 463 F. 2d 256 (D.C. Cir. 1972), cert. den 406 U. S. 976, 32 L Ed. 2d 676, 92 S. Ct. 2409 and J. M. Huber Corporation v. Denman, 367 F. 2d 104 (5th Cir. 1966).

The Mobil v. FPC decision quotes from the Huber case in a footnote as follows:

> "See 367 F2d at 113-114:
> (The lessors make) the very simple, yet profound, contention that there can be no 'sale' of gas by royalty owners since they have no gas to sell. And this seems to be true as a matter of oil and gas law, whether based on the ownership-in-place concept followed by Texas and others or on non-ownership theories of other jurisdictions. For all agree that as the gas leaves the well-mouth, the entire ownership of the gas is in the lessee, none being reserved in the lessor." (Emphasis ours)

The oil royalty clause of an oil and gas lease is different. The royalty may be paid in kind, at the lessee's option.

There is a general misconception of payment of oil and gas royalties under an oil and gas lease. Oil or gas royalty is simply compensation for the use of the lessor's land by the lessee

in its exploration and development of the land for oil or gas. Gas royalty can be considered as cash rent while oil royalty can be considered as crop rent.

Thank you for this opportunity to be heard.

Respectfully submitted,

B. E. Nordling,
Executive Secretary
SOUTHWEST KANSAS ROYALTY
OWNERS ASSOCIATION

STATEMENT OF

BERNARD E. NORDLING, EXECUTIVE SECRETARY

OF

SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

SENATE COMMITTEE ON FINANCE

May 23, 1980

STATEMENT OF
BERNARD E. NORDLING, EXECUTIVE SECRETARY
SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION
HUGOTON, KANSAS 67951

May 23, 1980

To the Honorable Members of the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance, United States Senate.

INTRODUCTION

Gentlemen:

My name is Bernard E. Nordling of Hugoton. I am Executive Secretary of the Southwest Kansas Royalty Owners Association. I am appearing on behalf of our Association to report on the impact of the windfall profit tax on royalty owners and to support S. 2521, providing for more equitable treatment of royalty owners under the WPT bill.

BACKGROUND INFORMATION

Our Association is a non-profit Kansas corporation, organized in 1948. We have a paid-up membership of over 2,000 members. Our membership is limited to landowners owning mineral interests in the Kansas portion of the Hugoton Field - lessors under oil and gas leases as distinguished from oil and gas lessees, producers, operators, or working interest owners. While membership in our organization is voluntary, our members own mineral interests in approximately 1,200,000 acres, not quite half of the producing acreage in the Hugoton Field.

SWKROA HAS VOICED OPPOSITION TO WINDFALL PROFIT TAX

For several months, our Association has expressed opposition to H.R. 3919. On January 16, 1980, the SWKROA Board of Directors adopted a resolution setting forth the reasons for opposing the tax. A copy of the resolution is attached, marked Exhibit "A," and made a part of this statement by reference.

The resolution was mailed to all members of Congress and to the President of the United States. We requested comments and help in opposing the bill or exempting royalty owners. Disappointingly, less than 10% of the Congressmen responded as did the White House. Little encouragement was given on exempting royalty owners from the oil tax. Even more disturbing was the failure on the part of some Congressmen to recognize the difference between a producer and a royalty owner.

The most encouraging note is the strong stand Kansas Senator Bob Dole has taken to exempt royalty owners from the windfall profit tax. Recognizing that royalty owners were unjustly treated under the tax, he attempted to remedy this inequity but without success.

In further recognition of the plight of the royalty owners, on the day President Carter signed the windfall profit tax bill into law, Senator Dole, with Oklahoma Senator David L. Boren, Kansas Senator Nancy Kassebaum, and seven other colleagues introduced a new bill, S. 2521, to entirely exempt small royalty

owners from the windfall profit tax up to 10 barrels per day of royalty interest. I will speak to the merits of this bill later in my statement.

OIL PRODUCTION IN KANSAS IN 1979

According to the Kansas Geological Survey, there were 56,921,000 barrels of oil produced in Kansas in 1979 from approximately 43,500 oil wells. Of these wells, 41,000 to 41,500 wells are in the "stripper" well category, producing less than 10 barrels of oil per day. Last year, Kansas ranked 7th nationwide in oil production.

NUMBER OF OIL ROYALTY OWNERS IN KANSAS

In the past few days, we have conducted a survey to determine the approximate number of oil royalty owners in Kansas. The survey was conducted by contacting primary first purchasers of domestic oil production. A sufficient number of first purchasers were contacted to obtain a fairly accurate projection of the number of royalty owners receiving royalties from oil production in Kansas. Our projected total is 215,543 royalty owners.

Of these 215,543 royalty owners, approximately 66%, or slightly over 142,000, are Kansas residents while the remaining 73,000 royalty owners live in other states throughout the country.

THE TAX IS INEQUITABLE AND UNFAIR TO ROYALTY OWNERS

The oil tax is inequitable and unfair to royalty owners for the reason they must pay the tax on the same basis as major oil companies. Under the WPT law, royalty owners are paying at a 70% tax rate on upper and lower tier oil. They pay at a tax rate of 60% for stripper oil and 30% for newly discovered oil, incremental tertiary oil, and heavy oil. These are at the same rates paid by the major oil companies, being some of the largest corporations in the world. On the other hand, independent producers are taxed at a reduced rate of 50% on the first 1,000 barrels per day on production of lower tier and upper tier oil and at a reduced rate of 30% on stripper well oil and National Petroleum Reserve oil. There is no justification for this arbitrary and unfair treatment of royalty owners.

The oil tax paid by royalty owners is confiscatory in nature. Oil is a wasting nonreplaceable natural resource. As each oil field is exhausted, the landowner-royalty owner will have a valueless capital asset in a specific location, whereas the oil producers can move to new locations for exploration and development of new oil and gas fields.

CONSUMERS WILL ULTIMATELY PAY THE TAX

While the theory behind the tax is to use revenues raised for income tax reductions, low income tax assistance and energy and transportation programs, the obvious end result of the tax will be that the consumer will pay the tax as a "pass-on" by the producers. In other words, the tax will logically be passed on by the major oil companies and independent producers to the consumers, thus causing double taxation for the royalty owners, who are consumers but who have no available means to pass on their portion of the tax.

THE WINDFALL PROFIT TAX RESULTS IN REDUCED INCOME TO ROYALTY OWNERS

Many of the 142,000 Kansas oil royalty owners are elderly persons receiving social security benefits. According to information furnished by the Social Security offices, there are a total of 372,317 persons in Kansas receiving social security benefits as of this date. The classification of such persons is as follows:

Age Group	Number of Persons
Under 65 years of age	96,923
Between ages of 65 and 71, inclusive	112,988
Persons 72 years of age and over	162,406
Total persons in Kansas receiving social security benefits	372,317

It is fair to assume that many of these persons depend on oil royalty income to supplement their social security benefits. It has been a shock to many retired royalty owners to have their royalty income reduced by as much as 35% from the windfall profit tax. For example, a widow in Stevens County received her royalty check last month. The gross royalty of $139.00 was reduced by $48.40 in windfall profit tax, or by 35%! Another social security recipient received gross monthly royalty of $118.23, with a reduction of windfall profit tax of $40.47, or a 34.2% reduction of her monthly income.

It seems rather strange for the federal government to take this money away from such individuals and then, under the revenue provisions of the WPT law, give a portion of the tax revenue back to them in the form of income tax reductions and low income assistance!

MISLEADING INFORMATION ABOUT THE WINDFALL PROFIT TAX

It is my understanding that aside from the SWKROA, few royalty owners throughout the United States let their opposition to the WPT be known to members of Congress prior to its passage. This is understandable. All advance publicity about the so-called "windfall profit tax" bill led one to believe that the

federal government wanted to prevent large oil companies from making huge profits when oil was decontrolled, and that under the proposed legislation, the major oil companies were paying the bulk of the tax. The tax came as a shock to many small royalty owners when they received their April royalty checks, with their monthly income being greatly reduced by the tax.

Another factor to consider is that the hundreds of thousands of royalty owners throughout the United States have no national organization to keep them informed of pending legislation or to protect their rights as do other groups. Thought has been given to organize such a group, but it seems an almost insurmountable task. Because of the lack of proper information, it is often too late for royalty owners to express their opinions to their Congressional representatives on legislation affecting their correlative rights.

THE SWKROA URGES THE PASSAGE OF S. 2521

Our organization urges the passage of S. 2521 to exempt royalty owners from the windfall profit tax up to 10 barrels per day of royalty interest, or to exempt royalty owners completely from the tax.

In addition to the reasons given above, millions of dollars in administrative costs each year would be saved by such an exemption, both in costs to the federal government, to the producers, and to the first purchasers of the oil subject to the WPT.

Respectfully submitted,

Bernard E. Nordling,
Executive Secretary
Southwest Kansas Royalty
Owners Association

BEN:mjh

Attachment

SUMMARY OF STATEMENT MADE BY BERNARD E. NORDLING, EXECUTIVE SECRETARY OF THE SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION, BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT OF THE SENATE COMMITTEE ON FINANCE

May 23, 1980

SUMMARY

1. Introduction.

2. Background information.

3. SWKROA has voiced opposition to the windfall profit tax prior to its passage and has received support from Senator Bob Dole and David Boren and some of their colleagues, to exempt royalty owners from the tax through S. 2521.

4. The WPT is inequitable and unfair to royalty owners.

5. Consumers will ultimately pay the tax.

6. The windfall profit tax results in reduced income to royalty owners.

7. Royalty owners received misleading information about the windfall profit tax prior to its passage. For that reason did not realize the bill affected them the same as the major oil companies.

8. The SWKROA urges the passage of S. 2521.

STATEMENT OF

L. F. STANLEY, MEMBER

OF

SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

SENATE COMMITTEE ON FINANCE

May 23, 1980

STATEMENT OF
L. F. STANLEY, MEMBER OF THE
SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION
SATANTA, KANSAS 67870

May 23, 1980

To Honorable Robert Dole and Honorable David L. Boren,
Members of the Subcommittee on Taxation and Debt
Management of the Senate Committee on Finance,
United States Senate.

INTRODUCTION

Gentlemen:

My name is L. F. Stanley of Satanta, Kansas. I am a member of the Southwest Kansas Royalty Owners Association and have been actively working with people who own mineral interests in Kansas and other states. From my experiences, I am deeply concerned about the effect the windfall profit tax is having on the elderly.

In a recent survey of companies who purchase Kansas produced crude oil and remit royalties to royalty owners, it was estimated that about 130,000 royalty owners receive less than $600.00 a year in royalty payments.

There is a misconception that the average royalty owner is rolling in wealth. When you consider that nearly all of the original royalty interests have gone through two or three estate settlements, and in each estate the royalty interests are divided among the heirs, very few persons own all the royalty from a

single oil well. This is confirmed since there are at least 215,543 royalty owners receiving royalty from about 43,500 oil wells in Kansas and about 60% of these are residents of Kansas. The average oil well in Kansas produces only 3.6 barrels of oil a day, and it is calculated that if an individual owned all the royalty interest in an average well, his or her oil royalty would approximate $15.00 per day. The windfall profit tax is computed at an average of about $4.50 per day. Thus, the royalty owner would net $10.50 a day before the ad valorem taxes are assessed.

Many royalty owners are elderly persons who are dependent upon their social security and oil royalty payments for their total support. Quite a number of royalty owners have sold the surface interest in their land, reserving a life estate in the minerals.

According to the Social Security office in Topeka, at the present time, the average social security payment to widows is $271.00 per month and the average retired person receives $289.00 per month. Thus the total income, before taxes, for a person having a full royalty interest in one oil well after the windfall profit tax is removed and the social security payment is less than $600.00 a month. When you consider that the basic care in an average nursing home for a person, not on Medicare, is

$25.48 per day, or $764.40 monthly, this is creating a new class of welfare clients, and the windfall profit tax is compounding the problem.

The removal of the windfall profit tax from the proceeds of the first 10 barrels of oil per day as proposed by S. 2521 would greatly improve the situation. I respectfully request that this Committee recommend to Congress that royalty owners be exempted from the WPT completely, or at least be granted an exemption from the tax of up to 10 barrels per day as provided by S. 2521.

Respectfully submitted,

L. F. Stanley

LFS:mjh

SUMMARY OF STATEMENT MADE BY
L. F. STANLEY BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE SENATE COMMITTEE ON FINANCE

May 23, 1980

Of the 215,543 persons receiving oil royalty from the 43,500 oil wells in Kansas, about 130,000 of these persons receive less than $600.00 in royalties. Since many of the owners of mineral interests are living on their social security benefits and their royalty payments, the windfall profit tax is creating a new class of welfare recipients. The royalty owner should be exempt from the windfall profit tax.

J. M. HUBER CORPORATION, Appellant,
v.
William Harvey DENMAN and Jay Pumphrey, Trustees of the Estate of S. B. Burnett, Deceased, et al., Appellees.

No. 22272.

United States Court of Appeals
Fifth Circuit.

Sept. 20, 1966.

Action by natural gas lessors for damages on ground that corporate lessee had breached and was continuing to breach contractual obligations under royalty clauses of three leases. The United States District Court for the Northern District of Texas, Leo Brewster, J., 251 F.Supp. 746, entered judgment for plaintiffs and appeal was taken. The Court of Appeals, John R. Brown, Circuit Judge, held that evidence sustained finding that lessors, in executing, and lessee-producer, in accepting, gas leases requiring payment to lessors of "market price" or "market value" of such gas intended to use quoted terms in their usual ordinary sense and not as synonymous with or identical to proceeds received under contract by lessee-producer its pipeline purchaser which purchased all of the gas, and that it was appropriate that Federal Power Commission, rather than Court of Appeals, initially determine jurisdiction of Commission over royalty rates which might exceed relevant ceilings of Commission.

Affirmed in part, and reversed and remanded in part.

1. Contracts ⇐113

In construing contract, court is to put itself in position of parties.

2. Contracts ⇐170(1)

Construction put on contract by a responsible action of parties is frequently best revelation of its purpose.

3. Mines and Minerals ⇐79(7)

Evidence sustained finding that lessors, in executing, and lessee-producer, in accepting, natural gas leases requiring payment to lessors of "market price" or "market value" of such gas intended to use quoted terms in their usual ordinary sense and not as synonymous with or identical to proceeds received under contract by lessee-producer from its pipeline purchaser which purchased all of the gas, in action by lessors against lessee for breach of contract for refusal to pay market price or market value. Natural Gas Act, § 1 et seq., 15 U.S.C.A. § 717 et seq.

4. Mines and Minerals ⇐79(3)

In determining "market price" or "market value," law looks not to particular transaction but the theoretical one between supposed free seller vis-a-vis the contemporary free buyer dealing freely at arm's length supposedly in relation to property which neither will ever own, buy or sell.

See publication Words and Phrases for other judicial constructions and definitions.

5. Mines and Minerals ⇐79(3)

Lessors' demand that lessee-producer have a firm commitment for sale of natural gas if and when produced before lessors would enter into lease, was not, standing alone, or in conjunction with contract obtained by lessee with pipeline company, inconsistent with expectation that in the future lessors would want payment for royalty on current value of gas being delivered and did not establish that terms "market price" or "market value" used in the leases referred to price that pipeline company would pay. Natural Gas Act, § 1 et seq., 15 U.S.C.A. § 717 et seq.

6. Mines and Minerals ⇐79(3)

That natural gas leases prescribed fixed minimum to be paid to lessors did not establish that terms "market price" or "market value" used in leases as price to be paid in the future were restricted to amount paid by pipeline purchaser to lessee-producer pursuant to contract entered into prior to leases. Natural Gas Act, § 1 et seq., 15 U.S.C.A. § 717 et seq.

7. Estoppel ⇐81

That lessors demanded that lessee-producer have firm commitment for sale of gas, if and when produced, before lessors would enter into lease, that such a contract with pipeline purchaser was entered into by lessee, and that, with lessors' approval, all of gas until exhaustion of reserves was committed to contract with pipeline purchaser did not estop lessors from claiming that "market price" and "market value" as used in leases referred to market price or market value for like gas in the field and not the price received by lessee from its pipeline purchaser. Natural Gas Act, § 1 et seq., 15 U.S.C.A. § 717 et seq.

8. Mines and Minerals ⇐79(3)

That coincident with contractual price increase, new division orders were executed specifically stating that they were applicable to natural gas run to pipeline purchaser and prescribing that royalty and working interest should be settled for on basis of 4 cents per thousand cubic feet did not commit lessors for life of lease to that construction of royalty clause, where moment of execution, royalty clause by its terms prescribed the 4 cents royalty for another six months and lessors had right to withdraw the orders in future. Natural Gas Act, § 1 et seq., 15 U.S.C.A. § 717 et seq.

9. Mines and Minerals ⇐79(1)

Division orders constitute precise and definite basis for payments so that payments made in accordance with them are final and binding, but they may nevertheless be withdrawn as to future. Natural Gas Act, § 1 et seq., 15 U.S.C.A. § 717 et seq.

10. Administrative Law and Procedure ⇐228

Doctrine of primary jurisdiction reference to administrative agency for initial decision has broad aim and is flexible.

11. Administrative Law and Procedure ⇐228

That jurisdiction of administrative agency was ultimately question of law and probably one of statutory construction did not preclude submission to the agency for initial decision of the question of its jurisdiction.

12. Administrative Law and Procedure ⇐228

Justification for judicial referral of jurisdictional question for initial resolution by administrative agency is even stronger than for a nonjurisdictional question.

13. Administrative Law and Procedure ⇐228

In divining legislative purpose, arguments for and against the agency jurisdiction over a matter should be evaluated by agency having responsibility for operating statutory machinery.

14. Mines and Minerals ⇐79(5)

There can be no "sale" of gas by royalty owners since they have no gas to sell and that is true whether based on ownership-in-place concept followed by Texas and others or on nonownership theories of other jurisdictions. Natural Gas Act, § 1(b), 15 U.S.C.A. § 717(b).

15. Mines and Minerals ⇐73

Under Texas oil and gas law, gas lease, unlike oil lease which undertakes to pay for or to deliver in kind royalty oil, constitutes present sale of all of gas in place at time lease is executed. Natural Gas Act, § 1(b), 15 U.S.C.A. § 717(b).

16. Mines and Minerals ⇐79(1)

Although landowner-lessor has no title in gas in place, royalty owners possess some character of property right. Natural Gas Act, § 1(b), 15 U.S.C.A. § 717(b).

17. Mines and Minerals ⇐79(5)

As gas leaves well mouth, entire ownership of gas is in lessee, none being reserved in lessor. Natural Gas Act, § 1(b), 15 U.S.C.A. § 717(b).

18. Mines and Minerals ⇐92.7

Neither form of transaction nor peculiarities of state law are controlling in determining whether there is a jurisdictional sale of gas under the Natural Gas Act. Natural Gas Act, § 1(b), 15 U.S.C.A. § 717(b).

19. Mines and Minerals ⇐79(1)

"Natural gas royalty" in legal concept is a deferred payment for initial grant, but it bears direct relation to current production or occasionally depends on nonproduction, for example under take-or-pay, minimum nomination requirements. Natural Gas Act, §§ 1(b), 4, 5, 7, 15 U.S.C.A. §§ 717(b), 717c, 717d, 717f.

See publication Words and Phrases for other judicial constructions and definitions.

20. Mines and Minerals ⇐92.7

It was appropriate that Federal Power Commission, rather than Court of Appeals, initially determine jurisdiction of Commission over royalty rates which might exceed relevant ceilings of Commission. Natural Gas Act, §§ 1(b), 4, 5, 7, 15 U.S.C.A. §§ 717(b), 717c, 717d, 717f.

21. Federal Civil Procedure ⇐1795, 1877

In view of acute public interest, dismissal of case involving question of jurisdiction of Federal Power Commission over natural gas royalties was not in order, and, if lessor declined to take part in reference to Federal Power Commission, Court of Appeals had ample power to require lessee and pipeline purchaser to go forward with reference to the Commission. Natural Gas Act, §§ 1(b), 4, 5, 7, 15 U.S.C.A. §§ 717(b), 717c, 717d, 717f.

C. C. Small, Jr., Austin, Tex., Thomas O. Moxcey, Denver, Colo., William Tucker, Denver, Colo., Small, Small, & Craig, Austin, Tex., for appellant.

Cecil E. Munn, Cantey, Hanger, Gooch, Cravens & Scarborough, Fort Worth, Tex., for appellees.

* Of the Second Circuit, sitting by designation.

Before RIVES, BROWN and MOORE,* Circuit Judges.

JOHN R. BROWN, Circuit Judge.

As with another case this day decided,[1] this one, thought by the parties to be a private controversy, turns out to have transcendent public interest issues. In each, besides deciding the private law questions, we direct a reference to the Federal Power Commission for it to determine under the doctrine of primary jurisdiction the jurisdiction of the FPC over rates to be paid for gas royalty. Post argument consideration led the Court to the view that in the ultimate resolution of private law issues, there were problems of great public interest. The Court by memoranda to counsel in this and *Weymouth* (see note 1, supra) called for, and we have received, extensive helpful briefs.[2]

I.

The Market Price Royalty Clause

The basic private legal question presented is whether under the terms of the oil and gas lease from Lessors to Lessee-Producer the amount payable as royalty is to be fixed by the stated percentage (1/4th) of (a) the price received by the Lessee from its Pipeline Purchaser or (b) the market price for like gas in the field.[3] This turns on the construction of the lease terms in the light of all pertinent factors.

It sharpens the relevance of facts and the significance of the trial Court's actions to bear in mind that the royalty clause in question prescribed (a) a fixed price for a ten-year period and thereafter for the period in controversy (b) the market price of such gas, but not less than the specified minimum.[4] The Lessors contend that it is the market price[5] without limitation to the actual proceeds while the Lessee-Producer urges that the value is fixed by the proceeds received by it from its Pipeline Purchaser.

It likewise steamlines our task to emphasize what the quarrel is not about. Contrary to the sometime colorful charges of the Lessor, the Lessee-Producer does not undertake to say that this clause (note 4, supra) is a "proceeds" rather than a "market price" standard. The Lessee-Producer gears royalty payments to the proceeds from the Pipeline-Purchaser, not because it is a "proceeds" clause, but, rather, because contemporaneous actions and other agreements limit "the market" to that afforded under the Northern Gas contract. The Lessee-Producer refuses, therefore, to get drawn into the academic debate pressed so hard by the Lessors that a market price clause is quite different from a proceeds clause.[6] Indeed, rather than disputing this recognized distinction, the Lessee-Producer asserts that because of other circumstances later discussed the terms "market price" and "market value" were not intended consensually to be used in their usual and ordinary sense. That sense is stated to be the "price at which willing buyers at or about the time of deliveries of gas produced from the leases were agreeing to pay willing sellers for comparable gas." This contention is a paraphrase of issues No. 2 and 3 out of the four stipulated to be tried by the District Judge and which he answered adversely to Lessee-Producer.[7]

1. Weymouth v. Colorado Interstate Gas Co., 5 Cir., 1966, 367 F.2d 84.

2. These included the formal brief of the FPC (with separate statement of Commissioner O'Connor) filed in response to the Court's express request and full exchange of briefs of all counsel in both cases on the FPC issue.

3. Lessor — Burnett Estate
Lessee-Producer (the Producer status under FPC) — Huber
Pipeline Purchaser — Northern Natural

4. The gas royalty clause reads as follows:

"To pay the Lessors monthly for one-fourth (1/4) of the gas produced at the mouth of the well from any gas well, where gas only is found, four cents per one thousand cubic feet for the first ten years of this contract, and thereafter, the market price of such gas, but in no event shall the price be computed at less than four cents per thousand cubic feet."

Of production at issue 93% is from the R-Lease, the balance from the B and the M Leases which provided a 1/8 royalty "of the market value in the field," etc.

5. For our purposes the distinction between market "price" and "value" is of no consequence. For simplicity all references will be to "market price."

6. The Lessors stress the following: Phillips Petroleum Co. v. Bynum, 5 Cir., 1946, 155 F.2d 196, 201; Union Producing Co. v. Pardue, 5 Cir., 1941, 117 F.2d 225, 227; Wall v. United Gas Public Service Co., 1934, 178 La. 908, 152 So. 561; Phillips Petroleum Co. v. Johnson, 5 Cir., 1946, 155 F.2d 185, 188, 189; W. R. Davis, Inc. v. State, 1944, 142 Tex. 637, 180 S.W.2d 429, 432; Foster v. Atlantic Refining Co., 5 Cir., 1964, 329 F.2d 485, 489; Sneed, Value of Lessors Share of Production Where Gas Only Is Produced, 25 Tex.Law Rev. 641, 646 (1947). See also, Brown, The Law of Oil and Gas Leases, 1958, §§ 6.09, 6.10.

7. The four stipulated issues were:

ISSUE NO. 1

Whether primary administrative jurisdiction of the subject matter is vested in the Federal Power Commission under the Natural Gas Act, 15 U.S.C.A., Secs. 717, et seq.

ISSUE NO. 2

Whether the payment of gas royalties to plaintiffs computed on the proceeds derived from the delivery of the gas produced from the wells described in the Amended Complaint to Northern Natural Gas Company in compliance with the "Northern Contract," as amended, fully satisfies all the express and implied obligations of defendant under the terms of the several leases, as amended, which leases are described in the Amended Complaint in respect to the marketing of gas production therefrom and the payment of royalty thereon, irrespective of the market price or the market value in the field of such gas or of gas generally.

ISSUE NO. 3

Whether the plaintiffs are legally entitled to collect royalty from defendant computed at a value or price in excess of the applicable effective rate, if any, under the Natural Gas Act, pursuant to the Rules and Regulations of the Federal Power Commission as to gas delivered under the "Northern Contract" to Northern Natural Gas Company, irrespective of the market price

In attacking the findings that it is the "market price" in the traditional legal sense, not the equivalent of the proceeds received from the Pipeline-Purchaser, the Lessee-Producer capsulates it in three steps: (1) this gas has a specific market, i. e., the Northern contract; (2) the market price of such gas is the amount received for the gas delivered to this specific market; (3) the Lessors, because of affirmative participation in the commitment of the gas to this specific market cannot claim there is a market other than the Northern contract. Elaborating, the contention runs, this is not an argument as to the difference in legal concept of "market price" and "proceeds received" clauses. Rather, the question for decision is whether, under the particulars of this case, the Northern Contract market is *the market* from which the market price is to be taken.

The circumstances surrounding the affirmative participation of the Lessors in the commitment of the gas to this particular market as reflected by the stipulation record may be briefly summarized. In early 1936 Lessee-Producer was negotiating with the Lessors for a lease on approximately 6,120 acres of unleased land overlying the Panhandle Gas Field of Texas, some of the land being in the sweet gas area and some of the land in the sour gas area of that Field. During such negotiations, Lessee-Producer was advised by the Lessors that, as a condition precedent to the making of such lease and as a part of the consideration for such lease, Lessee-Producer must have a positive contract with a pipeline company to take the production from the unleased area after it might be developed.

In order to meet this condition precedent and to establish a positive contract with a pipeline company, Lessee-Producer, on April 21, 1936, entered into the Northern [8] contract with Northern Gas, an interstate pipeline company, even though at that time Lessee-Producer had no lease and no binding agreement to obtain one from Lessors. On June 2, 1936, 42 days after the Northern Gas Contract was arranged, the Lessors delivered the "R-Lease to Lessee-Producer.

Two provisions of the R-Lease are particularly stressed, the first being the gas royalty clause (note 4, supra) and Sec. IX which referred to the preexisting Northern contract demanded as a condition precedent to the lease.[9] Subsequent contractual agreements between these parties also referred specifically to the Northern contract.[10]

Considering the fixed royalty of 4¢ for the first 10-year period expiring June 2, 1946 (note 4, supra), it is significant that under the Northern contract Lessee-Producer was to receive only 3½¢ per MCF until December 26, 1945, and from December 27, 1945, 4¢ for the remainder of the term of the contract (defined to be life of the leases to which it applied). In 1961 the contract price was renegotiated to 11¢ MCF and after FPC approval, this price was received. During the first 10-year period, the fixed royalty of 4¢ was paid, and no dispute exists as to it. Thereafter until 1961 Lessee-Producer paid royalty at 4¢ and after the 1961 increase on the basis of 11¢.

Against this background, the Lessee-Producer contends that these affirmative contractual actions permanently channeling the gas into the Northern contract bound the Lessor to accept the Northern contract as the sole and exclusive market. As such, these actions constitute as a matter of law, first, an express adoption of the contract, second, a ratification of it, and third, an estoppel to assert that the gas has any other market as between the parties.

In passing upon the stipulated issues 2 and 3 (see note 7, supra), the trial Court made categorical findings of fact that the Lessors, in executing, and the Lessee-Producer in accepting the R-Lease (and two others) intended to use the terms "market price" and "market value" in their usual and ordinary sense and not as synonymous with or identical to proceeds received under the Northern contract.

[1-3] When we bear in mind that in construing the contract, the Court is to put itself in the position of the parties [11] and that the construction put on the contract by responsible action of the parties is frequently the best revelation of its purpose, we think there were ample evidential facts to justify the Judge concluding that the literal terms, generally so well recognized in oil and gas law, should be given their literal meaning. There was, first, the fact that this lease was the product of extended negotiations conducted under the skilled eyes and hands of highly competent oil and gas lawyers. Realizing as they had to, that the earlier and rejected draft of February 19, 1936, had an express "net proceeds derived from the sale of gas" royalty clause which was in effect replaced by the "market price" clause (note 4, supra) the Lessee-Producer's reported declarations made through its general counsel—a voice not only of management, but with an articulate awareness of the significance of legal terms—clearly put its construction of a market, not a proceeds, basis on this royalty clause. There were similar representations made to the FPC that under its gas leases "it is obligated to pay royalty based on the market price at the wellhead."

[4-6] We do not minimize the beguiling appeal of the Lessee-Producer's theory. Without a doubt, with the Lessors' full approval, this committed until the exhaustion of the reserves [12] all of the gas [13] to this contract and hence to this "market." But the "market" as the descriptive of the buyer or the outlet for the sale is not synonymous with its larger meaning in fixing price or value. For in that situation the law looks not to the particular transaction but the theoretical one between the supposed free seller *vis-a-vis* the contemporary free buyer dealing freely at arm's length supposedly in relation to property which neither will ever own, buy or sell.[14] It was not, as this theory would make it read, an agreement to pay ¼th of the price received from the market on which this gas is sold. Rather, it was to pay

or the market value in the field of such gas or of gas generally.

ISSUE NO. 4

Whether the said gas division orders dated December 27, 1945, identified as Stipulation Exhibits Nos. 48, 49, 50, 51, 52 and 53 were in effect and binding on the plaintiffs on and subsequent to January 1, 1958.

8. Northern Natural Gas Company was then known as Northern Fuel Supply.

9. Section IX of the lease relating to the marketing of gas production reads:

"A contract for the sale of sweet gas produced from that portion of this lease which lies within what is now known to be the sweet gas area has been entered into between the Northern Fuel Supply Company as buyer and J. M. Huber Petroleum Company, which is the operating subsidiary of Lessee, as Seller. A true and correct copy of said gas sale contract has been furnished by the Lessee to the Lessor."

10. This included the August 10, 1938, lease in which Lessee-Producer undertook to drill and complete a well on the portions then leased and, if productive, "to proceed to deliver gas therefrom under its contract with the Northern Fuel Supply Company." Cited also are the unitization agreements of January 20, 1939 and November 2, 1939.

11. American Oil Co. v. Hart, 5 Cir., 1966, 356 F.2d 657.

12. Sun Oil Co. v. FPC, 1960, 364 U.S. 170, 80 S.Ct. 1388, 4 L.Ed.2d 1639; United Gas Pipe Line Co. v. FPC, 5 Cir., 1965, 350 F.2d 689, cert. granted, 1966, 383 U.S. 924, 86 S.Ct. 930, 15 L.Ed.2d 844.

13. The Northern contract applied to only 2,520 acres of the 6,120 acres conveyed under the R-Lease. Consequently, we think the Lessee-Producer persuasively refutes the Lessors' contention that had the intention been to confine the royalty basis to the proceeds of the Northern contract, such contract, otherwise incorporated by reference in Sec. IX, would again have been mentioned specifically.

14. As to the parties, the commodity, the market, is something less than "free" in this highly regulated gas business. See, Weymouth v. Colorado Interstate Gas Co., 5 Cir., 1966, 367 F.2d 84.

⅛th of the "market price" or "market value" as the case might be. The demand that the Lessee-Producer have a firm commitment for the sale of the gas if and when produced--standing alone or in conjunction with the Northern contract--was not inconsistent with the expectation that in the great unknown—the future down to exhaustion of the reserves—the Lessors wanted payment for royalty on the current value of the gas being delivered. So too was it consistent with a desire to have any and all increases without a ceiling while prescribing always the fixed minimum as the floor. The condition precedent demand served another vital purpose. It protected the Lessors against the possibility of producing gas wells being shut in from lack of a commercial outlet, a situation presenting some vexing legal problems.[15] More important than serving attractive grist for the lawyers' mill, and fees, a shut-in is economic frustration for an indeterminate time, certainly until the Lessor can take on another formidable lawsuit to establish breach of the covenants adequately to develop and market.

[7] With this analysis falls also the claim based on estoppel. With little more we reject also the claim that the division orders of December 27, 1945, committed the Lessors for the life of the lease to this construction of the royalty clause. (See Issue No. 4, note 7, supra). Coincident with the contractual price increase effective December 27, 1945, new division orders were prepared and executed.[16] The Lessors accepted royalty settlements under the division orders for approximately a year and thereafter attempted a unilateral revocation on January 30, 1947.

[8, 9] We think two replies of the Lessors suffice. The first is that as of the moment of execution, December 27, 1945, the royalty clause (note 4, supra) by its terms prescribed the 4¢ royalty for another six months down to June 2, 1946. More important, unless as in Union Producing Co. v. Driskell, 5 Cir., 1941, 117 F.2d 229, in which positions were significantly changed in reliance on the division order, such division orders have limited effectiveness. They do, of course, constitute a precise and definite basis for payments so that payments made in accordance with them are final and binding. Cf. Pan American Petroleum Corp. v. Long, 5 Cir., 1964, 340 F.2d 211, 222. But they may nonetheless be withdrawn as to the future. Phillips Petroleum Co. v. Williams, 5 Cir., 1947, 158 F.2d 723, 727; Chicago Corporation v. Wall, 1956, 156 Tex. 217, 293 S.W.2d 844, 847.

In thus approving the action of the trial Judge on stipulated issues 2, 3 and 4 (note 7, supra) the question left open and yet to be tried under the agreed procedural course is the "market price" of the gas run since June 2, 1946. It is the Lessors' theory that the market price during all or a part of this time has been 23¢ per MCF rather than the 4¢ or 11¢ as paid. Since this claim if sustained, nets a recovery in the neighborhood of $306,530.98 [17] both as a matter of principal and principle, there is a serious question whether a Court, state or federal, either initially or ultimately, may allow any amounts fixed by jury, court, or both as increased royalty payments without express prior approval of the Federal Power Commission if, as would these, the price thus fixed would exceed levels prescribed by the FPC.

15. See Brown, The Law of Oil and Gas Leases, § 6.08, 1966 Cumulative Supplement, 87-98; especially as to Gulf Oil Corporation v. Reid, 1960, 161 Tex. 51, 337 S.W.2d 267; Skelly Oil Co. v. Harris, 1962, 163 Tex. 92, 352 S.W.2d 950, and criticizing our decision in Vernon v. Union Oil Co., 5 Cir., 1959, 270 F.2d 441, and its stare decisis offspring, Duke v. Sun Oil Co., 5 Cir., 1963, 320 F.2d 853.

16. They specifically stated on their face they are applicable to "gas run to Northern Natural" and prescribed that "the royalty and working interest [shall be] settled for on the following basis: Four cents (4¢) per thousand cubic feet * * *."

17. Royalties actually paid aggregate $74,504.47. Royalties now claimed would approximate 95.8% of the total sales price ($319,834.96) received by Lessee-Producer from the Northern contract.

II.

FPC Primary Jurisdiction

The District Judge as to stipulated Issue No. 1 (see note 7, supra) held that the FPC had no jurisdiction over the amount to be paid royalty owners for the so-called royalty gas. This is the position taken by Lessors who vigorously oppose the contrary contention of Lessee-Producer.

In this and the other case [18] this Court was of the view that the public interest in this question loomed so large, that the Court should have at least the tentative views of the FPC. Accordingly, this Court requested that agency to file a brief amicus. Reflecting the seriousness of the problem, the Commission, after a series of extensions of time, filed a formal memorandum brief signed by its General Counsel and Solicitor. From its structure, it is apparent that it is not simply the views of its legal spokesman. It is a considered, although properly hesitant, communication by the Commission itself of its tentative views.[19] All this is demonstrated by the fact that Commissioner O'Connor filed a special statement which reflects the thorough, though ex parte, consideration given within the chambers of the Commission. Following this, the Court expressly invited unlimited comments, replies and rejoinders from all parties in both cases.

Not unnaturally, no party seems to have been moved by these advocative arguments found in not less than 14 memorandum briefs. True, the Lessee-Producer welcomes the FPC as a somewhat strange, but nonetheless formidable, ally. But the positions remain substantially the same. The Lessors deny either jurisdiction of the FPC or the appropriateness of the exercise of any power over royalty payments and contend without reservation that this is just a typical question for court resolution on the record made at a trial. Lessee-Producer asserts that the FPC has primary jurisdiction at least to pass initially on the royalty rates which will, or might, exceed relevant FPC ceilings. The principal difference between Lessee-Producer and FPC is that the Lessee-Producer insists that this is a pure question of law to be decided by this Court whereas the FPC urges that since it is *arguable* that the matter is within its jurisdiction both the question of *jurisdiction* and, if it exists, the appropriateness of the exercise of such power, are matters for primary jurisdiction referral to the FPC for initial decision.

We find ourselves in substantial agreement with the FPC. This means that the dual questions are left open. We emphasize that here, as we do at the close, lest anyone--party, reader, the FPC, reviewing Court, or Trial or Appellate Court after reference—conclude we are declaring any conclusions other than those in Part I as to the legal effect of the gas lease and particularly the Royalty Clause (see note 4, supra) and the decision that it is appropriate that the FPC, rather than this Court, initially determine the jurisdiction of the FPC over royalty payments. Except in those two limited respects, what--and all—we say is to set forth the respective contentions of the protagonists and illumine the problem by factors, pro and con, which might, or might not, have some relevance.

[10, 11] At the outset we recognize that this is a new application of the doctrine of primary jurisdiction. But considering the broad aim of this device and the consequent flexibility of it [20]

18. Weymouth v. Colorado Interstate Gas Co., 5 Cir., 1966, 367 F.2d 84.

19. The FPC is at pains to disclaim prejudgment, recognizing quite properly that this should await a formal submission and adversary or similar proceeding.

20. United States v. Western Pacific R.R., 1956, 352 U.S. 59, 77 S.Ct. 161, 1 L.Ed. 2d 126; Far East Conference v. United States, 1952, 342 U.S. 570, 72 S.Ct. 492, 96 L.Ed. 576.

there is really nothing startling about submitting to an agency for initial decision the question of its own jurisdiction. That this ultimately is a question of law, probably one of statutory construction, is not fatal. This Court with the express approval of the Supreme Court has ordered primary jurisdiction reference of a pure question of law– the legal validity of exculpatory tariffs.[21] More recently, we have ordered reference of far-reaching legal questions of the Transportation Act and the Agricultural Marketing Act and the interplay of each,[22] just as we have done in having an initial administrative determination of the validity of a tariff as justification for action claimed to violate the antitrust laws.[23]

[12] That that question of law happens to be one of jurisdiction does not force a different result. To the contrary, justification for judicial deferral of the jurisdictional question for initial resolution by an agency is even stronger than for a non-jurisdictional question. This is demonstrated by the many cases upholding the jurisdiction of administrative agencies to determine the coverage of their respective statutes and barring all attempts through judicial proceedings to avoid such determination.[24] Of even more direct pertinence to our problem are the recent cases under the National Labor Relations Act in which the Supreme Court has held that if the record indicates that a labor dispute is "arguably" subject to the jurisdiction of the NLRB, then Courts are not free to determine the question of whether the labor dispute is beyond the power of the Board.[25]

[13] We think powerful arguments can be marshalled for and against FPC jurisdiction over royalty payments. A consideration of the various factors demonstrates at least two things. The first is that in the setting of its contemporary construction from the fallout of *Phillips I*[26] it is at least "arguable" that jurisdiction exists. The second is that the factors arguing against jurisdiction are of an intensely practical nature. This is especially so in terms of administrative problems from assuming jurisdiction. Consequently in divining legislative purpose, these matters should be evaluated by the agency having responsibility for operating the statutory machinery. These factors might bear directly upon the question of jurisdiction, as such, and would most certainly bear heavily upon the extent to which the FPC, either by general policy declaration, decision or rule-making, might determine the extent to which the exercise of any such power would be appropriate.

Of course the whole problem centers around whether the dealings with respect to royalty constitute a "sale in interstate commerce for resale" under § 1(b), 15 U.S.C.A. § 717(b).[27] The Act is very specific.[28] But *Phillips I* in broad terms recognized FPC jurisdiction "over the rates of all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during or after transmission by an interstate pipeline company." 347 U.S. 672, 682, 74 S.Ct. 794, 799.

The FPC looks upon it as another means of achieving a comprehensive effective regulatory scheme.

"* * * When Congress enacted the Natural Gas Act, it was motivated by a desire 'to protect consumers against exploitation at the hands of natural gas companies.' Sunray Mid-Continent Oil Co. v. Federal Power Commission, 364 U.S. 137, 147 [80 S.Ct. 1392, 4 L.Ed.2d 1623]. To that end, Congress 'meant to create a comprehensive and effective regulatory scheme.' Panhandle Eastern Pipe Line Co. v. Public Service Commission, 332 U.S. 507, 520 [68 S.Ct. 190, 92 L.Ed. 128]. See Public Utilities Commission of Ohio v. United Fuel Gas Co., 317 U.S. 456, 467 [63 S.Ct. 369, 87 L.Ed. 396]."

FPC v. Transcontinental Gas Pipe Line Corp., 1961, 365 U.S. 1, 19–20, 81 S.Ct. 435, 445–446, 5 L.Ed.2d 377, 389. And since *Phillips*, a "natural gas" company includes an "independent producer." 18 C.F.R. 154.91.[29]

[14–17] At this point Lessors make a most formidable attack. It is the very simple, yet profound, contention that there can be no "sale" of gas by royalty owners since they have no gas to sell. And this seems to be true as a matter of oil and gas law, whether based on the ownership-in-place concept followed by Texas[30] and others or on non-ownership

21. River Terminals Corp. v. Southwestern Sugar & Molasses Co., 5 Cir., 1958, 253 F.2d 922, aff'd, 1959, 360 U.S. 411, 79 S. Ct. 1210, 3 L.Ed.2d 1324.

22. Agricultural Transp. Ass'n of Texas v. King, 5 Cir., 1965, 349 F.2d 873. See also, Louisville & N.R.R. v. Knox Homes Corp., 5 Cir., 1965, 343 F.2d 887.

23. Carter v. American Tel. & Tel. Co., 5 Cir., 1966, 365 F.2d 486.

24. The FPC memorandum brief cites as typical: Arkansas Power & Light Co. v. FPC, D.C.D.C., 1945, 60 F.Supp. 907, reversed, 1946, 81 U.S.App.D.C. 178, 156 F.2d 821, reversed, 1947, 330 U.S. 802, 67 S.Ct. 963, 91 L.Ed. 1261; United States v. Sing Tuck, 1904, 194 U.S. 161, 24 S.Ct. 621, 48 L.Ed. 917 (habeas corpus); Texas & Pac. Ry. Co. v. Abilene Cotton Oil Co., 1907, 204 U.S. 426, 27 S.Ct. 350, 51 L.Ed. 553 (common law suit for reparations); Sunshine Anthracite Coal Co. v. Adkins, 1940, 310 U.S. 381, 383, 60 S.Ct. 907, 84 L.Ed. 1263 (suit to enjoin collection of taxes, penalties, and interest demanded on the basis that, as ruled by the Coal Commission, plaintiff's coal was not exempt from the Bituminous Coal Code).

25. Marine Engineers Beneficial Ass'n, et al. v. Interlake Steamship Co., et al., 1962, 370 U.S. 173, 178, 182, 82 S.Ct. 1237, 8 L.Ed.2d 418; cf. Ineres S.S. Co. v. International Maritime Workers, 1963, 372 U.S. 24, 83 S.Ct. 611, 9 L.Ed.2d 557; Myers v. Bethlehem Shipbldg. Corp., 1938, 303 U.S. 41, 58 S.Ct. 459, 82 L.Ed. 638; Boire v. Miami Herald Publishing Co., 5 Cir., 1965, 343 F.2d 17, 21; Bokat v. Tidewater Equipment Co., 5 Cir., 1966, 363 F.2d 667. See Boire v. Greyhound Corp., 1964, 376 U.S. 473, 479, 84 S.Ct. 894, 11 L.Ed.2d 849, 854, characterizing Leedom v. Kyne and McCulloch v. Sociedad Nacional, etc. (358 U.S. 184, 79 S.Ct. 180, 3 L.Ed.2d 210; 372 U.S. 10, 83 S.Ct. 671, 9 L.Ed.2d 547, as involving "extraordinary circumstances."

26. Phillips Petroleum Co. v. State of Wisconsin, 1954, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035.

27. "The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas." 15 U.S.C.A. § 717 (b).

28. "Three things and three only Congress drew within its own regulatory power, delegated by the Act to its agent, the Federal Power Commission. These were: (1) the transportation of natural gas in interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or resale."
Panhandle Eastern Pipe Line Company v. Public Service Commission, 1947, 332 U. S. 507, 516, 68 S.Ct. 190, 195, 92 L.Ed. 128, 137.

29. "An 'independent producer' as that term is used in this part means any person as defined in the Natural Gas Act who is engaged in the production or gathering of natural gas and who transports natural gas in interstate commerce or sells natural gas in interstate commerce for resale, but who is not primarily engaged in the operation of an interstate pipeline."

30. All seem to recognize that under Texas oil and gas law, a gas lease, unlike an oil lease which undertakes to pay for or to deliver in kind royalty oil, constitutes a present sale of all of the gas in place at the time the lease is executed. Theisen v. Robison, 1928, 117 Tex. 489, 8 S.W.2d 646; Phillips Petroleum Co. v. Bynum, 5 Cir., 1946, 155 F.2d 196, 199; Phillips Petroleum Co. v. Johnson, 5 Cir., 1946, 155 F.2d 185, 190.
But although the Landowner-Lessor has no "title" in the gas in place, royalty owners possess some character of property right. See Elliff v. Texon Drilling Co., 1948, 146 Tex. 575, 210 S.W.2d 558, 4 A.L.R.2d 191 (royalty owners recover their interest in gas and distillate lost through a blowout caused by negligent

theories of other jurisdictions.[31] For all agree that as the gas leaves the well-mouth, the entire ownership of the gas is in the lessee, none being reserved in the lessor. Thus, they urge, merely a simple debtor-creditor relationship exists between Lessee-Producer and Lessors.

[18] But this is hardly a decisive answer any more. Ever since the decision in *Rayne Field*[32] the Supreme Court has made it clear that neither the form of the transaction nor the peculiarities of state law are controlling in determining whether there is a jurisdictional sale of gas under the Act. "A regulatory statute such as the Natural Gas Act would be hamstrung if it were tied down to technical concepts of local law." 381 U.S. 392, 400, 85 S.Ct. 1517, 1522, 14 L.Ed.2d 466, 472. That case involved a sale of leasehold interests in a substantially proven and developed gas field. Such lease-sale transaction was consummated while the gas was in the ground and before a cubic foot thereof had moved in interstate commerce. Consideration for such sale of leases was measured by a lump sum price as distinguished from a price per MCF payable on production. By oil and gas business and legal tests, this was a sale of gas reserves in place. Nevertheless the Supreme Court had no difficulty in determining that it was a "sale" under the Act. "The sales of leases here involved were, in most respects, equivalent to conventional sales of natural gas which unquestionably would be subject to Commission jurisdiction under Phillips Petroleum Co. v. State of Wisconsin, 347 U.S. 672 [74 S.Ct. 794, 98 L.Ed. 1035]." 381 U.S. 392, at 401, 85 S.Ct. 1517, at 1522. The Court finding great similarity to Gray v. Powell[33] measured the transaction in practical terms. Sales of leases became sales of gas for resale because this "accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States." Stressing its importance, the Court went on, "[t]hat is the significant and determinative economic fact * * *" and "* * * because of it the Commission * * * acted properly in treating these sales of leasehold interests as sales of natural gas within the meaning of the * * * Act."[34] 381 U.S. 392, 401, 85 S.Ct. 1517, 1523. See also People of State of California v. Lo-Vaca Gathering Co., 1965, 379 U.S. 366, 85 S.Ct. 486, 13 L.Ed.2d 357.

operations on an adjoining lease) and see McBride v. Hutson, 1957, 157 Tex. 632, 306 S.W.2d 888. Discussing the nature of the royalty interest, the Court said that although the "royalty interest was not, in correct oil and gas legal parlance, a 'mineral interest'" it was "clearly an interest in the minerals, and in the amount of one-eighth thereof, as well as an interest subject to alienation by its owner and taxable *ad valorem* as against him as real estate." The Court went on to say: "* * * the lessor or royalty owner actually owns one-eighth of the same minerals of which the lessee owns seven-eighths, although their respective estates are of different kinds due to the fact that the royalty eighth is free of expense, while the other seven-eighths are burdened with the obligations and conditions of the lease." Young v. Rudd, 1950, Tex.Civ.App., 226 S.W.2d 469; Cates v. Greene, 1938, Tex.Civ.App., 114 S.W.2d 592; Sheffield v. Hogg, 1934, 124 Tex. 290, 77 S.W.2d 1021; Frost v. Standard Oil of Kansas, 1937, Tex.Civ.App., 107 S.W.2d 1037.

31. In 1 Williams and Meyers, Oil & Gas Law, 31, it is shown that 14 states have adopted the ownership-in-place doctrine, 8 the doctrine of nonownership, 1 a qualified doctrine, and in 9 states there is not sufficient information to provide a basis for classification. Texas, therefore, is by no means alone in recognizing and applying this concept.

32. United Gas Improvement Co. v. Continental Oil Co., 1965, 381 U.S. 392, 85 S. Ct. 1517, 14 L.Ed.2d 466.

33. 1941, 314 U.S. 402, 62 S.Ct. 326, 86 L.Ed. 301.

34. Neither the Solicitor General nor the Court challenged the genuineness or the good faith of the substitute leasehold sale after conventional sales were rejected by FPC (See 381 U.S. 392, 85 S.Ct. 1517, 14 L.Ed.2d 466 at 471). There is thus no indication that the result would have been different had the landowners, as lessors, made the sale of the gas reserves in place direct to Texas Eastern. And there appears to be much justification for

As a corollary to the State-law-no-title-hence-no-sales-concept, the Lessors also argue that the royalty is unrelated to gas produced and is, rather, simply one part of the consideration given and received for the transfer of the gas reserves and the grant of the development privileges under the lease. Although the consideration received by the lessor frequently follows a common pattern[35] this is not necessarily so as the R-Lease in question here demonstrates. Two principal additional factors were the obligation to drill eleven wells plus the securing of an outlet through the Northern sales contract. And, with or without added unusual considerations, even royalty may be complex. Should it be proceeds, market value, market price, a minimum-maximum combination thereof? If a fractional interest, then what fraction—⅛th, 3/16ths, ¼th, 3/8ths, or what? All of these variables lead Lessors to argue that if the FPC has jurisdiction over royalties, then presumably it has jurisdiction over all other types of consideration given. Once that is established, and especially if the pattern of §§ 4 and 5 of the Act is pursued, it means that the FPC is squarely in the middle in determining, or at least approving as a § 7 condition precedent to the grant of a certificate, the terms and provisions of an initial lease between a landowner and a lessee. This would, so the argument continues, run headon into the 1(b) production or gathering proviso (see note 27, supra) and would, in any event, be concerned with transactions so remote in point of time and operation from the sale for resale as to be outside the scope of the Act.

But there are several possible answers which might ultimately be found to have merit. To hold that at some stage, the FPC has the power to review, approve or disapprove the amounts payable as royalty if in excess of FPC established ceilings, does not necessarily forecast a holding of universal jurisdiction over the making of the initial lease or the appraisal, assessment, approval or disapproval of the various elements going to make up the total consideration for the trade. There is, first, of course, the requirement that the transaction constitute a "sale for resale" or interstate transportation. This seldom occurs at this initial stage.[36]

[19] But jumping that hurdle there may be supportable reasons why royalty, for the purposes of the Act is to be distinguished from other kinds of legal considerations. Although in legal concept it is a deferred payment for the initial grant, it bears a direct relation to current production.[37] None is due until there is production. What is due depends directly on the amount of production. As each cubic foot of gas flows through the well-mouth orifice, it is known, therefore, that some specific (or ascertainable) sum is due for that fraction of production prescribed in the royalty clause (⅛th, 3/16th, ¼th, etc.).

And this practical consequence becomes more acute in the context of a regulated activity. Whatever may be the legal the-

the reading given the case in the FPC memorandum brief:

"It can hardly be doubted * * * that the Supreme Court would have reached the same result if instead the producers in that case had fixed their compensation in terms of a royalty on all gas subsequently sold by Texas Eastern."

35. See, e.g., the description of the characteristic triad of consideration payable to the lessor:

"The benefits accruing to a lessor under a mineral lease, come under three definite classifications, regardless of what various specific appellations may be applied to them, namely, bonus, delay rentals and royalty."

Norvell, J., Garrett v. Dils Co., 1957, 157 Tex. 92, 101, 299 S.W.2d 904, 910 (dissenting opinion).

36. But compare the R-Lease, executed pursuant to the condition precedent that the Northern sales contract be consummated.

37. Occasionally it depends on nonproduction, e.g., under take-or-pay, minimum nomination requirements, etc. See Callery Properties, Inc. v. FPC, 5 Cir., 1964, 335 F.2d 1004, 1021.

ory of title in the gas reserves, the cost of the gas to the Lessee-Producer is in two main categories. There is, first, the actual costs for exploration, development and production of all of the gas, both the working interest (e. g., 7/8ths) and the royalty (e. g., 1/8th). The second is the amount paid as royalty for the fraction prescribed as royalty. This second element is directly attributable to actual gas delivered through the well-mouth and is ordinarily measured directly thereby.[38]

The direct, immediate importance of royalty payments and the position of royalty owners in the regulatory scheme of the Act has been recognized by the FPC in both a general[39] and specific way in the area rate proceedings,[40] which many hope, will afford a workable solution. In the Permian Basin area rate decision, No. AR 61-1, opinion 468, 33 FPC * * * (now pending on review in the 10th Circuit), a forerunner of other area rate proceedings including the Hugoton-Anadarko area, No. AR 64-1, 30 FPC 1354, covering the gas fields involved here, it was treated as one of the significant costs.[41] Although apparently not discussing it in terms of cost attributable to royalty payments, the Commission recognizes generally that particular producers might be able to justify above-ceiling prices where costs exceed the area average and revenues.[42]

Its dynamic significance is dramatically illustrated by contemplating the dollar and cents impact of full success by the Lessors. Still unproved and obviously subject factually to much downward adjustment depending on proof of factors on market value,[43] the Lessors complaint demanded 23¢ MCF. This is in sharp contrast to the FPC ceiling of 11¢ MCF and far exceeds the FPC anti-triggering guideline of 19¢.[44] This poses a substantial threat to Northern,[45] the Pipeline Purchaser, depending upon the extent to which the FPC would allow the increase in Lessee-Producer's cost of service to be passed on or, if forbidden by *Mobile*[46] contract terms the extent to which the FPC would grant § 5 relief if the lower contractual maximum (11¢) was held to be not fair and reasonable.

Even assuming FPC rejection of Lessee-Producer's requested price increases from Northern, the other possible relief to avoid confiscation—abandonment—[47]

38. We have treated amounts due under "take-or-pay" clauses as sales of gas. See note 37, supra.

39. On a cost of service approach, Landowner-Lessors would generally benefit from dealing with a high cost Lessee-Producer.

40. In re Phillips Petroleum Co., 1960, 24 FPC 537; Wisconsin v. FPC, 1963, 373 U.S. 294, 83 S.Ct. 1266, 10 L.Ed.2d 357 (Phillips II).

41. Both the Examiner and the Commission calculated royalty at 12.5% (1/8th) of the selling price (presumably on a "proceeds" basis). The Commission changed the allowed amount slightly because of other adjustments. Showing that the Commission does not lump this "cost" in with others constituting both cost and consideration payable to lessor (e. g., "exploration and development costs" or "depletion, depreciation, and amortization of production investment costs") is the excerpt from Opinion No. 468:

	Cost in Cents per Mcf	
	Examiner	Commission
Exploration and Development Costs		
Dry Holes	1.07	1.42
Other Exploratory Costs	1.19	1.59
Allowance for Growth	.83	1.11
Production Operating Expense	2.88	2.70
Net Liquid Credit	(2.68)	(3.10)
Regulatory Expense	.14	.14
Depletion, Depreciation and Amortization of Production Investment Costs		
Successful Well Costs	2.16	2.42
Lease Acquisition Costs	.57	.64
Cost of Other Production Facilities	.23	.26
Return on Production Investment (at 12%)	3.91	4.38
Return on Working Capital	.20	.35
Subtotal	10.50	11.91
Royalty at 12½%	1.60	1.83
Production Taxes	.72	.90
Total	12.82	14.64

For a jurisdictional sale, royalty payments are considered an operating expense under Account Number 758, Commission's Uniform System of Accounting of Accounts for Natural Gas Companies, 18 C.F.R. Part 201, Account Number 758.

42. "It would seem clear that where a producer who has contracted for an above-ceiling price can show that his out-of-pocket expenses in connection with the operation of a particular well are greater than the revenues under the applicable area price, he should be entitled to appropriate relief, and there may be other circumstances where a producer as a matter of law or in the public interest would be entitled to some relief." (FPC Opinion No. 468, p. 105.)
Of course this has to be read in the light of this declaration:
"A significant early ruling in this proceeding was the Commission's order of May 14, 1962, holding that individual company cost-of-service evidence would not be received in evidence but that composite cost studies would be admissible." (FPC Op. 468, p. 2.)
and Mr. Justice Clark dissenting, Wisconsin v. FPC, 1963, 373 U.S. 294, 83 S.Ct. 1266, 10 L.Ed.2d 357, apparently forecasts constitutional questions in this event:
"Moreover, it must be remembered that the burden of proving just and reasonable rates is on the producer and he cannot be precluded from offering relevant proof of his cost. This he will demand in the event his statistics show his costs above those fixed for his area. And so the cold truth is that, after all of its area pricing investigation and the fixing of a rate pursuant thereto, the producer aggrieved at that rate may demand and be entitled to a full hearing on his cost." 373 U.S. 328, 83 S.Ct. 1284.

43. See, Weymouth v. Colorado Interstate Gas Co., 5 Cir., 1966, 367 F.2d 84.

44. Commissioner O'Connor in his separate statement summarizes the FPC ceilings:
"For the pricing area here involved, the increased rate ceiling is 11.0¢ per MCF (at 14.65 psia), and the ceiling for initial rate filings is 17.0¢. See Statement of General Policy No. 61-1, 24 FPC 818. For certain filed rate schedules, subject to the producer eliminating certain escalation clauses in the underlying contract, the guidelines are 11.6¢ and 12.0¢. See Seventh Amendment to the Statement of General Policy No. 61-1, 30 FPC 1370. The antitriggering guideline has been determined to be 19.0¢. See Tenth Amendment to the Statement of General Policy No. 61-1 (Order No. 296, issued April 5, 1965). There has been no in-line determination for Texas Railroad District No. 10, and there is no just and reasonable rate yet prescribed for the area, although such a proceeding is presently in hearing. See order instituting Area Rate Proceeding (Hugoton-Anadarko Area), Docket No. ARG1-1, 30 FPC 1354."

45. Northern now has 11¢ MCF field cost under the amended contract. This field cost would increase by 3¢ MCF if royalty is payable at 23¢ MCF as claimed. If passed on by Lessee-Producer to Northern, the price to Northern would increase from 11¢ to 14¢ MCF.

46. United Gas Pipe Line Co. v. Mobile Gas Service Corp., 1956, 350 U.S. 332, 76 S.Ct. 373, 100 L.Ed. 373; cf. United Gas Pipe Line Co. v. Memphis Light, Gas and Water Division, 1958, 358 U.S. 103, 79 S.Ct. 194, 3 L.Ed.2d 153.

47. Speaking of producers having excess costs, the FPC stated:
"Even in situation where producers are able to show that they are entitled to relief from the obligation to continue to sell flowing gas at the appropriate area ceiling, in most cases it may be

jeopardizes the interest of Northern, its immediate customers, its ultimate customers at the burner tips and the public interest generally in the withdrawal of these huge reserves from the interstate market.

The prospect affords little comfort to the Lessee-Producer here. Invoking contractual provisions which purported to release the parties in the event the subject matter came under regulation of state or federal agencies, its unilateral discontinuance of service was rejected by the Commission and the Third Circuit. J. M. Huber Corp. v. FPC, 3 Cir., 1956, 236 F.2d 550, cert. denied, 352 U.S. 971, 77 S.Ct. 363, 1 L.Ed.2d 324 (approved Continental Oil Co. v. FPC, 5 Cir., 1959, 266 F.2d 208).

To the Lessors, another telling blow against even the likelihood of FPC jurisdiction is the "historical" fact that the FPC has not yet asserted this power.[48] Indeed, the contention runs, its own administrative regulations and practices provide no machinery for passing on the level of payments of royalty made by a Lessee-Producer to a Lessor.

Amplifying its more cryptic telegraphic advices to Lessee-Producer,[49] the FPC's memorandum brief is a candid statement that it has not undertaken so far to regulate royalty rates. According to the FPC's memorandum brief which we either repeat or slightly paraphrase, the FPC historically has regulated jurisdictional sales of independent producers by requiring either the operator of the producing properties or signatory working interest owners to make the certificate and rate filings required under the Natural Gas Act. It is made for all of the gas involved in the particular sales contract regardless of the number of individuals or entities who may own separate interest therein.[50] Following *Phillips I* the FPC issued its order No. 174 series[51] in which it set forth the filing requirements applicable to independent producers. Those orders provided that independent producers should file certificate applications and rate schedules, but did not undertake to distinguish between

sufficient to permit them to abandon their unprofitable sales."

FPC' Permian Basin Area Rate Opinion No. 468, p. 105.

48. There are two isolated exceptions. Northern Natural Gas Producing Company, Docket Nos. G-1084 and G-1001, August 30, 1956 (unreported), 6 Oil and Gas Reporter 528 and Elk River Co. & Lumber Co., FPC Gas Rate Schedule No. 1, issued August 30, 1956 (unreported), 6 Oil and Gas Reporter 528. The FPC's memorandum brief treats these cases, and we think properly so, as "unique." Commissioner Digby, dissenting, discerned the far-reaching implications of the assertion of FPC jurisdiction "over the sale by royalty owners of gas retained either in an original commercial lease or by an overriding provision in an assignment of a lease.". But as a matter of practice, the FPC has not pursued it.

49. Apparently to respond to this Court's prehearing request for supplemental memoranda, Lessee-Producer wired the FPC: "We represent a lessor entitled under a gas lease to a monetary royalty based on the market price of the gas. The lessee owns eight-eighths of the gas and sells it in interstate commerce for resale. Can you advise whether the FPC fixes royalty rates between lessor and lessee or has any procedure to adjudicate such a dispute."

To this the FPC responded:

"Reurtel November 5 Federal Power Commission does not fix royalty rates between a lessor and lessee nor does it have any procedure to adjudicate such a dispute."

50. The provisions applicable to filings by independent producers are contained in § 154.91 of the regulations, 18 C.F.R. 154.-91.

51. Order No. 174, Docket No. R-138, issued July 16, 1954, 13 FPC 1195; Order No. 174-A, issued August 6, 1954, and modified September 24, 1954, 13 FPC 1255, 1410; and Order No. 174-B, issued December 17, 1954, 13 FPC 1576. These orders were the subject of extended treatment in a number of cases, but found by this Court to be nonreviewable. Magnolia Petroleum Co. v. FPC, 5 Cir., 1956, 236 F.2d 785, cert. denied, 1957, 352 U.S. 968, 77 S.Ct. 356, 1 L.Ed.2d 322; (see related cases 236 F.2d 812, 813, 816, 819, 824, 827, 828, 830, 835, 839 and editorial note 236 F.2d 785 at 793.)

an operator and an owner of some other interest except that, in order to relieve large numbers of parties from the filing requirements, order No. 174-B, 13 FPC at 1577-1579, provided that if the operator made a filing, other interested parties were not required to file. At that time there were no provisions prohibiting a filing by a non-signatory interest owner. Nevertheless, in two decisions,[52] the FPC ruled that a nonsignatory interest owner was not entitled to file under the regulations then in effect.[53] Subsequently the Commission[54] amended § 154.91 to codify the action taken by it in the *Humble* and *Midstates* cases.[55] As the regulations now stand (barring waiver for good cause)[56] only the signatory operator or signatory interest to a jurisdictional gas sales contract may file. The signatory operator is required to file under § 154.91(b). Under § 154.91(c) other signatory interest owners may file, but are not required to do so unless the operator is not a signatory party. Under § 154.91(d) a nonsignatory interest owner is not permitted to file.

The upshot of it is that the FPC regulations do not presently provide for separate filings by landowner royalty interests or overriding royalty interests who are not themselves signatory parties to the gas sales contract. Nor are operators required generally to provide information with respect to royalty interests in filing their applications for certificates to make jurisdictional sales.[57]

But Lessee-Pipeline (and the FPC memorandum brief) counter with a good deal of force that this nonaction proves little—certainly not in the light of *Phillips I* which put an end to 26 years of administrative inaction. The reach of power and the scope of regulation are not necessarily synonymous. The FPC, as any other administrative agency, has considerable discretion in determining the extent to which admitted power is to be employed, especially in terms of detailed administrative regulations.[58] And certainly this would be true if, as the FPC's memorandum brief asserts as a fact, there have been no occasions until the inquiry by this Court for the FPC either to pass upon royalty payments or its power to do so. For that matter, if the FPC finds the statutory power to exist and this is affirmed by the reviewing court, there is still a great likelihood that few of the transactions *vis-a-vis* Lessor—Lessee-Producer will have to come under FPC scrutiny as such. Thus, a "proceeds" royalty transaction presents no problem. The price collected by Lessee-Producer will at all times be subject to FPC regulation, within FPC established ceilings or collected subject to refund upon determination of the fair, just

52. Humble Oil & Refining Co., 14 FPC 592; Midstates Oil Corp., 14 FPC 703.

53. This Court in Sun Oil Co. v. FPC, 5 Cir., 1958, 256 F.2d 233, cert. denied, 1958, 358 U.S. 872, 79 S.Ct. 111, 3 L.Ed.2d 103, affirmed the Commission's practice under § 154.91 of not permitting nonoperating, nonsignatory interest owners to file.

54. Order No. 190, 16 FPC 492.

55. Sun Oil Co. v. FPC, 5 Cir., 1958, 256 F.2d 233, cert. denied, 1958, 358 U.S. 872, 79 S.Ct. 111, 3 L.Ed.2d 103. (See note 53, supra.)

56. See § 1.7(b), 18 C.F.R. 1.7(b).

57. The FPC suggests that this is the same approach it has taken with respect to percentage sales contracts (e.g., resale of the residue gas from a processing plant). Under § 154.91(c) the regulation so far has been at the processing plant end, not the sale by the Lessee-Producer to the processing plant. With admitted power to regulate the Lessee-Producer's sale to the processor, the FPC purposefully declines to do so because it is unnecessary to effective regulation. See FPC Opinion 468, Docket No. AR 61-1, p. 71.

58. See, e.g., dollar jurisdictional standards established by the National Labor Relations Board.

The FPC has done this by establishing a category of special certificate authorization for small producers. Rate and certificate filings by small independent producers, Order No. 308, October 29, 1965, 30 F.Reg. 14000.

and reasonable rate.[59] §§ 4, 5. Likewise, increases in the amounts payable for royalty, whether arising automatically by escalation, favored nation clauses, or the like, or through the forces of supply and demand in fixing the market price under a market price clause need not be reviewed if the increased price to be paid is still within the relevant FPC ceilings.

It might turn out, therefore, that the FPC, assuming the existence of the power to regulate the price paid for royalty for gas admittedly sold for resale and transported in interstate commerce, will be confined to two principal objectives. First, would be suitable regulations requiring the signatory working interest owner at the time of certification to report fully on the status and nature of the royalty obligations with subsequent or periodic reports as to changes thereon and the level of payments being made therefor. The second would be a requirement that before an amount in excess of the relevant FPC ceilings could be *payable*, either as a result of unilateral action by negotiation, compromise, or by court judgment, an application would first have to be filed for approval, rejection, or modification by the FPC. That hardly signals the chaos to which Lessors with much feeling prophesy.[60] And chaos or not, it must be remembered that if—and so far the if is a big one—the amounts paid for royalty constitute a "rate", §§ 4, 5, then primary jurisdiction is not only a matter of initial determination by the administrative agency. Rather it then becomes the exclusive role of the agency. State of Georgia v. Pennsylvania R.R., 1945, 324 U.S. 439, 65 S.Ct. 716, 89 L.Ed. 1051; Northern Natural Gas Co. v. State Corporation Commission of Kansas, 1963, 372 U.S. 84, 83 S.Ct. 646, 9 L.Ed.2d 601; Montana-Dakota Utilities Co. v. Northwestern Public Service Co., 1951, 341 U.S. 246, 251, 252, 71 S.Ct. 692, 95 L.Ed. 912; Socony Mobil Oil Co. v. Brooklyn Union Gas Co., 5 Cir., 1962, 299 F.2d 692, cert. denied, 371 U.S. 887, 83 S.Ct. 182, 9 L.Ed.2d 121, following the stay of this Court issued in Magnolia Petroleum Co. v. Federal Power Commission, 5 Cir., 1956, 236 F.2d 785, cert. denied, 352 U.S. 968, 77 S.Ct. 356, 1 L.Ed.2d 322.

[20] Thus we end, as we began, a consideration of these factors pro and con demonstrate that there is at least an arguable basis for FPC jurisdiction. Moreover, these factors ought first to be evaluated by the FPC in the resolution of the question of statutory power and, if that is found to exist, the necessary implementation of that in terms of the extent to which the exercise of that power is or will be appropriate. Lest we be misunderstood, we emphasize again that this analysis is merely to indicate why we conclude primary jurisdiction reference should be made, the Court all the while disclaims any purpose by what it has said or left unsaid, by its comments, express or implied, of declaring or intimating what its views are on the questions referred for initial decision by the FPC and the arguments pro and con.

59. Even there, the FPC memorandum brief points out that some regulatory control might be needed, if the percentage royalty interest (e.g., 1/4th) is increased markedly (e.g., 1/4th, 3/4ths, 1/2, etc.) with consequent significant increase in the price of gas to the consumer or an impairment of the exploratory developmental activities of the producer.

60. In attempting to resolve these difficult problems, the Court is not helped by the coercive tone of Lessor's statement that "if the court should yield to the FPC's demand that the parties be relegated to an administrative hearing * * * then whatever right the royalty owners in this case have is irretrievably lost. We simply cannot afford the luxury of an FPC hearing. By economic compulsion we will choose as the only feasible course of action to abandon the litigation and bow to Huber's will."

First, this is no contest between unequal combatants. On Lessors' claim for the years involved, over $300,000 is at stake with much more apt to follow on principles of collateral estoppel as to years subsequent to those in suit. Of more significance, this question is of vital importance to the public interest. Its impact will transcend the parties, the period of time involved here, and this particular relationship. In these two cases large volumes of gas and sums of money are involved and the trial Judge observed that there are "several other similar cases on the docket of this court in the Amarillo Division."

III.

[21] We therefore affirm the District Court on issues Nos. 2, 3, and 4 (Note 7, supra), but vacate the holding as to issue No. 1 and remand the cause to the District Court for further consistent proceedings.[61] Specifically, the District Court should defer further action including fixing of the actual "market price" pending invocation[62] by the parties of a ruling by the FPC: (1) (a) as to the jurisdiction of the FPC over payment for royalties for gas sold for resale and transported in interstate commerce, (b) the status of a royalty interest owner's transaction as a sale under the Act where incident to a sale for resale and transportation in interstate commerce, (c) the status of the royalty interest owner's transaction in this case as a sale under the Act; (2) if it should be determined that the FPC has jurisdiction and that at some stage or time the royalty transaction for payment therefor constitutes a sale under the Act (a) the filing requirements, if any, for certification and if required by whom and when, (b) the extent, if any, to which prior application to and approval by the FPC is required as to (i) the type, kind or nature of the royalty clause, (proceeds, market price, etc.), the percentage thereof (e. g., 1/4th, 1/8th, etc.), (ii) monetary payments which do not exceed relevant FPC ceilings, (iii) monetary payments which are or will likely be in excess of relevant FPC ceilings.

For obvious reasons we do not undertake to blueprint the proceedings before the Commission. Nor, in specifying the specific subjects of inquiry and report, do we mean to foreclose other relevant, specific inquiries or variations thereof which might be developed in the proceeding and which will or might have a significant bearing upon the substantial public issue questions of great importance. Rather, the test should be: when the FPC rules and the reviewing Court[63] enforces, will the decision likely supply the answers needed by the trial Court in determining precisely and to what extent matters are or are not for FPC determination and those reserved for court determination?[64]

Affirmed in part.

Reversed and remanded in part.

61. In view of the acute public interest, dismissal under F.R.Civ.P. 41(a) (2) is not in order but if, as suggested (note 60, supra) the Lessor declines, then the Court has ample power to require Lessee-Pipeline to go forward with the reference to FPC.

62. The FPC memorandum brief states that this may be done in a number of ways: E. g., by a complaint under § 1.6(b) or petition for declaratory order or other relief under §§ 1.7(a), (b), or (c), of the Commission's Rules of Practice and Procedure (18 C.F.R. §§ 1.6(b); 1.7(a), (b), or (c). Other procedures in which the questions might be raised could be initiated by application for a certificate of public convenience and necessity under Part 157 or submission of a rate schedule for filing under Part 154 of the Commission's Regulations Under the Natural Gas Act (18 C.F.R. Parts 157 and 154).

63. Under § 19 of the Act review is to the Court of Appeals. See FPC v. Texaco, Inc., 1964, 377 U.S. 33, 84 S.Ct. 1105, 12 L.Ed.2d 112. The presence of intervenors might, therefore, take review out of the 5th Circuit and return it to us later as a matter of established law.

64. To assure that each of the respective trial Courts, the FPC and reviewing Courts will know precisely what was before us, we direct that the Clerk of this Court will on remand include in each record copies of the pre- and post-argument memoranda from Court to counsel in both cases and all briefs, memoranda filed in both cases with respect thereto. Counsel are requested to collaborate with the Clerk in affording requisite copies.

MOBIL OIL CORPORATION, Petitioner,

v.

FEDERAL POWER COMMISSION, Respondent, Panhandle Eastern Pipe Line Company et al., Intervenors.

J. M. HUBER CORPORATION, Petitioner,

v.

FEDERAL POWER COMMISSION, Respondent, Philadelphia Gas Works Division of UGI Corporation, Shell Oil Company, Intervenors.

WESTERN NATURAL GAS COMPANY, Petitioner,

v.

FEDERAL POWER COMMISSION, Respondent, Philadelphia Gas Works Division of UGI Corporation, Carl F. Matzen, et al., Intervenors.

AMOCO PRODUCTION COMPANY, Petitioner,

v.

FEDERAL POWER COMMISSION, Respondent, Philadelphia Gas Works Division of UGI Corporation, Carl F. Matzen, et al., Intervenors.

The LAND AND ROYALTY OWNERS OF LOUISIANA, Petitioner,

v.

FEDERAL POWER COMMISSION, Respondent, Mobil Oil Corporation, Philadelphia Gas Works Division of UGI Corporation, Intervenors.

Carl F. MATZEN et al., Petitioners,

v.

FEDERAL POWER COMMISSION, Respondent, Mobil Oil Corporation et al., Intervenors.

William Harvey DENMAN et al., Petitioners,

v.

FEDERAL POWER COMMISSION, Respondent, Cities Service Oil Company et al., Intervenors.

Nos. 23463, 23491, 23511, 23633, 23654, 24051, 24180.

United States Court of Appeals, District of Columbia Circuit.

Argued March 4, 1971.

Decided Dec. 17, 1971.

Certiorari Denied June 7, 1972.

See 92 S.Ct. 2409, 2410, 2413.

Rehearing Granted in Part in No. 23491

Aug. 29, 1972.

Proceeding on petitions for review of order of Federal Power Commission. The Court of Appeals, Leventhal, Circuit Judge, held that royalty provisions, which were contained within oil and gas leases, and which provided for retention by royalty holders of a percentage interest in gas sold in interstate commerce, did not constitute sales of natural gas for resale in interstate commerce subject to Natural Gas Act, and thus lessor landowners were not subject to regulation as natural gas companies whose sales were covered by filings of their lessees.

Reversed.

MacKinnon, Circuit Judge, filed concurring opinion.

1. Gas ⇐2

Royalty provisions, which were contained within oil and gas leases, and which provided for retention by royalty holders of a percentage interest in gas sold in interstate commerce, did not constitute sales of natural gas for resale in interstate commerce subject to Natural Gas Act, and thus lessor landowners were not subject to regulation of natural gas companies whose sales were covered by filings of their lessees. Natural Gas Act, §§ 1(b), 2, 2(6), 4, 15 U.S.C.A. §§ 717(b), 717a, 717a(6), 717c.

2. Gas ⇐2

Intention of Congress, with respect to Natural Gas Act, cannot be conclusively determined by reference to concepts and classifications under state law decisions normally disposing of "private" controversies. Natural Gas Act, §§ 1(b), 2(6), 15 U.S.C.A. §§ 717(b), 717a(6).

3. Gas ⇐14.3(2)

Federal Power Commission's jurisdiction over rates chargeable by natural gas producer includes authority to determine reasonableness of costs incurred, even though such costs are not subject to direct FPC control, and thus Commission has authority to review royalty payments, or drilling rig rentals, or any other element of producer's cost of service.

Mr. Carroll L. Gilliam, Washington, D. C., with whom Messrs. Philip R. Ehrenkranz, Washington, D. C., and William H. Emerson, Tulsa, Okl., were on the brief, for petitioners in Nos. 23,463, 23,511 and 23,633; also argued for intervenor Cities Service Oil Company in Nos. 23,463, 24,051 and 24,180. Mr. William J. Grove, Washington, D. C., entered an appearance for petitioner in No. 23,633.

Mr. Sherman S. Poland, Washington, D. C., with whom Messrs. James B. Reed, Houston, Tex., and Daniel F. Collins, Washington, D. C., were on the brief, for petitioner in No. 23,491 and intervenor J. M. Huber Corporation in No. 24,180.

Mr. Dale M. Stucky, Wichita, Kan., for petitioners in No. 24,051 and intervenors Carl F. Matzen, et al., in Nos. 23,463, 23,511 and 23,633.

Mr. H. H. Hillyer, Jr., New Orleans, La., for petitioner in No. 23,654.

Mr. Cecil E. Munn, Fort Worth, Tex., for petitioners in No. 24,180.

Mr. Israel Convisser, Attorney, Federal Power Commission, with whom Messrs. Gordon Gooch, General Counsel, Leo E. Forquer, Assistant General Counsel, Federal Power Commission, and Peter H. Schiff, Solicitor, Federal Power Commission at the time the brief was filed, were on the brief, for respondent.

Mr. Dan A. Bruce, Houston, Tex., with whom Mr. Thomas G. Johnson, New York City, was on the brief, for intervenor Shell Oil Company in Nos. 23,491, 24,051 and 24,180.

Mr. Graydon D. Luthey, Tulsa, Okl., was on the brief for intervenor Cities Service Oil Company in Nos. 23,463, 24,051 and 24,180.

Mr. Charles E. McGee, Washington, D. C., was on the brief for intervenor Atlantic Richfield Company in No. 24,051. Mr. John T. Ketcham, Washington, D. C., also entered an appearance for intervenor Atlantic Richfield Company in No. 24,051.

Mr. James J. Flood, Jr., Houston, Tex., entered an appearance for intervenor Panhandle Eastern Oil Company in Nos. 23,463, 24,051 and 24,180.

Before LEVENTHAL, ROBINSON and MacKINNON, Circuit Judges.

LEVENTHAL, Circuit Judge:

These are petitions for review of an order of the Federal Power Commission (FPC), accompanied by its opinion No. 562, 42 FPC 164, which determined and declared that the royalty provisions of oil and gas leases constitute sales of natural gas for resale in interstate commerce subject to the Natural Gas Act, and that the landowners are subject to regulation as natural gas companies whose sales are covered by the filings of their lessees, the producer-operators. We reverse.

Facts and Prior Proceedings

In J. M. Huber Corp. v. Denman, 367 F.2d 104 (5th Cir. 1966), the court agreed with landowners that the particular oil and gas leases they executed required the gas-producer lessees to make royalty payments based on the current "market price" of the gas and not, as

lessees contended, on the actual price received by the producer for the gas.

The market price was not determined because the lessor's claim, for a royalty based on a market price of 23¢ per mcf for gas run since 1946, presented "a serious question whether a Court, state or federal, either initially or ultimately, may allow any amounts fixed by jury, court, or both as increased royalty payments without express prior approval of the Federal Power Commission if, as would these, the price thus fixed would exceed levels prescribed by the FPC." (367 F.2d at 110, 111.) The court took account of the public interest issues involved, and directed a reference by the parties to the FPC under the doctrine of primary jurisdiction for that agency to make an initial determination of its jurisdiction over rates to be paid for gas royalty.

Thereafter the royalty owner-landholders in *Huber* petitioned the FPC for a declaratory order disclaiming jurisdiction over royalty payments. Several lessee-producers involved in similar litigation filed complaints seeking an FPC determination that such royalties are subject to FPC jurisdiction. The FPC consolidated the dockets for hearing and decision. After prehearing conferences and evidentiary hearings, the presiding examiner concluded that the royalty owners are "natural gas companies as defined in the Natural Gas Act"[1] and that a royalty owner seeking an increase in royalty payment must apply to the FPC beforehand. The Commission affirmed in part by a vote of 3 2. It declared that "the royalty provisions of oil and gas leases constitute sales of natural gas for resale in interstate commerce subject to all the provisions of the Natural Gas Act."[2] However, it held that the royalty owners need not make a separate filing to the FPC; the producers' filings were held to cover the royalty "sales" adequately for regulatory purposes.[3]

1. R. 4459; 42 FPC at 198.

2. R. 5043; 42 FPC at 174.

Petitions to review have been filed both by Mobil Oil Corporation and other producers, and by royalty owners, and the cases have been consolidated. The royalty owners challenge the FPC's jurisdictional decision. The producers challenge the contemporaneous ruling, referred to in more detail hereafter, that the royalty owners are entitled to payment on the basis of their contract terms even when higher than the producer's effective rate, provided no breach of ceiling prices is wrought. We find error in the jurisdictional determination.

Ruling That The FPC Does Not Have Jurisdiction Over The Payment of Royalties Under A Typical Natural Gas Lease

[1] In the FPC's order of June 23, 1967, setting a hearing on whether royalty payments to the lessors are subject to its jurisdiction, the Commission authorized receipt of evidence relating to general industry contracting practices with respect to gas leases so as to be more fully informed as to the general background of the problem and possible economic and legal consequences before making its determination.

Evidence was introduced on industry practice with respect to oil and gas lease agreements. The evidence is well summarized in the opinion of the Presiding Examiner. He focused on the development wherein the landowner has sometimes reserved a royalty of a percentage of the physical hydrocarbon recovered (for oil), has sometimes reserved a royalty of a percentage of the proceeds thereof, and has sometimes reserved a royalty of a percentage of the "market value" thereof at the well or in the field. This portion of the Examiner's opinion provides useful background information and is set forth in an Appendix to this opinion.

The Commission found one "basic fact" determinative of the jurisdictional

3. *Id.*

issue: "the effective retention by the royalty holders of a percentage interest in the gas sold in interstate commerce." This led to the conclusion "that if he has contracted to retain an economic interest in interstate sales, he has joined the other interest owners in such sales and he has become a seller of natural gas and therefore a natural gas company."[4]

For jurisdiction to attach under the Natural Gas Act, the royalty owners must be held engaged in a "sale in interstate commerce of natural gas for resale." Section 2(6) of the Act defines a "natural gas company" to mean "a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale."[5] Section 1(b) of the Act provides, 15 U.S.C. § 717(b):

> "The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

Whether landowners or other royalty owners are engaged in the "sale" of natural gas in interstate commerce for resale within the meaning of § 1(b) of the Act must be determined by reference to the intention of Congress.

The Act was passed in 1938 and it has not heretofore been construed to apply to ordinary lessors. While inaction is not controlling on intent, the widespread assumption and acquiescence therein, including administrative and legislative acquiescence, extending over such a great period of time is not lightly to be brushed aside.

[2] The intention of Congress cannot be conclusively determined by reference to concepts and classifications under state law decisions normally disposing of "private" controversies. United Gas Improvement Co. v. Continental Oil Co., [the Rayne Field case] 381 U.S. 392, 400, 85 S.Ct. 1517, 14 L.Ed.2d 466 (1965).[6]

It must ultimately be ascertained in the light of regulatory purpose and objective. But as a point of departure we may properly begin with the presumption that Congress, like other legislatures, has in mind the ordinary, usual, and natural sense of a word like "sale."[7] This canon is given reinforcement for this term because "sale" was not one of the terms for which Congress provided an express or supplemental definition in § 2 ("Definitions") of the Natural Gas Act.[8]

We have no need to pursue the intricacies of oil-and-gas law, or to take note of the way in which state law concepts vary in describing the interests created by oil and gas leases.[9] It suffices for

4. 42 F.P.C. at 172.

5. 15 U.S.C. § 717a(6).

6. Certainly Congress did not intend to create a state checkerboard of federal regulation and non-regulation depending on the varying concepts under local law of the leaseholder's interest.

7. McNally v. Hill, 293 U.S. 131, 55 S.Ct. 24, 79 L.Ed. 238 (1934); see Old Colony RR v. Comm'r, 284 U.S. 552, 560, 52 S.Ct. 211, 76 L.Ed. 484 (1932).

8. 15 U.S.C. § 717a.

9. Among the classifications found by one text writer, with numerous citations to each one (omitted here) are: profit *a prendre*, corporeal hereditament, incorporeal hereditament, an estate in land, not an estate in land, an estate in oil and gas, not an estate in oil and gas, a servitude, a chattel real, real estate, interest in land, not an interest in land, personal property, a freehold, a tenancy at will, property interest, and the relation of landlord and tenant. 1A W. Summers, Law of Oil and Gas § 152 at 371–374 (2d ed. 1954). He concludes, "Perhaps

this case that generally the royalty owner is not considered, either in common parlance or in conceptions of state law decisions, to be engaged in any "sale" of gas.[10] As to state law we refer to Judge Brown's discussion in *Huber*.[11] The lease terms give the lessee all possessory interests in gas produced during the life of the lease, including full right of sale.

The general understanding of lack of any "sale" by the royalty owner, an understanding rooted in state law concepts, is underscored by the opinion in Burnet v. Harmel, 287 U.S. 103, 53 S.Ct. 74, 77 L.Ed. 199 (1932) decided only a few years before passage of the Natural Gas Act. While that opinion interprets a tax statute, there is pertinence in Justice Stone's discussion of the lack of incidents of a "sale" by the royalty owner, both in technical terms and common understanding. See 287 U.S. at 107, 53 S.Ct. at 75:

> [T]he statute speaks of a "sale," and these leases would not generally be described as a "sale" of the mineral content of the soil, using the term either in its technical sense or as it is commonly understood. Nor would the payments made by lessee to lessor generally be denominated the purchase price of the oil and gas. By virtue of the lease, the lessee acquires the privilege of exploiting the land for the production of oil and gas for a prescribed period; he may explore, drill, and produce oil and gas, if found. Such operations with respect to a mine have been said to resemble a manufacturing business carried on by the use of the soil, to which the passing of title of the minerals is but an incident, rather than a sale of the land or of any interest in it or in its mineral content. Stratton's Independence v. Howbert, 231 U.S. 399, 414, 415 [34 S.Ct. 136, 58 L.Ed. 285]; see Von Baumbach v. Sargent Land Co., 242 U.S. 503, 521 [37 S.Ct. 201, 61 L.Ed. 460].[12]

The Court referred to its rule of long-standing, that "payments by lessees to lessors under mining leases were not a conversion of capital, as upon a sale of capital assets, but were income to the lessor, like payments of rent." *Id.* at 108, 53 S.Ct. at 76.

The FPC's opinion stated "it would be senseless to attempt to determine what is a natural gas company and what is a sale on the basis of Hornbook definitions or local decisions not applicable to the Natural Gas Act. . . . For purposes of the Act, a 'natural gas company' is engaged in 'the sale in interstate commerce of [natural] gas for resale' but whether his operations would be classified as a 'sale' under private law is not determinative, U.G.I. v. Continental Oil Co., 381 U.S. 392 [85 S.Ct. 1517, 14 L.Ed.2d 466]." (R. 5041).

In UGI v. Continental Oil Co., *supra*, referred to as the *Rayne Field* case, the Supreme Court extended FPC jurisdiction over sales of certain leases, although the Act addresses itself, in terms, to sales of gas. Sound analysis of that case requires development of its background.

In Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035 (1954), the Court held that FPC had jurisdiction over "well-head" sales of natural gas by independent producers to interstate pipeline companies for resale in interstate commerce. As the *Phillips* opinion made clear (347 U.S. at 677, 74 S.Ct. at 796) the producers admitted "as they must" that they were engaged in "the sale in interstate commerce of natural gas for resale" and hence came within the basic coverage of § 1(b). The issue was whether the sales of an independent producer were excluded from regulation by the ultimate, and negative, clause of § 1(b) excluding "the 'production or gathering of natural gas.'" The Court rejected the contention of exclusion, in view of the Act's text and legislative history, including notably the Federal effort to plug the "gap" in regulation of the natural gas industry created by decisions prohibiting state regulation of interstate commerce aspects. The Court found "a congressional intent to give the Commission jurisdiction over the rates of all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company."[13]

In *Rayne Field*, an interstate pipeline company made arrangements to buy the producers' leasehold interests in the lands in which the natural gas was located, instead of buying the gas produced directly. The gas reserves in Rayne Field were proven and the field was substantially developed. The Court noted "The provisions of the lease-sale agreements were such that they were very close in economic effect to conventional sales of natural gas." (381 U.S. at 396, 85 S.Ct. at 1520). The Court concluded (p. 401, 85 S.Ct. at 1522):

> "The sales of leases here involved were, in most respects, equivalent to conventional sales of natural gas which unquestionably would be subject to Commission jurisdiction under Phillips Petroleum Co. v. State of Wisconsin, 347 U.S. 672. [74 S.Ct. 794, 98 L.Ed. 1035] . . . [I]t is perfectly clear that the sales of these leases in Rayne Field, a proven and substantially developed field, accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States. That is the significant and determinative economic fact. To ignore it would substantially undercut *Phillips*. . . ."[14]

It is in this context, of a transaction that was in form a lease of reserves but in economic impact the equivalent of "conventional sales of natural gas" that the Court, in upholding FPC jurisdiction to avoid "gaps" in the regulatory framework, stated (381 U.S. at 400, 85 S.Ct. at 1522):

> "A regulatory statute such as the Natural Gas Act would be hamstrung if it were tied down to technical concepts of local law." *Rayne Field*, *supra*, 381 U.S. at 400, 85 S.Ct. at 1522.

These opinions were written with full awareness of the significance, in commercial and regulatory terms, of the

sometime courts and legislatures will recognize the fact that oil and gas leases are different from other forms of contracts and conveyances, and that the interests created by them cannot be properly classified under common interests in property, and will speak of such interests as the interest of an oil and gas lessee. . . ." *Id.* at § 153, p. 382.

10. We put to one side any special case of a landowner who takes a share of the gas produced as his royalty and resells it.

11. See 367 F.2d at 113-114:
"[The lessors make] the very simple, yet profound, contention that there can be no 'sale' of gas by royalty owners since they have no gas to sell. And this seems to be true as a matter of oil and gas law, whether based on the ownership-in-place concept followed by Texas and others or on non-ownership theories of other jurisdictions. For all agree that as the gas leaves the well-mouth, the entire ownership of the gas is in the lessee, none being reserved in the lessor."
Judge Brown's citations reveal that even in Texas, where a lease constitutes a present sale of all the gas in place, the royalty owner possesses some property right in the minerals.

12. Von Baumbach v. Sargent Land Co. is one of the Minnesota Royalty Cases involving state leases of iron ore lands. The leading case thereon points out that mineral leases were developed under the law of tenancy and not through the law of sales. Thus the miner never got his title to his mineral through a sale by the owner but rather as a product of the use for which rent was paid and title was acquired by an appropriate use of the leased premises. State v. Evans, 99 Minn. 220, 108 N.W. 958, 960 (1906).

13. See 347 U.S. at 682, 74 S.Ct. at 799.

14. The FPC's decision in *Rayne Field* observed that it "would exalt form over substance, would give greater weight to the technicalities of contract draftsmanship than to the achievement of the purposes of the Natural Gas Act, and would impair our ability to control the price received for gas sold to the pipelines in interstate commerce to the detriment of the ultimate consumer" to hold that it had no jurisdiction. 29 FPC 249, 256, *quoted at* 381 U.S. at 398, 85 S.Ct. at 1521.

sales of gas by independent producers to interstate pipeline companies. In establishing a Congressional intent to regulate those sales the Court began, in *Phillips* with what were plainly and admittedly "sales in interstate commerce of natural gas." This was fortified when *Rayne Field* extended coverage to producers' sale of their leases to interstate pipelines, for that extension was on the ground that these lease transfers were the equivalent "in economic effect to the concept of conventional sales" and such conclusion was required so as not to open gaps in Federal regulation. In both cases the Court did not undercut, it rather underlined, the need for a jurisdictional foundation in "sales in interstate commerce"—plain and admitted in *Phillips*, and existing through economic equivalent in *Rayne Field*.

When we come to an ordinary lease by the landowner to the producer there is neither a "customary" sale in interstate commerce nor its equivalent in economic effect. Such a lease is a transaction that is itself customary and conventional, but one that precedes the "conventional" sales in interstate commerce with which Congress was concerned, indeed even precedes the "production and gathering" which § 1(b) visualized as preceding the sale in interstate commerce over which jurisdiction was being established.

Turning to the "significant and determinative economic facts," basically the significant fact for a sale in interstate commerce is interstate movement either by the seller, prior to or in connection with the sale, or by the purchaser, typically an interstate pipeline company, subsequent to or in connection with the sale. In the case of a typical oil and gas lease, there is no such interstate movement by either the transferor or transferee.

In *Rayne Field*, the gas reserves were known and had been substantially developed by or in behalf of the lessees-producers. A gas lease, however, transfers only the right to explore, develop, and market if exploration is successful; no royalty is paid if no gas is discovered. In *Rayne Field* the lease-buyers were interstate pipeline companies—clearly "natural gas companies" under the Act—and it was known that the gas was destined for interstate commerce. As to leases of reserves from landowners to lessee-producers there is no knowledge when the lease is executed of the ultimate destination of any gas that might be discovered,[15] no knowledge whether the gas, if discovered, will be sold either to an interstate pipeline or to any other customer that will move it across state lines. While the lease by the landowner provides for a royalty in the event of the discovery and sale of gas, typically he has no control over any incident of such sale either as to the quantity to be sold, the price to be paid, the identity of the purchaser or whether it shall be sold in interstate or intrastate commerce. To refer to the royalty owner as engaging in the sale is to depart from the common understanding of the words used, industry parlance, economic equivalent, or any other foundation hitherto considered a source for discerning Congressional intention.

The Commission's approach was this, that when a landowner executes a "proceeds" or "value" lease "he has contracted to retain an economic interest in interstate sales by the producer," and "has joined the other interest owners in such sales and he has become a seller of natural gas." [16] But an economic interest in the proceeds of a sale, unaccompanied by authority to determine the incidents of the sale, does not make one a seller. The developer of a shopping center does not become a seller of food because he leases to a supermarket on percentage rental terms. A patentee who licenses various manufacturers on a royalty per-

15. The producer is a natural gas company because of the interstate movement conducted either by him or by his customer, assuming he discovers gas and makes a sale in interstate commerce.

16. R. 542, 42 FPC at 172.

centage basis is not generally considered the seller of the articles. Nor does the lessor become a seller of an article merely because the article was produced on or from the land that he leased. An owner of farmland leased to a farming tenant does not become a seller of produce raised because his rent may be a fraction of the price received for the crops. An owner of a mine leased to an operator does not become a seller of the ore produced because the stipulated compensation for the lease is a fixed fraction of the price received for the ore produced.

If the statutory use of "seller" or "sale" of natural gas in interstate commerce is referable to the meaning of these words in ordinary usage, or as likely understood by Congress, the FPC's ruling is clearly unsound. We do not think a different result warranted or mandated on the ground that the purpose of the Act is to protect the ultimate beneficiaries against exploitation by natural gas companies. That was indeed the objective of Congress, see FPC v. Hope Natural Gas Co., 320 U.S. 591, 610, 64 S.Ct. 281, 88 L.Ed. 333 (1944). The FPC is to be commended for attempting to further that objective, but it is not sufficient justification upon which to base an expansion of the Act to activities clearly not within its terms. Congress did not give the FPC carte blanche to take whatever action it might consider appropriate in furtherance of this purpose. The FPC is limited by the provision establishing its jurisdiction, and we do not find in that provision, rooted as it is in a sale in interstate commerce, any basis for reaching out to cover the landowner's lease or its royalty payments. We think it too far removed from the interstate sale. When there is a sale of gas to a pipeline in interstate commerce, the FPC will of course have the jurisdiction and the responsibility to exercise control in the interest of the ultimate consumer.

We turn to a consideration of what may be implied as to jurisdiction from the requirement of effective Federal regulation of producers and pipelines. Of course for leases executed after this controversy took shape, it seems probable that producers will be able, and indeed have been able, to insist on leases drafted so as to avoid recurrence of the present controversies.

[3] More significantly, the FPC's jurisdiction over rates chargeable by a producer includes authority to determine the reasonableness of costs incurred, even though these are not subject to direct FPC control, and that establishes authority to review royalty payments, or drilling rig rentals, or any other element of the producer's cost of service.[17] Permian Basin Area Rate Cases, 390 U.S. 747, passim and at pp. 824-825, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968). And we interject that this is the only approach that even the FPC has in mind for handling other elements of the total payments made by producers to landowners, *e. g.*, the cash bonus, delay rentals.

Intervenor Shell Oil Co. put forward the contention that jurisdiction should rest on the burden created on interstate commerce by allowing royalty payments in excess of producers' rates. The Commission opinion stated that "since we find that an actual sale for resale by an interest owner does take place under the royalty provisions of the mineral leases the argument of Shell and Tenneco constitute an additional, but not the basic, reason for asserting jurisdiction." [18]

If an interpretative ruling stretching the Act as written to cover leases by landowners is to be countenanced on the score of necessity, and we do not say this will be possible, the underlying record

17. In the Permian Basin area rate decision, eventually sustained by the Supreme Court, the FPC calculated the average cost of producers affected, as to royalty payments, on an assumption of 12½% of total cost of service (including return on capital). FPC opinion No. 468, 34 FPC 159, at 192 (1965).

18. 42 F.P.C. at 172, 173, R. 5043.

must be more comprehensive and profound—broader and deeper, as it were—than the findings and analysis presented on this record. The case as it comes before us, with a cursory "makeweight" reference to a possible theory of economic burden, is in a wholly different posture from that presented in United States v. Southwestern Cable Co., 392 U.S. 157, 88 S.Ct. 1994, 20 L.Ed.2d 1001 (1968), which held CATV systems to be within the Federal Communications Act's coverage of "all interstate and foreign communication by wire or radio", 47 U.S.C. § 152(a), and relied significantly on the FPC's finding that achievement of its regulatory purposes would be placed in jeopardy by the unregulated growth of CATV.

As to the problem of economic burden and higher prices for consumers, although the record contains evidence and findings concerning different forms of industry contracts (see Appendix) we have no findings concerning the extent or significance of market price contracts. And the FPC's opinion gives no concrete indication of whether, in what circumstances, or to what extent, there may be an economically meaningful problem of "market prices" in excess of ceilings. In the *Huber* case the judgment entitling the royalty owners to pursue their claim made no determination of amounts of recovery. Apparently such litigation may come to involve substantial sums even if pursued so as to recover royalties based on ceilings higher than filed rates. This we infer from the fact that Mobil Oil and other producers have appealed from the ruling of the FPC that although the royalty owners' filing obligations are met by virtue of the filings made by the producers,[19] a royalty owner is not limited to the rate filed by the producer and may enforce his contract as calling for a higher rate if permitted by the Act.[20] The record simply does not focus on what may be involved in the possibility of recovery of royalty calculated on the basis of "market prices" higher than ceilings.

Questions have come to our mind concerning the FPC's theory as to how the royalty owners may be shoe-horned into the existing regulations, and we at least have it in mind that if the FPC's assertion of jurisdiction over royalty owners were sustained its regulatory problems might be more complicated than it has assumed.[21] To avoid any misunderstanding we interject that we have not been made uneasy by the contentions the producers have presented to us,[22] for we see no theoretical impediment to producers' being held on the basis of a contract to a royalty payment related to a base higher than the producers' filed rate. United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332, 76 S.Ct. 373, 100 L.Ed. 373 (1956). The producers make no claim, even obliquely, that they face financial or other difficulties requiring relief from contractual obligations, see Permian Basin Area Rate Cases, *supra*, 390 U.S. at 822, 88 S.Ct. 1344, 20 L.Ed.2d 312, and insofar as general equitable considerations are concerned we suppose the FPC may have had in mind that its area ceilings are predicated on an assumption of royalty costs at a conventional fraction of ceiling prices (see note 17, *supra*).

In any event we are not persuaded that the maintenance in either state or Federal courts of contract (lease) controversies between royalty owners and lessees will undercut the Federal regulatory system. The controversies hitherto delineated by the private parties have focused on the producers' assertion of the need of the royalty owners to abide by the producers' filings and receipts. The problem of relationship of market prices to producer ceilings presents different considerations.

Without purporting to rule on the matter in any way, we can certainly visualize the possibility that a court confronted with a contention of entitlement to a market price basis higher than the producer's ceiling would consider it to run counter to the intention of the parties, unless there is something to rebut the fair presumption that they contemplated interstate movement and market prices compatible therewith.[23] The court might also consider that this result would be in furtherance of the general principle against application of contracts so as to contravene public policy, whether or not the result would be in violation of supremacy clause doctrine prohibiting state rules or decisions that require a regulated company to take action inconsistent with Federal regulation, see Northern Natural Gas Co. v. State Corp. Comm. of Kansas, 372 U.S. 84, 83 S.Ct. 646, 9 L.Ed.2d 601 (1963).[24]

The court handling the contract clause could avoid becoming embroiled in the ascertainment of the Federal ceiling by referring that issue to the FPC, invoking the broad and supple doctrine of primary jurisdiction, see J. M. Huber Corp.

19. The FPC stated (42 FPC at 173, R. 5013) that by operation of the law the jurisdictional royalty interest has in effect been covered by the producer filing since 1954, on the same theory as a producer's filing covers the interests of all non-signatory parties, and should continue to be so covered. Therefore the FPC concluded no amendment or extension of existing rules was needed.

20. "Where he [the royalty owner] has contracted for the market price or value it would appear that he has contracted for a payment equal to the maximum rate for such gas which could have been received [by the producer] as fixed under the law by this Commission. . . . Where no just and reasonable rate has been fixed and the producer has agreed to pay the royalty interest owner more than he himself receives for the gas, we believe that the basis of the effective rate [the rate filed by the producer] subject to adjustment when the just and reasonable rate is determined." 42 FPC at 174.

21. We are puzzled by the FPC conception that royalty owners are, and have since 1954 been, natural gas companies under the Act, limited under § 4 of the Act to their rates as filed, even though they have not made filings and indeed could not have made filings, and by the corollary conception that the royalty owners are deemed covered by the filings made by the producers yet may now sue the producers for a higher basis.

It is one thing to consider a nonsignatory represented by the signatory when they have a common interest. But as we see it the reason why the FPC is asserting jurisdiction over the royalty owner is to handle the situation of a controversy between royalty owner and producer, and we are at least uneasy with an analysis whereby the royalty owner makes his filing by incorporation within the producer's filing and yet is free to seek a higher basis. If the royalty owners should recover on a basis of a market value higher than the rate that was filed by producers, it is difficult to discern how they may be deemed in compliance with the obligation of natural gas companies, for any sale subject to the jurisdiction of the FPC, to charge only the rate that is set forth in a public schedule filed with the Commision. It seems clear that the provisions of the regulations do not fit lessors.

We are also uneasy with the FPC's assumption that there can be no controversy between the landowner and the producer if an area ceiling is established. As we understand it the royalty owner was not, and apparently could not have been, a party to the area rate proceeding. If this is correct, it is not easy to see on what basis he can be held concluded by what has been established in such a proceeding, whether on conventional findings, or following a settlement.

22. They complain that they are made subject to immediate contingent liabilities to make retroactive royalty payments if the FPC authorizes area rates higher than those previously filed by the producers even though the producers are prohibited from retroactively adjusting their rates.

23. Compare Permian Basin Area Rate Cases, *supra*, 390 U.S. at 792, 88 S.Ct. 1344, 1373, 20 L.Ed.2d 312 et seq., upholding departure from field prices in the public interest on the ground, inter alia, that various significant increases in field prices were "symptomatic of the deficiencies of the market mechanism."

24. The question would arise whether a decision requiring a producer to pay the royalty owner on a basis higher than his Federal ceiling would be interfering with his carrying on interstate commerce conformably with the conduct prescribed for the producer by the Federal regulatory agency.

The question might be obviated in a particular case if the court discerned an intrastate market, capable of absorbing the volumes involved, not subject to any Federal ceiling.

v. Denman, *supra*, 367 F.2d at 111; *cf.* Brawner Building Inc. v. Shehyn, 143 U.S.App.D.C. 125, 442 F.2d 847 (1971).[25] This would bring the FPC into the dispute between the royalty owner and the lessee-producer, but the FPC would be acting properly, on reference from the courts, rather than unduly stretching its jurisdiction and the statutory mandate to extend to royalty owners.

Special Circumstances of Denman "R" Lease

While Commissioners Carver and O'Connor wrote strong dissenting opinions from the assertion of jurisdiction over the royalty interest in most gas leases, they agreed with the majority that variations in the Denman "R" lease rendered its royalties jurisdictional. Commissioner Carver found that the circumstances show "the lessor clearly identified his interests with those of the lessee-producer. The privity found lacking in the usual and normal leasing arrangement is supplied under these particular facts."[26] We do not consider this matter, as we do not know whether a majority of the FPC would have taken the same approach initially, or would wish to do so in the wake of our decision.[27]

Reversed.

APPENDIX

Excerpts from Opinion of Presiding Examiner, see 42 FPC at 190, 191:

> Every provision in a lease is open to negotiation, but not every provision is actually negotiated in every transaction. The most common items of negotiation between the lessor and prospective lessee are the amount of cash bonus, the amount of delay rental, the length of the primary term, and the royalty fraction.
>
> The cash bonus is the cash consideration paid by the lessee to the lessor for granting the mineral lease and may range from a minimal amount to a substantial sum.
>
> The delayed rental is a payment for the privilege of deferring the commencement of drilling operations or the commencement of production.
>
> The primary term is the term of the lease during which the lease may be continued in effect without drilling operations or production by the payment of a delayed rental.
>
> * * * * * *
>
> The landowner may create by grant or by reservation various estates in land. The interest we are concerned with here is called royalty and is created by a reservation in an oil and gas lease in which the landowner grants to the lessee certain rights and privileges, such as, to explore, drill and produce oil and gas, and in the same instrument reserves to himself, free from the expenses of production, a share in the oil and gas produced or the proceeds thereof. Williams and Meyers, Oil and Gas Law, Manual of Terms, 342; Volume 1, secs. 202, 202.1, 202.3. This share is usually expressed in terms of a fraction of the production. The fraction is generally one-eighth and in some instances a larger amount. The royalty interest as to oil produced is usually taken in kind, but as to gas produced, while the right to take in kind may be reserved, it is seldom done as a practical matter due to its characteristics and the lack of market other than the pipeline to which the lessee delivers the gas. The common provisions in the leases for accounting to the lessor for royalty as to the gas produced provide for the lessee to pay the lessor for his fractional part the market value in the field or a percentage of the proceeds derived from the sale of the gas.
>
> In addition to the lessor's royalty interest, there is also another type of royalty interest called an overriding royalty interest. Such interest is most commonly created when a lessee enters into a farm-out agreement with another producer. In such an agreement the lessee retains either an undivided interest in the leases or an override interest. Both the lessor royalty interest and the overriding royalty interest as a contractual matter receive their respective interests free of any of the costs of production, except for taxes. The working interest owners generally share the expenses of development and operation of the property, proportionate to their interest in the property. Although the overriding royalty interest owner is a bare holder of a right to receive proceeds, the lessor royalty interest owner is protected by certain implied covenants with respect to the development of a lease and the marketing of the product.
>
> * * *
>
> In Docket No. RI67-113, there are involved three leases as to mineral rights in Texas, designated as the "R Lease" entered into on June 2, 1936, the "B Lease" and the "M Lease" on January 22, 1926. The royalty provision insofar as necessary for consideration here, under the "R Lease" which accounts for 93 percent of the production of gas provides for Huber, the lessee:
>
> > To pay the Lessors monthly for one-fourth (¼) of the gas produced at the mouth of the well from any gas well, where gas only is found, four cents per one thousand cubic feet for the first ten years of this contract, and thereafter, the market price of such gas but in no event shall the price be computed at less than four cents per one thousand cubic feet.
>
> Under the B and M Leases the royalty clause provides:
>
> > To pay the Lessor the equal one-eighths part of the market value in the field for the gas from each well where gas only is found, while the same is being used off the premises, * * *
>
> The type of lease varies as to mineral rights in Kansas under Docket Nos. RI67-114, RI67-310 and RI67-400. The royalty clauses in the leases here necessary for consideration generally provide for the lessee to pay the lessor on gas marketed from each well where gas only is found one-eighth of the proceeds if sold at the well, or if marketed by the lessee off the premises, then one-eighth of its market value at the well. Some of the leases set forth only a proceeds type royalty clause and others only a market type royalty clause. Regardless of the type of royalty clause set forth in the leases involved in these proceedings, the landowners claim entitlement at the market price.
>
> MacKINNON, Circuit Judge (concurring):
>
> I agree with the result and with the opinion insofar as it decides issues in this case. However, with respect to future cases that might involve the relationship of market prices to producer ceilings, I see no necessity to discuss the effect of the intent of the parties, public policy, federal supremacy, or the use of primary jurisdiction.[1]

ORDER

PER CURIAM.

On December 30, 1971 petitioner filed a petition for rehearing. Respondent filed a response thereto on January 24, 1972. On January 28, 1972 William Harvey Denman et al. filed a motion for leave to respond to the petition for rehearing. On March 6, 1972 an order was entered granting the conditional request of William Harvey Denman et al. for permission to respond to the petition for rehearing and extending the time for the filing of a response to and including March 16, 1972. No response has been filed, and on due consideration, it is

Ordered by the Court that the petition for rehearing is granted to the extent of clarifying that it is the court's intention in reversing to permit, but not to require, the Federal Power Commission to enter a further order in regard to the "R" Lease controversy, as it may be advised after further proceedings, not inconsistent with the opinion of this court.

25. The producer could file for a declaration of ceiling, with notice to the royalty owner as party affected.

26. R. 5057, 42 F.P.C. at 183.

27. Braniff Airways, Inc. v. CAB, 126 U.S.App.D.C. 399, 379 F.2d 453 (1967).

1. *See* majority opinion, pp. 265–266, inclusive.

STATEMENT OF JOHN BOWER IN OPPOSITION TO A SEVERANCE TAX

Before the House Committee On Assessment and Taxation,

March 15, 1983

MR. CHAIRMAN:

The quest for a severance tax has become a modern day cruaade. Behold the brave knights, clad in shining armor, riding forth on white horses to save the hapless people from the greedy oil barons!

Reports in the media indicate this thing is greased for passage. Apparently promotors are so confident that only a few showed up to speak for it yesterday. Some of them did not seem to like the bill.

Everyone in this room knows why you are being pushed into this, with little regard for the long term effect on the state. People don't think they will have to pay the tax! They see the legislature spending more and more every year, and they want somebody else to pay the bill. It is selfishness, pure and simple.

Senator Steininger put it bluntly when he said that the rights of the state come ahead of the rights of 3000 oil men. As an attorney, he ought to know better. The Nazi holocaust was justified by just such logic.

Yet here we see our cities, unwilling to tax their people, or even their own industry, to finance their spending schemes, asking you to reach out and put the bite on rural industry. What will they be after next year--grain elevators and feed yards?

Do you really need to spend so much of our money? Some of us don't understand, when people are out of work, when farmers and businesses are going broke, how you can go on talking glibly about how much government salaries should be raised. Doesn't anyone have the wisdom or courage to face the simple truth that we can't go on giving unearned pay increases every year without destroying our economy and our nation?

But the governor claims to have uncovered a bonanza, and as the Bible says, "Where the carcass is, the vultures will be gathered together." But, before you risk the future of Kansas on slicing up this supposed melon, you ought to look at things as they are in the real world. Instead of milking the cow, you may be cooking the goose.

ATTACHMENT IV
(3-15-83)

It happenned before. The media flays the rich oil men, but the truth is oil and gas producers and royalty owners have been robbed of billions of dollars by American price controls. Exploration stopped, lines formed at gas pumps, houses went cold.

Foreign producers formed OPEC and broke American price fixing. Prices jumped sky high. Faced with paying the real price of energy, Americans belatedly became economy conscious. The nation's moribund oil industry came back to life, and money once again began to flow into exploration.

Now prices are coming back down to more justifiable levels. OPEK ministers have patched up an agreement which they hope will halt the slide at 29 dollars a barrel, which slices quite a chunk off the fiscal note of this bill. If that fails, oil could go to 20 dollars. Then where are we?

Kansas oil prices have already fallen near 20 percent since Governor Carlin first proposed his severance tax. Now they are coming down some more. Add on an 8 percent tax and you will shut down a lot of operations. Already drilling rigs are parked and men are out of work.

Let me give you an example of the oil business as it really is in Kansas. Oil and gas were discovered north of McLouth in 1939. By the early 1950's, nearly 800,000 barrels of oil had been produced from the McLouth pool. With oil selling for less than a dollar after the war, the field was abandoned when the state ordered an end to surface disposal of salt water. Casing was pulled and sold for junk. Oil rights were worthless.

The rise in oil prices changed all that. In 1980 an attempt was begun to recover the remaining oil, estimated by an engineer at more than 2 million barrels. Drilling began two years ago. Twelve wells have been drilled, eight of them yielding oil. Total production to date, however, has been less than 4500 barrels. The producers have spent more than 1.5 million dollars in this venture. I can tell you they don't feel much like J R Ewing.

While this example may not be wholly typical of Kansas oil production, it is a lot more so than all this hype about "big oil." Operations will be curtailed or shut down. Rural communities will be hurt.

About a third of the McLouth pool is under our farm. Of nine wells staked, three have been drilled, at a cost of more than $500,000. Sales from our lease have been 530 barrels, worth $13,527.72. Our royalties have been $1690.96, on which we paid property taxes of $636.66. If these men go broke, nobody else is likely to try recovering this oil during my lifetime.

Think about these things.

BEREDCO INC.
Rotary Drilling Contractor

401 E. DOUGLAS, SUITE 402, WICHITA, KANSAS 67202 (316) 265-2856 / (316) 265-3311

TO: THE MEMBERS OF THE ASSESSMENT AND TAXATION COMMITTEE
OF THE HOUSE OF REPRESENTATIVES

My name is Jerry Marcus, I spent 12½ years in the Beef business before coming into the oil industry 2½ years ago. As a Vice-President & Director of MBPXL Corporation (now Excel Corporation) and as a graduate of the Wharton School of Finance at the University of Pennsylvania, I am acutely aware of the fundamentals of Business investment strategy. It is investment in Kansas business that will keep our State strong and provide jobs, income, and an increasing tax base.

Oil & Gas exploration in Kansas is totally dependent upon the ability of investors from within Kansas and investors from outside our State to feel confident that an investment will bring an appropriate rate of return. If such an investment cannot attain an acceptable level of return, it will not be made or it will be made in another investment or another place where the return is acceptable.

I am here today to explain new facts. Facts which have not been explained to you or to the people of Kansas. These facts are important for their affect on Kansas.

Every Kansan must be made aware that since September, 1982, Kansas Crude oil, which averages 35 gravity, has been selling for $1.65 per barrel less than in Oklahoma, Texas, Colorado, Nebraska, and other states. The cause of this lower price is twofold: (1) Kansas has a very poor pipeline system to transport Kansas production out of this state. Most Kansas production must be refined within the state. Recently, there have been permanent closings of 2 refineries in Kansas City, 3 others in southern Kansas and northeast Oklahoma. (2) Kansas pipelines are common stream -- mixing a blend of sweet and sour crudes within the same line, with little or no ability to separate qualities. This has caused Kansas crude oil to be penalized by all major purchasers by deducting a higher gravity adjustment than surrounding states due to a lower refining yield for the average Kansas mixed stream crude. It is likely that this $1.65 differential will remain for years.

ATTACHMENT V
(3-15-83)

A $1.65 is equivalent to 5.7% cost on $29.00 crude. We already have a 4% Ad Valorem tax and with the proposed 8% Severance tax (4% net), every investor or producer must subtract 13.7% (5.7 + 4.0 + 4.0) when comparing an investment in Kansas versus a like investment in Oklahoma where a 7% cost exists. If you compare this 13.7% cost against investment in Colorado or Nebraska, where a 4-5% tax exists, you would get approximately 10% less for your investment. Will you invest for oil in Kansas if you can get 10% more for your investment in Nebraska or Colorado or 7% more in Oklahoma?

It should not be difficult to imagine the tremendous impact these differentials in return on investment will have on investment in Kansas Oil & Gas exploration.

There is no question that many of our present Oil & Gas exploration companies are already diverting substantial investment away from Kansas and our daily production of oil is already beginning to decline. This is only to be expected, because Kansas, with its impending Severence tax is no longer attractive. Present drilling activity is already down over 40% from the previous year.

It is clearly probable that Kansas will lose 50% or more from 1982 levels of investment in Oil & Gas exploration if <u>any</u> Severance tax is passed. The consequences to the property and income tax base will be devastating and yet, no economic impact analysis has been presented to reflect these facts.

At the end of 1982, Kansas Oil production was at a rate of 70 million barrels annually. If investment drops 50%, Kansans must be made aware that within 3 years, $500 million in annual gross revenues from production will be lost from this State along with $20 million annually in State income tax revenues. Within 7 years, this annual loss of State income tax will climb to $40 million and will have accumulated to a loss of $140 million over 7 years. The $500 million loss of gross revenues will climb to $1 billion loss annually within 7-8 years, and it will have accumulated to a loss of $3½ billion in gross revenue over 7 years. Imagine what a loss to this State not to have the reinvestment of $3½ billion during the next 7 years!

It would be tragic for Kansas to lose its 2nd largest industry. In all surrounding states where the Oil & Gas industry is also suffering from falling oil prices and a significant downturn in exploration activity, local and state governments are supportive, doing everything in their power to help. In Oklahoma, S.B. 197 has been introduced which would exempt exploratory wells from Severance tax. In North Dakota, where exploration has all but ceased in the Williston Basin, the State Senate will soon introduce a similar bill to exempt new production. Kansas must do the same. We must have a positive image to restore investor confidence.

Our Governor and this legislature and our local governments do so many things to attract other industries into this State and to help them grow. We give property tax abatement, issue industrial revenue bonds, and make all kinds of special concessions. What do we do to keep our mature industries here?

I plead with each and everyone of you to consider the real issue. Do not "kill the goose that layed the golden egg". It is not too late. If you kill the Severance tax bill and work to stimulate this industry and all industries in this state, the tax base will grow and present tax structure will provide.

It is not your fault that you have not been given all the facts to make your decision regarding the Severance tax issue. Our industry must take the blame for poor communications.

As elected officials, I am sure that every person on this committee has the best interest of Kansas in his heart and in his mind and would not want to act in any way which would severly damage the future of this state.

J. D. Marcus
President

MARCH 14, 1983

GENTLEMEN:

THE KANSAS COAL INDUSTRY IS TRULY A DEPRESSED INDUSTRY.

DURING THE CLEAN AIR ACT OF THE EARLY 70's, KANSAS COAL WAS LEGISLATED OUT OF MUCH OF ITS' MARKET DUE TO LOW So_2 REQUIRMENTS.

MUCH OF THAT MARKET AREA IS NOW BEING SERVED BY WESTERN COAL, WITH COAL SEAMS RANGING FROM 40'-75' IN THICKNESS AS COMPARED TO KANSAS SEAMS OF 14"-18".

WE COMPETE REGULARLY WITH COAL PRODUCED IN OKLAHOMA, MISSOURI AND ILLINOIS, OF WHICH NONE OF THESE STATES HAVE A SEVERANCE TAX ON COAL.

WE ARE CURRENTLY ENCOUNTERING PETROLEUM COKE COMPETING IN THE COAL MARKET PLACE AT 50% THE PRICE OF COAL.

SHOULD ALL OF THE COAL SEVERENED IN KANSAS BE UTILIZED IN KANSAS, THERE WOULD NOT BE SUFFICIENT QUANTITY TO SATISFY THE NEEDS OF ONE LARGE POWER PLANT.

ANNUAL COAL REQUIREMENT:

LARGE POWER PLANT	3.5 MILLION TONS
MEDIUM POWER PLANT	1.0 MILLION TONS
CITY POWER PLANT	0.5 MILLION TONS
CEMENT PLANT	120,000 TONS

AS YOU CAN SEE, KANSAS IS DEFINITELY AN IMPORTER OF COAL.

GENTLEMEN, I PRAY THAT YOU WILL TAKE THE TIME TO UNDERSTAND THE COAL INDUSTRY IN KANSAS, PRIOR TO CASTING YOUR VOTE TO KILL THE INDUSTRY THAT HAS SERVED KANSAS WELL FOR MORE THAN 100 YEARS.

RESPECTFULLY SUBMITTED

THE MACKIE-CLEMENS FUEL COMPANY
DENNIS G. WOOLMAN
VICE-PRESIDENT

ATTACHMENT VI
(3-15-83)

F A C T S H E E T

TOTAL KANSAS COAL PRODUCTION FOR 1982	1,395,923 TONS
CLEMENS PRODUCTION FOR 1982	298,730 TONS
NUMBER OF EMPLOYEES	97
PAYROLL - (INCLUDING FRINGES)	$4.5 MILLION
EMPLOYEES STATE INCOME TAX	$ 95,000.00
EMPLOYEES STATE SALES TAX	$ 34,000.00
COMPANY COUNTY TAXES	$ 94,000.00

CONTRACT CARRIER FOR CLEMENS COAL

20 TRUCKS - TOTAL REVENUE	$2.0 MILLION
FUEL PURCHASED IN KANSAS	$ 500,000.00
TIRES AND MAINTENANCE	$ 268,000.00

(7)

ALTERNATE
FUELS
INC.

P.O. Box 769 Arma, Kansas 66712

March 15, 1983

House of Representatives
Assessment and Taxation Committee
State Capitol Building
Topeka, Kansas 66612

Dear Mr. Chairman and Committee Members:

My name is George M. Barberich, I am Vice-President of Alternate Fuels, Inc. We are a surface coal mining concern in southeast Kansas. Our company provides coal for some of the cement plants fuel supply of which our coal becomes a part of their finished product. What are some of the Kansas cement plants doing about their fuel needs today? They are burning Oklahoma coal, petroleum coke, other waste by-products, all of which are cheaper than Kansas produced coal on todays market.

The demand for Kansas coal is gradually diminishing. It is being forced to give way to low sulfur coal from the western states and also Oklahoma. The vein thickness in the western mines may exceed 70 feet, while in Kansas we are fortunate if it exceeds 20 inches. Kansas coal has to be washed causing shrinkage of over 20 percent. The western coal is 100 percent marketable. Kansas coal has more than 6 times the amount of sulfur than western coal and even some Oklahoma coals. Kansas coal is unable to harness another economic hardship.

Our employees future is at stake here. Everything that our company and others in the industry (what few of us have survived) have worked for is about to be discarded. It takes just as much effort to extract the next ton of coal as it did the previous ton. These are just some of the problems facing our industry in Kansas. The ones mentioned here are presented in laymans terms, the others become very technical.

Mr. Chairman and committee members, I urge you to review the facts. We are not a thriving industry operating on a large margin of profit. Please do not place the faith and future of our employees, our buyers, our vendors and everyone involved in the industry in any greater jeopardy than it already is.

Respectfully submitted,

George M. Barberich

George M. Barberich
Vice-President

ATTACHMENT VII
(3-15-83)

Phone: 316-347-4791

P. O. BOX 1389

TELEPHONES 316 232-2280
316 232-2281

Bills Coal Company, Inc.

DIVISION OFFICE

KANSAS — OKLAHOMA — MISSOURI

PITTSBURG, KANSAS 66762

March 14, 1983

Honorable James D. Braden
Chairman, House Assessment and Taxation Committee
Kansas House of Representatives
Topeka, Kansas 66612

Dear Sir:

As a matter of sound business practice, Bill's Coal Co., Inc. is opposed to any form of a severance tax on coal.

The coal industry in Kansas is at best marginally profitable. The coals which we mine are deep, thin seams which, while relatively high in heating value, are also high in sulfur content. Since the coals are already undesirable because of the high sulfur, any increase in the price of our coal becomes doubly detrimental.

I'm sure that you have already heard much of the depressed coal industry in general. With the existing over capacity industry wide, the profit margins within which we must submit bids on coal contracts is extremely narrow, any increase of taxes , not only one of the magnitude proposed here, will, of necessity, do basic, irreparable damage to our firms ability to continue to do business in the State of Kansas.

In addition to the damage which can be done in competing with surrounding coal producing areas, of more immediate concern is our ability to produce coal at a profit under our existing long term contracts.

Our company currently operates under long term contracts to produce over one million tons of coal annually. All of this coal is sold at fixed prices under contract with no adjustment made for increased costs of any kind. With over 50 percent of our available reserves located in Kansas, it is imperative that the fixed costs related to mining that coal remain constant.

We have made every attempt to control our costs so that we may be competitive in a buyers market. We have laid off operating personnel, we have decreased supervisory and staff positions, we have consolidated offices and operations, we have closed marginal projects.

ATTACHMENT VIII
(3-15-83)

To now tax our company out of existance would be a great injustice to the people who rely on us for their livelyhood and the people who depend on them.

Sincerely,

BILL'S COAL, CO., INC.

Ron Pommier

cmh

LONE STAR INDUSTRIES, INC.

Cement & Construction Materials Group

P. O. Box 297
Bonner Springs, Kansas 66012

March 10, 1983

Tax and Assessment Committee
House of Representatives
State Capitol Building
Topeka, Kansas 66612

Re: Proposed Severance Tax on Coal

Dear Mr. Chairman and Committee Members:

Please enter our opposition to the proposed Severance Tax on Coal now being considered by your committee and scheduled for public hearing on or about March 15, 1983. I would like to express our basis for opposition, avoiding extension of remarks and detail for the sake of brevity. I plan to make an appearance at the hearing for the purpose of making a further statement and to answer any questions.

We estimate the proposed Severance Tax will add a minimum of $2.00 per ton to our coal cost at the plant. Coal is our major fuel source. This abrupt additional cost per ton provides no additional benefit to our operations in the way of fuel efficiency, man-hours saved, or other direct or indirect contribution to our operations.

Any rise in costs, especially unproductive, is serious in these times. As costs rise and prices fall, or at best remain static, it is essential that a prudent businessman make an on-going study of a given operation to determine that the business gives an appropriate return on investment. A substantial jump in cost of fuel supply such as would result from this proposed tax, could have a serious impact upon our operations at Bonner Springs, Kansas.

Our Bonner Springs cement plant has been a part of the community since 1908. It presently has over 160 employees with an annual payroll of approximately three and one-half million dollars. The contribution to the state and local economy through corporate and personal taxes, transportation services, and all other contributions to the state and local financial well-being you can recognize without further enumeration.

ATTACHMENT IX
(3-15-83)

LONE STAR INDUSTRIES, INC.
Cement & Construction Materials Group

P. O. Box 297
Bonner Springs, Kansas 66012

March 10, 1983

If this tax is passed, we would have to consider at least two alternatives:

1. At the present, we purchase coal from a Kansas supplier. This is the result of a combination of economics and a desire to do business within the state. If such a tax becomes a fact, it might become necessary and good business judgement to find our source outside the state.

2. Such an additional cost would undoubtedly precipitate a study of feasibility of keeping this old and costly operation open. This is not idle conjecture, since the Company has recently shut down (temporarily it is hoped) a plant of comparable age in one of the active markets because the cost of fuel and raw materials continued to increase with no productive benefit therefrom, rendering the continued operation at this time impractical.

Revenues from a healthy industrial environment in the State of Kansas will result in better cash flow benefits to the State than this specific severance tax. The overall long-term effects should be seriously considered before any such tax is approved.

Sincerely yours,

LONE STAR INDUSTRIES, INC.

C. A. Buckelew

C. A. Buckelew
Plant Manager

CAB/rm

GENERAL PORTLAND INC.

STATE OF KANSAS

HOUSE ASSESSMENT AND TAXATION COMMITTEE

MR. CHAIRMAN, COMMITTEE MEMBERS, GUESTS: I REPRESENT THE VICTOR DIVISION OF GENERAL PORTLAND INC., A MANUFACTURER OF CEMENT IN THE STATE OF KANSAS. WE SPEAK AGAINST THE IMPOSITION OF A SEVERANCE TAX ON COAL MINED IN KANSAS AS SUCH A TAX WILL TEND TO DRAIN MONEY FROM THE STATE AND HAVE A NEGATIVE EFFECT ON THE KANSAS ECONOMY.

GENERAL PORTLAND INC. RELIES ON COAL AS ITS PRIMARY FUEL IN MANUFACTURING CEMENT. AN EIGHT PERCENT TAX ON COAL WOULD INCREASE OUR PRODUCTION COSTS AND FORCE US TO CONSIDER OUT OF STATE COAL SOURCES ALSO NEAR OUR PLANT SITE. IF WE PURCHASE COAL FROM OTHER STATES, SUCH AS MISSOURI OR OKLAHOMA, IT WILL HURT THE FINANCIAL POSITION OF OUR KANSAS COAL SUPPLIERS, THEIR EMPLOYEES, AND THE COMMUNITIES THAT RELY ON THESE COAL SUPPLIERS FOR THEIR WELL-BEING.

ATTACHMENT X

(3-15-83)

HIGHER COAL COSTS FOR GENERAL PORTLAND WILL ALSO MAKE US LESS COMPETITIVE WITH CEMENT PLANTS IN OTHER STATES. WE SHIP CEMENT TO CUSTOMERS IN TEXAS, OKLAHOMA, MISSOURI AND NEBRASKA AS WELL AS KANSAS. THE HIGHER COST OF OUR PRODUCT DUE TO A SEVERANCE TAX ON COAL WOULD NOT ONLY DECREASE OUR VOLUME SHIPPED TO OTHER STATES, BUT WOULD HAVE THE ADDED DISADVANTAGE OF ENCOURAGING MORE OUT OF STATE CEMENT TO BE SHIPPED INTO KANSAS. THE NET EFFECT IN BOTH INSTANCES CLEARLY IS AN ECONOMIC LOSS FOR OUR STATE. OBVIOUSLY, LOWER SALES VOLUME FOR GENERAL PORTLAND INC. WOULD HAVE UNDESIRABLE EFFECTS ON THE MORE THAN 150 KANSANS WE EMPLOY AND THE COMMUNITIES IN WHICH THEY LIVE.

THE FOREGOING COMPELS US TO OPPOSE THE SEVERANCE TAX ON COAL AS IT WILL HAVE UNACCEPTABLE REPERCUSSIONS ON THE INDUSTRIES, PEOPLE, AND COMMUNITIES OF KANSAS.

STATE OF KANSAS

HAROLD GULDNER
REPRESENTATIVE, 122ND DISTRICT
GREELEY, HAMILTON, KEARNY, SCOTT
WICHITA COUNTIES
P.O. BOX 648
SYRACUSE, KANSAS 67878

TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
VICE CHAIRMAN: ELECTIONS
MEMBER: ENERGY AND NATURAL RESOURCES
TRANSPORTATION

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I am here today representing an area in which the people derive a living either directly or indirectly from the number one or number two industry in the State of Kansas. Both of these industries are in a deflated position due to world wide overproduction which is causing job losses and bankruptcies.

I have people wondering what's the matter with the Legislature when the number one industry of the state, agriculture, gets .8 of 1% of a 3 billion dollar budget spent on it and then is asked to cut some more. And the number two industry, the oil and gas industry, which is already paying 200 million dollars in taxes is asked to pay another 90 or 100 million dollars in taxes. Where are our priorities?

My people are beginning to look on the Legislature like the people of this area probably did Quantrill's Raiders. They know they are about to be raided again, they're just not sure when and for how much.

In the guise of socking it to the big oil companies, we are surely going to put a lot of small independent producers out of business. It's as bad as passing bonds to get a new business in town that puts three small old businesses on main street out of business which have been paying taxes for maybe 40 or 50 years.

Producing counties are going to suffer losses with any tax but if we do not keep the ad valorem credits and at least an 8% rebate, they will suffer more.

I know some think the producing counties shouldn't be entitled to all of this. Who has to build and maintain roads for the industry? Who has to build schools and furnish housing

ATTACHMENT XI
(3-15-83)

STATE OF KANSAS

HAROLD GULDNER
REPRESENTATIVE, 122ND DISTRICT
GREELEY, HAMILTON, KEARNY, SCOTT
& WICHITA COUNTIES
P.O. BOX 648
SYRACUSE, KANSAS 67878

TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
VICE-CHAIRMAN: ELECTIONS
MEMBER: ENERGY AND NATURAL RESOURCES
TRANSPORTATION

for the workers of the industry and their children? And who now has to help do something for the unemployed of the industry?

I could say a lot more but in closing, I want to say that this is not a fair tax, but knowing that things are not always done fairly here, I hope that if you pass this unfair tax, that you will at least try to pass the fairest of the unfair taxes. Doesn't that seem fair?

STATEMENT

Before the
Kansas House Committee
on Assessment and Taxation

In Opposition To
S.B. 267

on Behalf of
Independent Salt Company
Kanopolis, Kansas

by

M. D. Keener, Manager

March 15, 1983

ATTACHMENT XII
(3-15-83)

Where does salt come from?

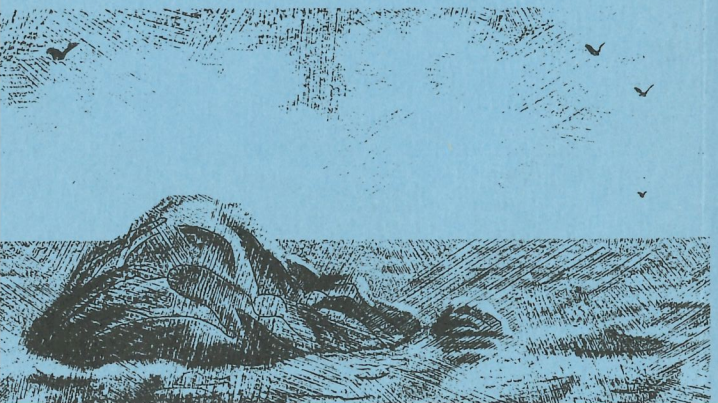
Over 200 million years ago when dinosaurs roamed the earth, Kansas looked much different than it does today. It was under water, covered by the salt waters of an inland sea. The water is gone — but the salt isn't. It was left by the evaporation of sea and subsequently covered by earth and rock. As the centuries went by, more and more earth and rock covered the salt bed. The weight and pressure of this earth was so great that the salt was compressed into solid rock, called halite.

The discovery

Thousands of years passed without anyone knowing the salt was there. But in 1889 in Hutchinson, Kansas, a man named Ben Blanchard accidentally found the salt while drilling for oil and natural gas.

Other engineers came to investigate when they heard about the discovery. They found that the rich rock salt deposit in Hutchinson was 100 by 40 miles in area and about 325 feet thick — one of the largest deposits known in the world. It is estimated that this area has enough salt to supply the needs of everyone in the United States for more than 250,000 years!

But this discovery was just the beginning of the excitement. Soon mines were popping up all over the area trying to reach the precious salt 600 feet below the surface. Many of these mining companies have come and gone but one company that succeeded and is still producing salt in Hutchinson is Carey Salt.



The production of Carey Salt

Carey's production began in 1923 when the 650 ft. mine shaft was completed. The dedication of this mine was of enough importance that President Warren Harding, along with Kansas Governor John M. Davis, attended the ceremonies. Since then, Carey has constantly modernized and improved their procedures and facilities.

The facilities at Carey include both a rock salt mine and an evaporation plant. The salt produced by each of these is different in form and has different uses.

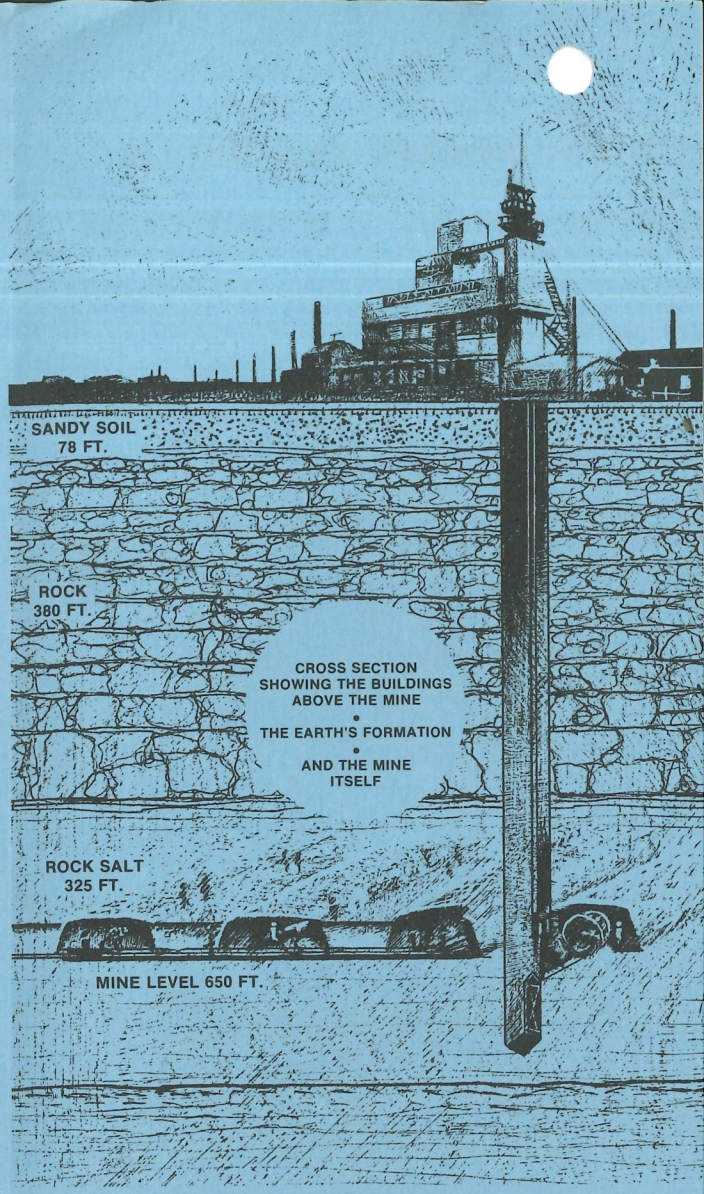
Rock salt mining

It takes people and special equipment to bring salt from 600 feet underground to the surface. At Carey every step of the journey from mine to market is modern, mechanized, and efficient.

● 650 ft. below the earth's surface, explosives blast 300-400 tons of rock salt from the face of the salt deposit. The salt is then crushed, loaded into rail cars and transported to the mine elevator by an electric locomotive. The mine elevator is called a "skip."

● A fully-loaded skip holds the contents of one rail car or 4 tons of salt, and can make a round trip every three minutes. There are two skips in the shaft, one is being lowered as the other is being raised. Hoisting is done by cables operated by an electrically powered winch in the above-ground hoist house.

● Above ground, the rock salt is further crushed into particles ranging in size from ⅝" in diameter to a fine powder. These particles are screened into several grades of rock salt product.



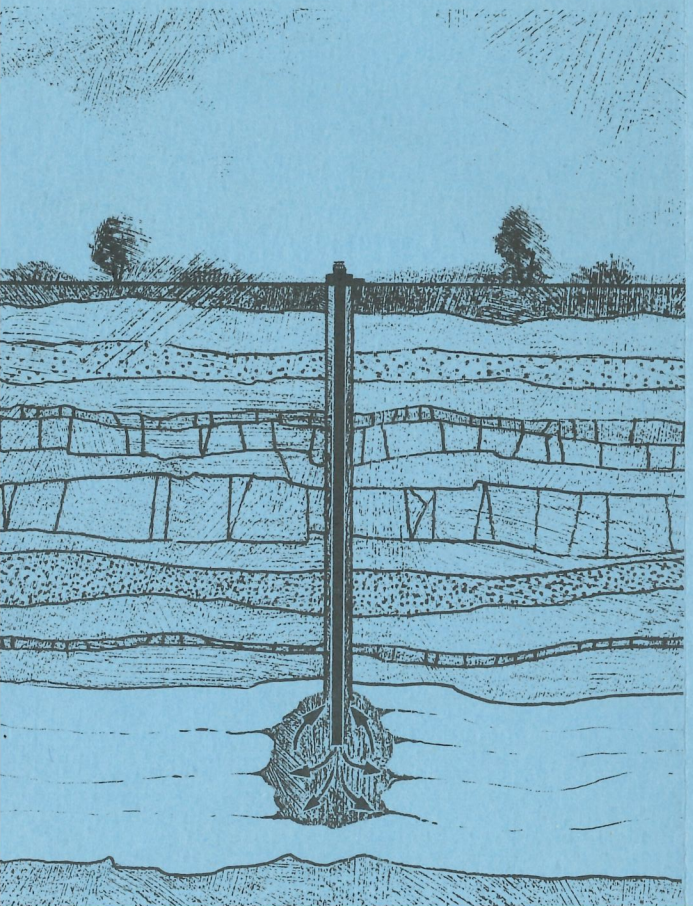
The drawing above shows how rock salt (halite) is removed from the mine and hoisted to the top of the "Breaker House." Here the salt is dropped into a crusher, ground into smaller sizes, and then elevated to the top of the mill. Here the salt is screened or graded into various grades. It is then ready for use by industry, agriculture, or consumer.

Evaporated salt

The second type of salt produced by Carey is evaporated salt. Deep wells are drilled into the layer of rock salt 600 feet underground. Fresh water is then pumped down a pipe to the rock salt deposit, dissolving the salt. This water, which now contains the dissolved salt, is called brine. The brine is then pumped to the surface where it is fed into large closed kettles called vacuum pans. The salt solution is then boiled.

As it boils, the water is evaporated leaving the salt crystals behind. After screening to obtain consistent particle size, Carey salt is boxed and ready for market.

Evaporated salt is used for a multitude of purposes including the seasoning of food. Nearly everyone uses evaporated salt in some manner every day.



Meeting the salt needs of the nation

The salt that Carey produces is shipped all over the country and is used in a variety of ways. In fact, it is estimated that there are over 14,000 different uses for salt. That's why Carey has 38 different salt products.

A common misconception is that most of the salt produced is for human consumption. However, only about 7 percent of the U.S. consumption of salt is for food purposes.

Much of the salt is used in the manufacture of chemicals — about 55 percent. And the second largest use of salt is for deicing streets and highways and for road base stabilization.

Salt in livestock feeds amounts to approximately the same percentage as that used in human foods. Numerous other industries use large quantities of salt in the production of oil, metals, rubber, paper and pulp, for softening water, and many, many other uses.

All totaled, Americans use approximately 44.1 million tons of salt every year.

Carey's role

Helping meet the enormous salt need of the nation is a challenging job. A job Carey Salt has been dedicated to for over 50 years. In the future, Carey will continue, through research, to improve production techniques to make good salt products even better.

carey salt

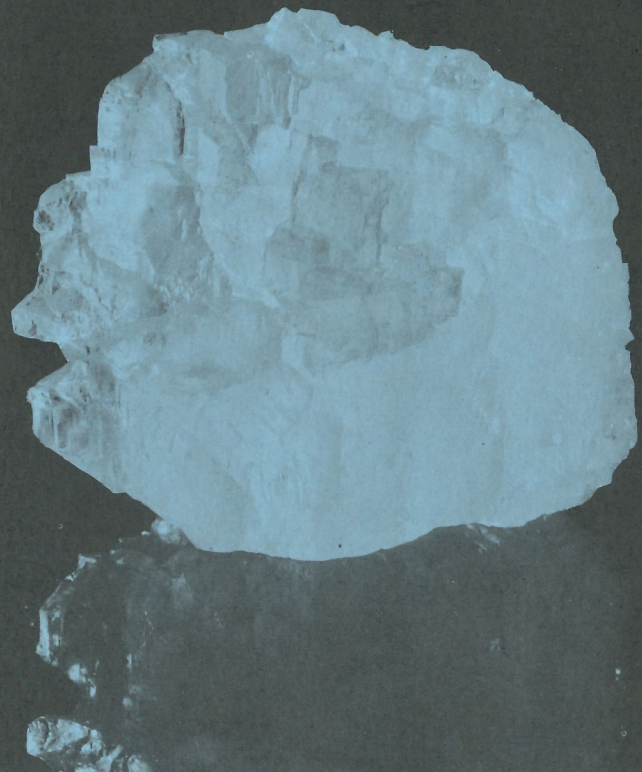
1800 Carey Boulevard • Hutchinson, Kansas 67501

CRY 55

Printed in U.S.A.

salt

The most precious mineral in the world



Chairman Braden
Committee Members:

My name is M. D. Keener. I am manager of the Independent Salt Company, located in Ellsworth County Kansas, mailing address P.O. Box 36, Kanopolis, Kansas 67454.

I have been directly involved with the sale and distribution of this company's production for the past 29 years. I have seen good times and bad, but none worse than the present.

I find it more than a little disconcerting to be appearing before this committee in opposition to SB 267 on such short notice. There has not been any indication, no statements, no requests, no publications and certainly no voice from the public that anything other than our energy reserves were being depleted rapidly enough to warrant severance tax consideration.

This short notice is very unfortunate as it does not provide adequate time for the research required to develop the facts and figures necessary to our opposition and to your decision. The Senate apparently acted without facts and figures and therefore their last minute addition of salt should be considered a ploy, to further opposition and add confusion to the severance tax issue.

In 1981, before the Senate Committee, I suggested that instead of adding a severance tax to Rock Salt, they should be considering tax relief to help export the one Kansas natural resource we have in abundance, at one time estimated at 5,000 billion tons or a little over 3,000,000 years supply at present production rates. <u>That was not a frivolous suggestion.</u>

<u>We need help</u> to meet the intense competition from out of state production, that with tax supported water transportation, has shrunk our trade territory from virtually nationwide to a 400 mile radius of our production point.

<u>We need help</u> to cope with the conditions that have reduced our work force to the lowest level in our 70 year history. In the past we have operated our plant with between 60 and 70 people and worked a lot of overtime, at one time we employed over 100. We now employ 53 people on a 40 hour week. This years lowered production and sales figures dictate that unless something improves immediately both the number of people and the hours must be reduced even further.

<u>We need help</u> with the situation that has caused our costs, labor, insurance, taxes, energy, transportation, equipment and supplies to rise rapidly, while our production and returns for our product keep declining. We are receiving less money for our product today than we have anytime in the last 5 years. I do not mean proportionately less, I mean actually less dollars per ton.

We need help, we certainly do not need and cannot stand additional burdens of increased taxes, or even proposals that consume valuable time and add additional expense to oppose. Burdens that at best will cause further deterioration of Kansas employment and may cause the complete loss of some Kansas industry. There is some concern that all Kansas producers and directly related transportation entities (we normally load between 7,000 and 10,000 trucks and 2000 to 3000 rail cars per year) may not survive the present economic conditions.

Presentations of this nature are very difficult, for we do not want to share our cost of production or figures on our returns, with our competition. These figures are available on a confidential basis to any member of this committee that may require verification. I can tell you that our production for the fiscal year ending in June of 1983 will be the lowest in the last 10 years; less than 60% of our best year and less than 50% of our reasonable production capacity.

I believe the projections made by the Senate are based upon some erroneous information. Recent inquiries by the Kansas Geological Survey resulted in a report to the Legislative Research Department that indicates 1981 values for evaporated salt produced in Kansas was $60.23 per ton and rock salt was $11.60 per ton. This report further indicates that production figures were 900,631 tons of evaporated salt and 508,582 tons of rock salt, causing a total produced salt value of slightly over $60,000,000. These figures seem to have a very close relationship to the 8% severance tax proposed and the 4.8 million of projected revenue.

I have no way of confirming these figures, we do not talk to our competitors about prices or production. I do see evaporated salt selling in the field for $27.00 per ton and I have seen and hold many -rock salt contracts producing less than $6.00 per ton. If anyone can assure me of this $11.60 per ton for even our present depressed rock salt production, I will be happy to accept an 8% severance tax.

I suggest that you also consider that since we do not have profits to absorb increased costs, and since we cannot pass them on to our neighboring states because of outside competition, nearly all of these costs must be passed on to Kansas consumers, primarily the State of Kansas on their ice control contract. We have no other place to put it.

Committee Members I implore you to secure the necessary information to make the proper decision in this matter. The Kansas Salt Industry as been an important part of the Kansas economy for nearly 100 years, the company I represent has been in business at the present location for 70 years. Do not destroy or further weaken this industry for political expediency that can only adversely affect the already critical Kansas employment situation.

My time is up, if any of you have questions or require additional information I will be happy to comply at your convenience. Thank you for your attention.

M. D. Keener, Manager
Independent Salt Company

CARGILL
SALT DIVISION

P.O. Box 1403
Hutchinson, Kansas 67501
316/663-2141

CARGILL SALT

Members of the House of Representatives
Assessment and Taxation Committee
State House
Topeka, Kansas 66612

SUBJECT: Severance tax bill / Substitute for Senate Bill 267

The severance tax bill that was passed by the Senate and forwarded to the House includes a tax on salt produced in Kansas. As a result of the above, we have some major concerns that we believe need to be shared, relative to the future of the salt business in Kansas.

1. An 8% tax on natural gas would increase Cargill's operating costs for fuel and electricity by more than $180,000 per year. This operating cost increase is non-recoverable, due to the nature of our business.

2. The salt industry is highly competitive and currently over produced. Kansas evaporated salt products compete with salt products produced in Utah, Texas, Louisiana, Michigan, and Ohio. Increases in costs that do not effect all salt producers equally would place a competitive barrier to the extent of our trade territory.

   Of the salt producing states mentioned above, only Louisiana has a severance tax on salt. This tax amounts to $.06 per ton on dry salt, and 1/2 cent per ton on brine.

   Kansas evaporated salt producers routinely ship their products to at least 18 states, and some export to Mexico. An 8% tax on salt produced, plus an 8% tax on natural gas would in effect reduce this trade territory substantially geographically, with a tonnage loss of some 20-30% of Cargill's current business. Currently less than 15% of our production is sold in Kansas.

   Since there are 4 evaporated salt producers in Kansas, I can only assume their situation is as critical.

3. If a severance tax is needed, we believe it should be restricted to limited supply minerals. Salt deposits in Kansas are wide spread, and at current mining rates will meet the market demands for several centuries.

4. The salt industry is capital and fixed cost intensive, with historically low per ton margin returns. This tax will serve in reducing our returns, and our tons sold. Fewer tons to divide into our fixed costs will at best discourage future investments, and worst case cause one or more salt companies to reduce or cease operation.

ATTACHMENT XIII
(3-15-83)

5. Three salt producers are located in Reno county, with one additional producer in Rice and Ellsworth counties. The brunt of any hardship resulting from this tax will be borne by these three counties.

6. Cargill employs 116 people in Hutchinson, as mentioned earlier our business is sensitive to volume. Reduced volume will without question result in a reduced work force.

7. Our competition in Michigan and Ohio use coal or steam from coal fired utilities for plant use. In the past 18 months our price for natural gas has increased some 24%. A severance tax on natural gas will continue to reduce our market reach, our margins, and the gap between production costs of gas and coal fired plants.

8. The proposed severance tax on salt, according to the newspaper, would raise $5,000,000. If this is true we have a tax on gross sales, not a severance tax. Gross sales on all salt products produced in Kansas in 1982 was $60,147,605.

In summary, we ask that you consider the elements of this letter, and request that you examine the overall regressive effects a severance tax will have on an important part of Kansas industry.

Sincerely
Cargill Salt

Gerald O. Rohlfsen
Profit Center Manager

GOR/sr

STATEMENT

BEFORE THE KANSAS HOUSE
COMMITTEE ON ASSESSMENT AND TAXATION

IN OPPOSITION TO
SENATE BILL 267

ON BEHALF OF
CAREY SALT DIVISION OF PROCESSED MINERALS INC
HUTCHINSON, KANSAS

BY
EUGENE C. DUFFY
VICE PRESIDENT AND GENERAL MANAGER

MARCH 15, 1983

ATTACHMENT XIV
(3-15-83)

SENATE BILL 267

AND THE FUTURE OF THE SALT INDUSTRY IN KANSAS

A Position Paper Prepared by Carey Salt

Political pressure and popular sentiment may soon give Kansas a severance tax. The stated purpose of the tax is a laudable one: to ensure the quality of public education in our state. We at Carey Salt do not question the state's need for additional revenues. However, for the sake of our industry and our employees, we must speak out against the parts of the bill that will adversely affect us.

The Kansas Legislature has tacked salt onto the current severance tax bill. Senate Bill 267, as it now stands, would impose an 8% tax on all Kansas salt products. We at Carey -- management and production staff alike -- feel strongly that the severance tax bill puts Carey and the entire Kansas salt industry at a severe competitive disadvantage. We believe that this bill unfairly discriminates against Kansas salt producers, that it will have a negative economic impact on the Central Kansas economy, and that it will ultimately reduce rather than increase revenues.

To put the matter in concrete terms, this 8% tax could close down our Hutchinson plant...it could,in fact, put an end to all salt production within the state.

We say Senate Bill 267 is discriminatory because it taxes salt while leaving other non-energy related resources, such as gypsum, sand, and gravel, untaxed. Nor does it tax the commercial extraction of ground water -- our most precious natural resource. It also omits salt producers that use, but do not sell, salt to other consumers: producers such as chemical companies that use large quantities of salt in the manufacture of their products. Oil and gas storage facilities also use brine to create underground storage. They, too, would avoid the severance tax.

Furthermore, the tax bill would impose the 8% tax on the full combined costs of extraction, processing, and packaging Kansas salt. So, in reality, it is much more like a general sales tax than a severance tax. If this same method were

applied to oil and gas, the severance tax would be assessed at the service station gas pump and at the home owner's gas meter. Of course, that's not what will be done to oil and gas. The tax will be on the price at the wellhead. We're told that a barrel of crude oil that can sell for upwards of $30 may cost as little as $1 to pump out of the ground. In the salt business, we just don't have margins like that.

The oil and gas industries have profited handsomely from substantial price escalations over the last decade. Our experience in the salt industry has been very different. Some of our products have actually fallen in price. For example, Carey's ice control salt sold for $8.50 per ton F.O.B. in 1980. This winter, the same product sold as low as $4.50 per ton. During the same period, natural gas, our industry's main energy source, has escalated nearly 50% in price. So Carey, like other Kansas salt producers, is caught in a serious profit squeeze. It has been several years since Kansas producers have successfully increased prices. We are presently meeting resistance on a 2% to 3% increase that was implemented in mid-February, and we will not know the outcome for another sixty to ninety days. In the Midwest, Kansas salt producers face an essentially stagnant market. Flat population and household growth, increased health concerns about sodium and salt, downturns in cattle production, and continued environmental concerns regarding ice control salt have virtually eliminated all growth. At the same time, we face increasing competition from outside the state.

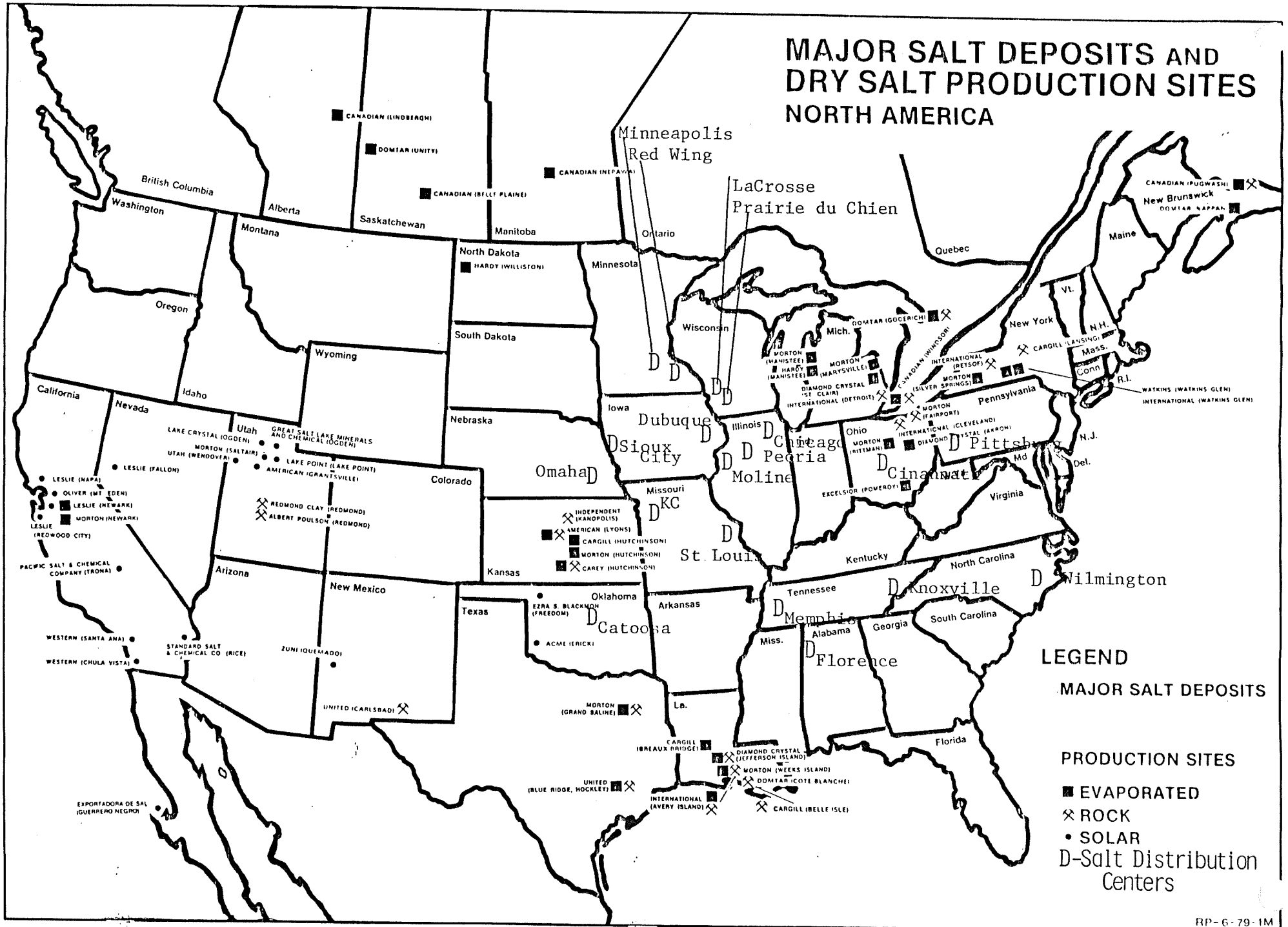
If you look at the map of the United States marked with the locations of the country's salt producers and distribution centers (attached to this paper), you'll see that a number of suppliers have located facilities throughout our traditional market areas on the Arkansas, Mississippi, and Missouri rivers. From these sites they can take advantage of subsidized barge rates that are lower than rail and truck rates Kansas producers must pay. But that's only one aspect of the competition these days. Our escalating energy costs are causing evaporated salt users to switch to energy-free solar salt and rock salt products. In the past three years, one solar producer has increased output from 400,000 tons to 600,000 tons annually and has targeted the Midwest market, which has historically belonged to Kansas producers. Another solar salt producer located in Utah is in the process of doubling capacity -- again targeting the Midwest market. This same producer has constructed a rock salt processing facility in Chicago in an attempt to penetrate the Northeastern portions of the Midwest

markets with lower-cost salt. Our competition is intensifying while demand remains essentially flat.

During the last three years, Carey alone has reduced its work force 14%. Competition from less expensive salt products has already begun to take its toll. The proposed severance tax contained in Senate Bill 267 would dramatically and adversely affect our labor force. If Kansas producers become non-competitive through the enactment of this bill, up to 1,500 jobs could be lost. Reductions in our sales volume would also impact the trucking industry, which transports 80% of our salt products. The state would face increased unemployment and welfare payments -- not only to unemployed salt industry workers, but to workers laid off in related fields as well. The result would be reduced -- not enhanced revenues for the state.

According to the Kansas Legislative Research Department, the 8% tax specified in the present bill would add $4.00 per ton to the price of the salt we sell. That's more than enough to make the difference between making and losing a sale. In comparison, Ohio and Utah impose severance taxes of 4¢ and 10¢ per dry ton, respectively. Louisiana's severance tax is 6¢ per dry ton and 1/2¢ per ton of brine. Other major salt producing states -- Michigan, South Dakota, California, Texas, Oklahoma and New Mexico -- have no severance tax on salt. The proposed Kansas severance tax is nearly 100 times higher than what other states have found appropriate. It's enough to price Kansas salt out of the marketplace and put Kansas producers out of business.

The 8% tax is clearly out of line. The few states that have imposed severance taxes on salt have done so at a level that allows their home industries to remain competitive and viable, so that they can produce tax revenues by prospering in the marketplace. We ask that Kansas legislators do no less for Kansas producers. No one will be served by crippling a Kansas industry and putting more Kansas workers in the unemployment lines. Carey and other Kansas salt producers will incur the severance tax on gas and oil as an increase in the price we pay for the natural gas we use to process salt. That alone will add 75¢ per ton to the cost of many of our salt products. The present bill asks us to pay a second time on the total value of our salt process, which will already include the increased natural gas costs. We can't survive double taxation. We cannot remain competitive at an effective tax rate of 16 percent per ton. We ask that the bill be rewritten to exclude salt products. We'll pay the severance tax when we pay for the millions of dollars of natural gas we use each year in our production process. But we cannot afford to pay it twice.


MAJOR SALT DEPOSITS AND DRY SALT PRODUCTION SITES
NORTH AMERICA
Minneapolis
Red Wing
LaCrosse
Prairie du Chien
Dubuque
Sioux City
Omaha
Moline
Peoria
Chicago
Cincinnati
Pittsburg
Wilmington
Knoxville
Memphis
Catoosa
Florence
St. Louis
KC
Canadian (Lindbergh)
Domtar (Unity)
Canadian (Belle Plaine)
Canadian (Nepawa)
Hardy (Williston)
Canadian (Pugwash)
New Brunswick
Domtar (Nappan)
Domtar (Goderich)
Canadian (Windsor)
Morton (Manistee)
Hardy (Manistee)
Morton (Marysville)
Diamond Crystal (St. Clair)
International (Detroit)
International (Retsof)
Morton (Silver Springs)
Cargill (Lansing)
Watkins (Watkins Glen)
International (Watkins Glen)
Morton (Fairport)
International (Cleveland)
Diamond Crystal (Akron)
Morton (Pittman)
Excelsior (Pomeroy)
Lake Crystal (Ogden)
Great Salt Lake Minerals and Chemical (Ogden)
Morton (Saltair)
Utah (Wendover)
Lake Point (Lake Point)
American (Grantsville)
Leslie (Napa)
Leslie (Fallon)
Oliver (Mt. Eden)
Leslie (Newark)
Morton (Newark)
Leslie (Redwood City)
Redmond Clay (Redmond)
Albert Poulson (Redmond)
Pacific Salt & Chemical Company (Trona)
Western (Santa Ana)
Western (Chula Vista)
Standard Salt & Chemical Co. (Rice)
Zuni (Quemado)
United (Carlsbad)
Independent (Kanopolis)
American (Lyons)
Cargill (Hutchinson)
Morton (Hutchinson)
Carey (Hutchinson)
Ezra S. Blackmon (Freedom)
Acme (Erick)
Morton (Grand Saline)
Cargill (Breaux Bridge)
Diamond Crystal (Jefferson Island)
Morton (Weeks Island)
Domtar (Cote Blanche)
United (Blue Ridge, Hockley)
International (Avery Island)
Cargill (Belle Isle)
Exportadora de Sal (Guerrero Negro)
British Columbia
Alberta
Saskatchewan
Manitoba
Ontario
Quebec
Maine
Washington
Montana
Oregon
Idaho
Wyoming
California
Nevada
Utah
Colorado
Arizona
New Mexico
North Dakota
South Dakota
Nebraska
Kansas
Oklahoma
Texas
Minnesota
Iowa
Missouri
Arkansas
Louisiana
Wisconsin
Illinois
Michigan
Ohio
Kentucky
Tennessee
Mississippi
Alabama
Georgia
Florida
South Carolina
North Carolina
Virginia
Pennsylvania
New York
Vt.
N.H.
Mass.
Conn.
R.I.
N.J.
Md.
Del.
LEGEND
MAJOR SALT DEPOSITS
PRODUCTION SITES
EVAPORATED
ROCK
SOLAR
D-Salt Distribution Centers
RP-6-79-1M

American Salt Company

3142 BROADWAY • KANSAS CITY, MO. 64111
PHONE 816-753-7100

March 15, 1983

Chairman James Braden and Members
House Committee on Assessment and Taxation
State of Kansas
Topeka, Kansas

Subject: Proposed Severance Tax (Senate Bill 267)

American Salt Company opposes the inclusion of salt in Senate Bill No. 267 as amended and passed by the Senate Committee of the Whole. We solicit your support in removing salt from any proposed severance tax bill.

American Salt Company operates an underground rock salt mine and a vacuum pan evaporation salt plant at Lyons, Kansas. We employ approximately 230 people in Kansas with an annual payroll approaching five million dollars. The salt industry is highly competitive, capital intensive and a major user of energy. The proposed severance tax on salt and energy would seriously jeopardize the Kansas salt producers' ability to compete successfully against salt producers in other states. Some of the reasons for our position are as follows:

1) The salt industry is a highly competitive industry. The substantial additional cost imposed upon us by a severance tax that does not apply to our competitors from other salt producing states such as Texas, Oklahoma, Utah, North Dakota, Louisiana, Michigan and Ohio would place the Kansas producers in an extremely uncompetitive position. It would, in effect, shrink our marketing areas and result in a reduction of salt production.

   Salt marketing areas are determined by the cost of salt at the producing point, plus the freight to transport it to the customer. The location where the FOB plant cost plus the freight cost equalizes with the costs of a producer from another state defines the marketing area. As the cost at the producing point increases, the salt cannot be shipped

ATTACHMENT XV
(3-15-83)

as far and still be competitive, so the marketing area shrinks. Very favorable freight rates on the inland waterways from Louisiana producers to such points as Kansas City, St. Louis and Omaha have already shrunk the marketing area for Kansas rock salt producers. The additional burden on Kansas producers imposed by the proposed tax would further reduce the Kansas producers' marketing areas.

According to the U.S. Bureau of Mines, Kansas producers sold 1,409,000 tons of salt in 1981. This was down from over 1½ million tons in 1980. During the same period, shipments in Kansas alone totaled only 300,000 tons with a portion of that coming in from other states. In fact, due to low production costs and favorable freight rates, solar salt from Utah is being sold in Kansas as well as surrounding states. Utah solar salt can be produced at 1/10 the cost of Kansas evaporated salt because the sun and wind provide the energy to remove salt from salt water obtained out of the Great Salt Lake. Freight rates from Utah are 25 to 50% lower than in Kansas because the carriers have freight going West and haul salt back East at reduced rates. A few years ago very little Utah solar salt was marketed East of the Continental Divide. Now it's being sold as far East as Ohio.

In order to maintain production volumes, Kansas producers must be competitive in other states. This proposed tax would place Kansas producers in a severe competitive disadvantage which would result in a depressed industry with the associated unemployment and declining tax revenues.

2) The salt industry requires high capital investments and historically produces marginal returns on investment. Additional taxes and resultant increased costs would erode these margins further, making our industry less attractive for investment. An industry that cannot attract investment is generally unhealthy and only adds to the burdens of the state.

3) A severance tax on both energy and salt would, in effect, be a double taxation of our finished products. Since salt production requires large quantities of energy, an additional burden would be placed on producers due to increased fuel costs resulting from the proposed severance tax. We believe Kansas producers would have to absorb the increased cost.

4) As we understand the proposed bill, an 8% tax is to be applied to the gross value of the salt severed. "Gross value" as defined in the bill means the salt price after extraction and preparation for shipment. We do not consider this to be a true severance tax, but instead a manufacturing tax, gross receipts tax or a value added tax.

   After extraction, salt remains a low priced commodity until it is subjected to additional processing and refining. Salt is upgraded and enhanced by further refining along with the addition of other ingredients and materials. Chemical additives to make salt free flowing are required for industrial users. Nutrients, flow agents and other ingredients are processed with salt for food users. Mineral supplements are added for the agricultural industry. Salt is processed and refined into many shapes and sizes from popcorn salt to blocks. Refined salt products are packaged in a wide variety of containers and materials.

   Any tax on the processing, refining, ingredients and other materials required to produce salt products represents a cost over and above that applied solely on the extracted salt mineral. Since the proposed tax is essentially based on the sales price of the final products, it would result in significantly reduced profit margins to the Kansas salt producers and would have an adverse effect on the long term viability of the Kansas salt industry.

5) Salt is an abundant mineral resource in Kansas with enough reserves to supply demands for thousands of years. Since salt is not a limited supply mineral or a rapidly depleting resource, we do not believe a severance tax should be imposed on salt.

We believe it is in the best interests of the State of Kansas, its citizens and industry, to promote and maintain a healthy, viable business climate. The inclusion of salt in any proposed severance tax bill is counter productive to these interests. We urge you to remove salt from any such bill.

Sincerely,

AMERICAN SALT COMPANY

Ronald J. Nugent

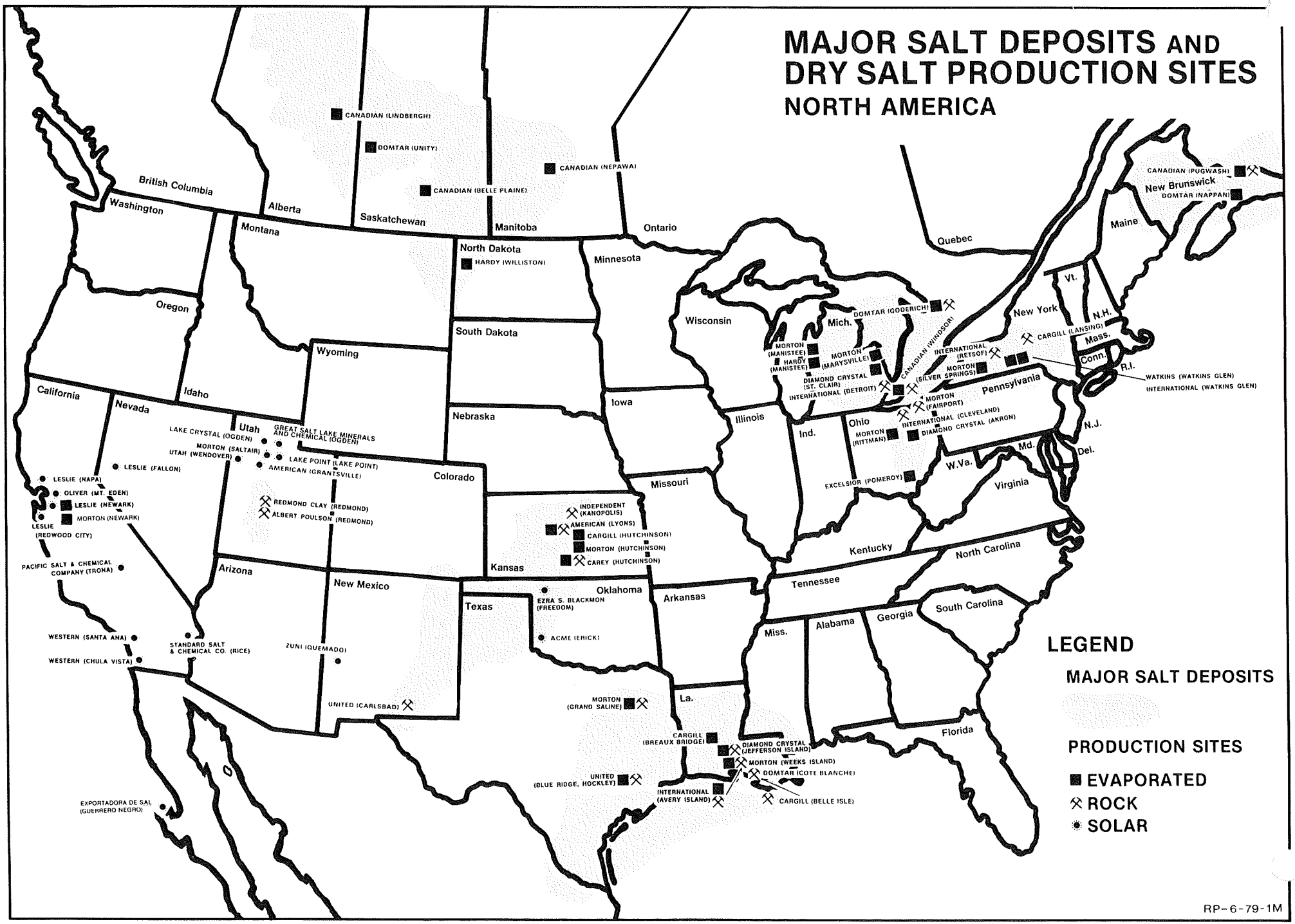
Ronald J. Nugent
Vice President and General Manager

RJN:kh

FREIGHT RATE COMPARISON

IN $/TON

DESTINATION	FROM: BY:	Louisiana Barge	Lyons, Kansas Truck	Lyons, Kansas Rail
Chicago		$4.75/T	$34.60/T	$24.20/T
Kansas City		12.35	14.00	8.33
Minneapolis		11.95	31.80	34.00
St. Louis		4.00	20.00	28.00
Tulsa		6.37	17.40	22.22


MAJOR SALT DEPOSITS AND DRY SALT PRODUCTION SITES
NORTH AMERICA
CANADIAN (LINDBERGH)
DOMTAR (UNITY)
CANADIAN (NEPAWA)
CANADIAN (BELLE PLAINE)
British Columbia
Alberta
Saskatchewan
Manitoba
Ontario
Quebec
Washington
Montana
North Dakota
HARDY (WILLISTON)
Minnesota
Oregon
South Dakota
Wyoming
Wisconsin
Mich.
DOMTAR (GODERICH)
MORTON (MANISTEE)
HARDY (MANISTEE)
MORTON (MARYSVILLE)
DIAMOND CRYSTAL (ST. CLAIR)
INTERNATIONAL (DETROIT)
CANADIAN (WINDSOR)
INTERNATIONAL (RETSOF)
MORTON (SILVER SPRINGS)
CARGILL (LANSING)
New York
Vt.
N.H.
Mass.
Conn.
R.I.
WATKINS (WATKINS GLEN)
INTERNATIONAL (WATKINS GLEN)
Maine
CANADIAN (PUGWASH)
New Brunswick
DOMTAR (NAPPAN)
California
Nevada
Idaho
Utah
LAKE CRYSTAL (OGDEN)
GREAT SALT LAKE MINERALS AND CHEMICAL (OGDEN)
MORTON (SALTAIR)
UTAH (WENDOVER)
LAKE POINT (LAKE POINT)
AMERICAN (GRANTSVILLE)
LESLIE (FALLON)
Colorado
Nebraska
Iowa
Illinois
Ind.
Ohio
MORTON (FAIRPORT)
INTERNATIONAL (CLEVELAND)
DIAMOND CRYSTAL (AKRON)
MORTON (RITTMAN)
Pennsylvania
N.J.
Md.
Del.
W.Va.
Virginia
LESLIE (NAPA)
OLIVER (MT. EDEN)
LESLIE (NEWARK)
MORTON (NEWARK)
LESLIE (REDWOOD CITY)
REDMOND CLAY (REDMOND)
ALBERT POULSON (REDMOND)
Missouri
INDEPENDENT (KANOPOLIS)
AMERICAN (LYONS)
CARGILL (HUTCHINSON)
MORTON (HUTCHINSON)
CAREY (HUTCHINSON)
EXCELSIOR (POMEROY)
Kentucky
North Carolina
Tennessee
PACIFIC SALT & CHEMICAL COMPANY (TRONA)
Arizona
New Mexico
Kansas
Oklahoma
Arkansas
Texas
EZRA S. BLACKMON (FREEDOM)
ACME (ERICK)
South Carolina
Georgia
Alabama
Miss.
WESTERN (SANTA ANA)
WESTERN (CHULA VISTA)
STANDARD SALT & CHEMICAL CO. (RICE)
ZUNI (QUEMADO)
UNITED (CARLSBAD)
MORTON (GRAND SALINE)
La.
CARGILL (BREAUX BRIDGE)
DIAMOND CRYSTAL (JEFFERSON ISLAND)
MORTON (WEEKS ISLAND)
DOMTAR (COTE BLANCHE)
CARGILL (BELLE ISLE)
UNITED (BLUE RIDGE, HOCKLEY)
INTERNATIONAL (AVERY ISLAND)
Florida
EXPORTADORA DE SAL (GUERRERO NEGRO)
LEGEND
MAJOR SALT DEPOSITS
PRODUCTION SITES
EVAPORATED
ROCK
SOLAR
RP-6-79-1M

TO: House Committee on Assessment and Taxation
BY: R. D. Randall
RE: Opposition to Severance Tax

March 15, 1983

STATEMENT

Mr. Chairman and members of the Committee, I am Dick Randall, General Counsel for Petroleum, Inc., and Chairman of the KIOGA Legislative Committee. I am opposed to passage of any severance tax legislation, including S.B. #267.

Kansas is a "stripper well" state, with approximately 42,400 oil wells and 11,000 gas wells. Over 88% (37,400) of the oil wells are classified as stripper wells. Most of the gas wells are also small and many suffer economically from declining pressures and water encroachment. Kansas cannot be equated with larger well states for taxation rates and compete successfully for investment capital. (Exhibits 'A' and 'B' attached.)

All owners of Kansas oil and gas leases now pay a "severance type" ad valorem tax to the counties. This is a fair tax based on price, production volumes, and operating costs. All oil and gas leases are reassessed each year by those counties. Total ad valorem taxes paid by our industry soared seven fold, from $17.3 million in 1973 to $117.5 million in 1982. (Exhibit 'C' attached.)

The posted price for Kansas crude oil has declined over 25% from $39 to $29 in less than two years (Av. $27.50 corr. for gravity). OPEC nations are about to announce a new base price of $29 (down $5.00). Derby and two other Kansas purchasers already cut their prices for Kansas crude to $28 last Friday. (Exhibit 'D' attached.)

The Kansas oil and gas industry is in a severe cash flow crunch at current prices. Rigs are down, drilling budgets are being slashed and numbers of employees reduced. Some Kansas operators are already insolvent and are facing possible bankruptcy. The greatest long term damage from an additional severance tax, will be the immediate and continuing loss of investment capital for drilling new wells.

My company is a Kansas based independent oil and gas producer, but we operate in 12 other states. In the 1960's, Petroleum, Inc. shifted most of its Kansas exploration budget money to other states. In less than 15 years, our Kansas oil production declined from 4600 BOPD to 1400 BOPD (2/3 drop). This illustrates how rapidly oil production falls when new wells are not added each year. In 1981 and 1982, Petroleum, Inc. stepped up its activity in Kansas and drilled 102 wells. As a result, our oil production is now up to 1700 BOPD.

Kansas oil and gas exploration economics will not be competitive for our company if any additional severance tax is imposed. It is competitive now only because the small well potential, the lower oil and gas prices, and the higher production costs are offset by lower entry costs, better company employee efficiency, and a fairer taxing method. Our decision is that if a severance tax passes, Petroleum, Inc. will again shift its exploration budget out of Kansas to larger well states.

Any fair severance tax bill must give full credit for ad valorem taxes paid by the oil and gas industry. The ad valorem tax credit in S.B. #267 is both fair and workable. The 3 barrel exemption is absolutely essential to preserve our low production wells in western Kansas. Any fair severance tax must also include royalty owners who do not pay costs of production. To exclude royalty owners would insure a legal attack on its constitutionality in the courts.

A severance tax is a bad tax, and is a very unreliable source of revenue in a stripper well state like Kansas. In any given year, revenue could fall drastically from price and production declines. Kansas cannot afford to forever damage the energy producing and capital creating capacity of its second largest industry with an additional severance tax.

I urge you to vote against all severance tax legislation in the interests of the people of Kansas and their future energy needs. Thank you.

ATTACHMENT XVI
(3-15-83)

* * * * *

BY: R. D. Randall
RE: Opposition to Severance Tax

March 15, 1983

* SELECTED STATE CRUDE OIL PRODUCTION STATISTICS FOR 1981

State	Av. Daily Prod./Well	** Ann. Crude Oil Prod.	*** Av. No. Employees	No. Oil Wells	No. Stripper Wells (1980)	% Stripper Wells	Severance Tax %
Alaska	2,300.7	587	7,632	700	0	0	15
Florida	905.1	35	10,623	117	0	0	8
Louisiana	48.8	451	125,332	25,320	15,889	63.8	12.5
N. Dakota	48.2	46	12,045	2,570	878	34.2	11.5
Wyoming	31.1	122	26,312	11,574	3,252	28.1	6 ****
Colorado	28.5	30	31,568	2,898	1,143	39.4	4
California	19.7	385	92,253	47,362	25,400	53.6	- ****
Texas	14.4	952	385,343	180,627	103,594	57.4	4.6
New Mexico	11.9	72	23,147	16,289	12,519	76.9	3.75
Nebraska	9.7	7	6,909	1,870	1,223	65.4	3
Oklahoma	5.1	154	116,790	82,639	66,128	80.1	7
Kansas	4.1	65	31,993	42,402	37,412 *****	88.2	- ****
Illinois	2.5	26	36,250	26,100	24,501	93.9	- ****

*All figures are from the 1982 Edition of IPAA Publication "THE OIL PRODUCING INDUSTRY IN YOUR STATE"
**Total Crude Oil Production figures are in millions of barrels.
***Total No. of employees does not include service station employees.
****These states impose substantial ad valorem taxes on oil and gas leases.
*****IPAA report shows Kansas operators plugged 5,055 stripper wells during 1980.

EXHIBIT 'A'

BY: R. D. Randall
: Opposition to Severance Tax

March 15, 1983

How oil and gas severance taxes differ among states

State	Oil	Natural gas	Notes
Alabama	6% of gross value (4% producion tax, plus 2% conservation tax).	Same	Additional 2% tax on Smackover formation production. Additonal tax does not apply for 10 years to wells coming into production after Sept. 1, 1979. Wells producing 40 b/d or less in unitized fields are exempted.
Alaska	15% of gross value.	10% of gross value.	Oil from properties coming into production after June 30, 1981, taxed for first 5 years at former 12.25% rate.
Arizona	2.5% of value.	Same	Deductions for delivery, processing.
Arkansas	5% of market value. 4% stripper rate.	0.3¢/Mcf.	Arkansas Oil Museum tax of 5 mills/bbl.
California	Annual levy limited to amount needed to support Oil and Gas Division.	Same	Various local taxes and fees.
Colorado	Graduated rate of 2-5% of gross income. 4% maximum on shale oil.	Same	Stripper wells (10 b/d or less) exempt. Credit allowed for local property taxes and contributions to impacted localities.
Florida	8% of gross value.	5% of gross value.	Rate is 5% for tertiary production and wells producing less than 100 b/d.
Georgia	Maximum 5 mills/bbl.	Maximum ½ mill/Mcf.	
Idaho	2% of wellhead value.	Same	
Indiana	1% of value.	Same	Plus property taxes.
Kansas	No severance tax.	Same	State collects Health and Environment and Conservation fees. Local ad valorem taxes are principal revenue source.
Kentucky	4.5% of market value.	Same	Plus property taxes.
Louisiana	12.5% of value.	7¢/Mcf.	Wells producing 25 b/d or less of oil and 50% salt water—6.25%; 10 b/d or less—3.25%.
Maryland	No severance tax.	Same	Allegany County has 7% of wholesale market value tax on natural gas.
Michigan	6.6% of gross value. 4% stripper and marginal.	5% of gross value.	
Mississippi	6% of gross value.	Same	Oil and Gas Board annually sets "maintenance charge" in mills per bbl/Mcf.
Montana	5% to Mar. 31, 1983, 6% thereafter (on gross value).	2.65% of gross value.	Plus Resource Indemnity Trust tax ($25 + 0.5% of gross value over $5,000), millage conservation tax, ad valorem taxes. Federal WPT deducted in determining value.
Nebraska	3% of value.	Same	Plus millage conservation tax.
Nevada	No severance tax.	Same	Conservation tax: 5 mills/bbl, 5 mills/50 Mcf.
New Mexico	3.75% of value.	12.6¢/Mcf (rate tied to consumer price index).	Plus ad valorem production tax, emergency school tax, gross receipts tax on sales, gas processor's privilege tax.
North Carolina	No severance tax.	Same	Tax dedicated solely to Oil and Gas Conservation Act administration can be imposed at maximum of 5 mill/bbl, ½ mill/Mcf.
North Dakota	11.5% of gross value.	5% of gross value.	A 5% "production tax" applies to oil and gas; the 6.5% "extraction tax" imposed by a 1980 initiative applies only to oil and exempts the first 100 b/d of royalty owners.
Ohio	3¢/bbl.	1¢/Mcf.	
Oklahoma	7.085% of gross value.	Same	Conservation tax levied on natural gas production.
Oregon	6% of value.	Same	Proceeds to a state Common School Fund.
South Dakota	4.5% of value.	Same	
Tennessee	1.5% of sale price.	Same	
Texas	4.6% of market value.	7.5% of market value.	Oil conservation tax $^{3}/_{16}$ of 1¢/bbl.
Utah	2% of wellhead value.	Same	Conservation tax at rate (maximum 2 mills on dollar value) set by Oil and Gas Conservation Commission. First $50,000 production/designated field is exempt from state severance tax. Rights to oil and gas in place subject to ad valorem taxes.
West Virginia	4.34% of value.	8.63% of value (over $5,000/year).	Rates shown are those used in levying the "business and occupation tax" on gross proceeds of sales. There is also a conservation tax of 3¢/year/acre leased. First 25,000 acres are exempt.
Wyoming	6% of value. 4% of stripper production (10 b/d or less).	Same	Oil and Gas Conservation Commission levies for its own expenses a conservation tax not to exceed $^{4}/_{5}$ mill on value of oil and gas produced. Ad valorem taxes on lease property are based on gross production of preceding year.

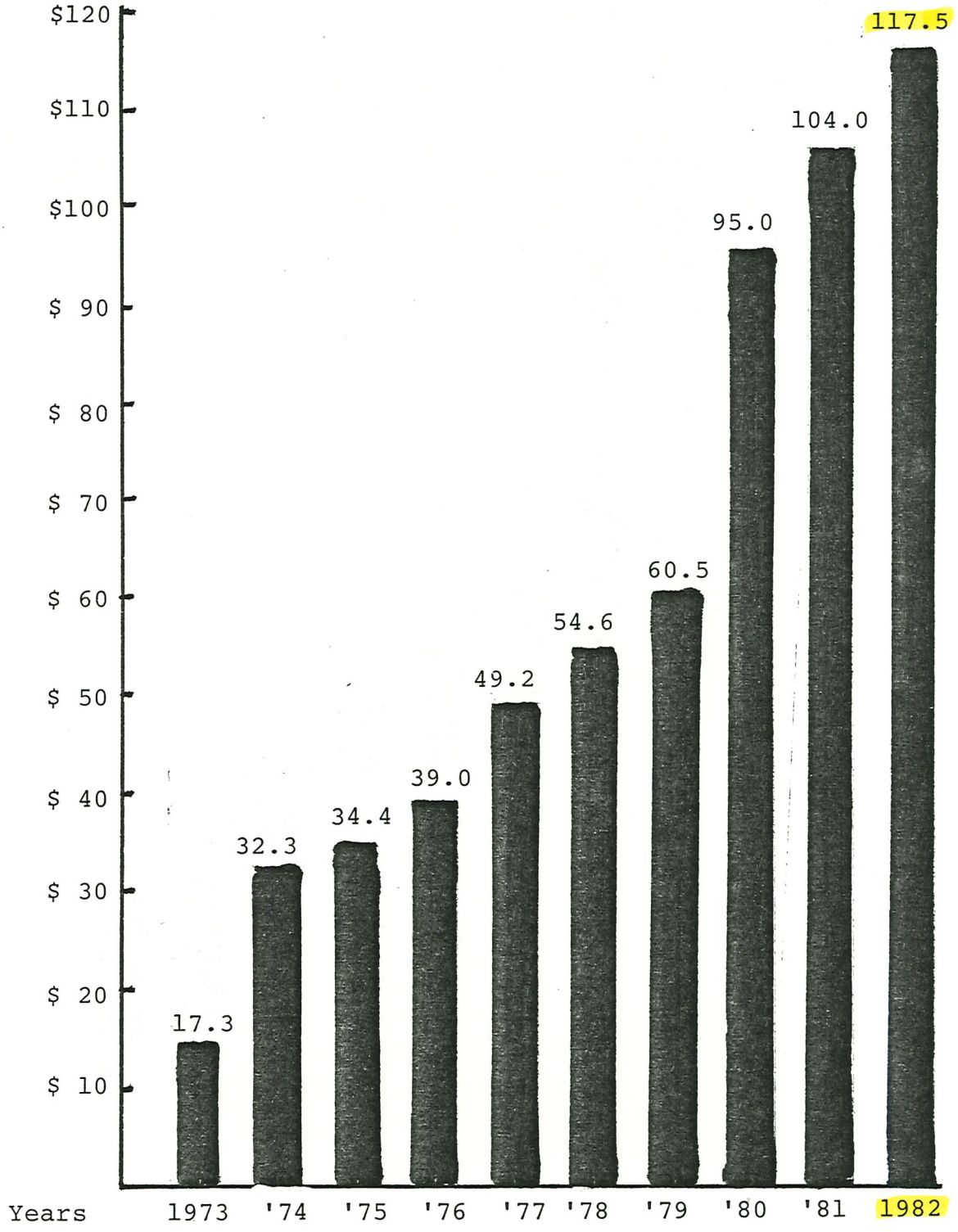
Source: American Petroleum Institute

EXHIBIT 'B'

BY: R. D. Randall
RE: Opposition to Severance Tax March 15, 1983

KANSAS OIL & GAS LEASE AD VALOREM TAXES PAID

* COMPARISON OF TOTAL TAXES PAID BY YEAR



* Source: Kansas Department of Revenue
Property Valuation Department

EXHIBIT 'C'

BY: R. D. Randall
RE: Opposition to Severance Tax

RECEIVED

March 15, 1983

DERBY REFINING COMPANY
P. O. BOX 1030
WICHITA, KANSAS 67201

CRUDE OIL PRICE BULLETIN NO. 5-83

(Supersedes Crude Oil Price Bulletin No. 4-83)

Effective 7:00 A.M. March 11, 1983, subject to change without notice, and subject to the applicable rules and regulations of all governmental authorities and to the provisions of its Division Order and/or contract agreements Derby Refining Company will pay the following prices per barrel of 42 United States gallons for marketable crude oil delivered for its account into authorized pipelines or other receiving agencies. As to crude oil and condensate transported in media other than carrier pipelines, these prices may be reduced by an amount not exceeding the per barrel cost of such transportation.

AREA		
KANSAS:	All Fields - - - - - - - - - -	$ 28.00 (A)
OKLAHOMA:	Panhandle - - - - - - - - - -	$ 28.00 (A)
	All other (sweet crude)- - -	$ 29.00 (B)

GRAVITY SCALE:

(A) Less $0.015 per barrel per 0.1° API below 40.0°.

(B) Less $0.02 per barrel per full degree from 40.9° to 35.0°, then $0.015 per barrel per 0.1° API below 35.0°.

The above prices posted for crude oil and condensate are based upon computation of volume for use of 100% tank tables or mutually acceptable automatic measuring equipment with deductions in full for all B.S.&W. and corrected for temperatures to 60°F., in accordance with usual industry practices.

If any appropriate government authority requires any adjustments to the prices or effective date shown hereon, including retroactive adjustments, Derby Refining Company reserves the right to amend this bulletin and to recover any excess payment through withholding payments from future settlements or by separate invoice.

DERBY REFINING COMPANY

EXHIBIT 'D'

March 14, 1983

Kansas House of Representatives
Statehouse
Topeka, Kansas

Gentlemen:

Kansas manufacturing firms serving the oil industry continue to struggle to stay solvent after one of the worst declines in their history. In southeast Kansas alone, we can account for in excess of eight hundred jobs that have been lost in the past year due to this decline. Manufacturers throughout the nation that supply the oil industry are shutting their doors because of the rapid decline of the drilling activity. Unfortunately, industry experts do not paint a very bright picture for the next several years.

Manufacturing plants in Kansas, for example, turn out approximately 50% of all pumping units built in the U.S. Every one of these firms has experienced layoffs, some resulting in hundreds of workers at a single company. These employees were paid with dollars earned through sales to Kansas oil companies as well as other oil companies in the U.S. and internationally. The sales made to Kansas oil companies however, are very important because most of the firms manufacture primarily small units such as those used throughout Kansas. Also, these companies manufacture larger units which are used in the western part of our state.

In southeast Kansas there have been well in excess of ten million dollars in lost wages due to layoffs in oil related manufacturing. These dollars would have turned over four to six times before leaving a Kansas community and possibly several more times before leaving Kansas. Thus, we may be looking at 50 to 75 million dollars or more, worth of lost sales, services and taxes in southeast Kansas during a twelve month period. Consider the magnitude of the dollar loss for all of Kansas!

ATTACHMENT XVII
(3-15-83)

Kansas manufacturers are fighting for every sale, and day after day watch their products compete in a market where being a mere 1% too high in their price can cost their company a sale. Why? Because oilmen throughout the country, but especially in Kansas, with small producing wells, are trying to survive too! As a result, each oil company is trying to stretch every dollar to compensate for losses suffered in lower revenues due to declining prices for their product, high interest rates and increasingly more taxes.

The oil industry has been a boom to Kansas. Consider for a moment the revenue that already flows into the state and county treasuries, in the form of sales taxes, individual and corporate income taxes, property taxes, and inventory taxes paid by Kansas oil companies, oilfield equipment manufacturers, service companies, and all their employees. Add to this revenue those taxes generated by the multitude of small businessmen and their employees who depend on sales made to the oil related companies and their employees.

Not only will the Kansas oilman and his suppliers of equipment and services be affected in the event of a Kansas severance tax, others will also be affected. As an example, several local merchants, owners of service firms such as barbershops, and professionals such as doctors have commented to us how their sales and income are down because of our firm's layoffs. Ask any retail merchant in Coffeyville whether or not he is feeling the effect of the decline of the oil industry. Then tell that same merchant that you are considering another tax that may cost even more jobs in his city and see what he has to say to you.

Don't allow an important and necessary industry to Kansas be continually taxed to the point that even more jobs are lost and more factories close their doors.

Please do not allow a severance tax to pass in Kansas at the risk of losing hundreds more jobs, perhaps even thousands.

Let us instead work together - - Kansas Political Leaders and Kansas Business Leaders to find alternate avenues to help solve our State's need for cutting expenses and generating additional revenue.

Sincerely,

Bernard L. Dick

Bernard L. Dick
Executive Vice-President

GEO Churchill, Inc., Chanute, KS

TESTIMONY OF J. M. BOYD
PLANT MANAGER, WICHITA, KANSAS PLANT
VULCAN MATERIALS COMPANY, CHEMICALS DIVISION
BEFORE THE TAXATION AND ASSESSMENT COMMITTEE
MARCH 15, 1983

I wish to thank the Committee's members for this opportunity to express my concerns about the impact of the minerals severance tax proposed in S.B. 267 on our Wichita, Kansas, chemical plant.

In general, Vulcan does not favor the concept of a minerals severance tax for the many reasons which have already been advanced by this State's oil and gas producers and salt producers. More specifically, Vulcan is opposed to this proposed tax because it could sharply increase plant costs for both energy and feedstock brine, thereby placing the Wichita plant at a competitive disadvantage.

Vulcan's Wichita plant produces a variety of inorganic and organic chemicals, but all of the plant's chemical manufacturing ultimately depends upon the electrolytic production of chlorine and caustic soda (sodium hydroxide) from salt. We hydraulically mine underground salt deposits to produce saturated brine which is then softened to remove calcium and magnesium. The resulting solution is fed to electrolytic cells that transform the salt into chlorine, caustic soda, and hydrogen.

Chlorine/caustic production is energy intensive. Electrolytic cells consume large amounts of increasingly expensive electric power. In addition to electricity, production of caustic soda requires large quantities of steam to purify and concentrate the caustic from the electrolytic cells to a salable product. Because Kansas electric utilities burn large quantities of natural gas in generating electricity and we burn gas in the plant's boilers and a cogeneration unit to raise process steam, a severance tax on natural gas,

ATTACHMENT XVIII
(3-15-83)

which certainly would be passed along by the electric and gas utilities, would further increase the Wichita plant's already high energy costs.

The Wichita plant, employing 700 people, is unique as it is the only chloralkali plant in the midwest. Even though our production rates have been reduced during this recessionary period, we have not laid anyone off. In fact, we have had stable growth since 1962. This is in contrast to the chloralkali industry as a whole. In 1982, approximately 10% of the total U.S. production (4,245 tons/day) was shut down due to non-competitive costs in a falling market. In fact, the remaining industry operating rates averaged 61% of capacity in 1982. Vulcan's Wichita plant cannot pass through the added costs of this severance tax because our products have to be competitive with those in other areas of the country.

In addition to indirectly causing the plant's energy costs to increase, the proposed severance tax would also appear to apply directly to our production of salt for chemical feedstock use. However, it seems to me that S.B. 267 as it is presently proposed did not contemplate the application of the salt severance tax to brine produced for use as a chemical feedstock. Since we are the purchaser and producer of a brine used only for chemical feedstock, and not for sale, how would the value be determined? The difficulty in establishing an open market price for brine which is usually determined by specialized contracts would indicate that brine be excluded from the salt severance tax or at least S.B. 267 modified to recognize lower valuations for brine. I know salt is a mineral and a resource of the state; however, the vast deposits of salt (Exhibit I) makes me wonder why salt was picked instead of gravel, or gypsum which are equally abundant.

In summation, even if the feedstock brine valuation problem can be resolved equitably, a severance tax on the salt we produce to make chemicals

would increase the Wichita plant's tax burden, and flow-through of an oil and gas severance tax would increase the plant's energy costs. The Wichita plant would get both barrels; I estimate that the proposed minerals severance tax could cost the plant as much as $1,374,274 per year. (See Exhibit II, attached). Such increases in taxes and costs make the Wichita plant less attractive to Vulcan as a site for future expansions and also harm the plant's ability to compete in the marketplace.

EXHIBIT II

TESTIMONY OF J. M. BOYD, WICHITA PLANT MANAGER
VULCAN MATERIALS COMPANY, CHEMICALS DIVISION

Commodity (Units)	Projected 1983 Units Consumed or Produced	Est. Unit Cost ($/Unit)	Est. 1983 Value ($)	Severance Tax Rate (%)	Severance Tax Passed Thru ($)
Natural Gas, (MCF)	4,098,000	3.04	12,457,920	8	996,634
Electricity, (KWH)	499,770,000	0.00302	1,509,305	8	120,744
Salt, (Tons)	360,000	8.92	3,212,200	8	256,896
			Total		1,374,274

Commercial Mining

South Central	195,598,865 Tons Salt
Hutchinson	192,518,569 Tons Salt
Remaining	1,308,612,883 Tons Salt

NonCommercial

Salt Present not Suitable for Mining	789,326,131 Tons Salt

Commercial: Leave 50 ft layer on top

Only remove 80% of that salt available

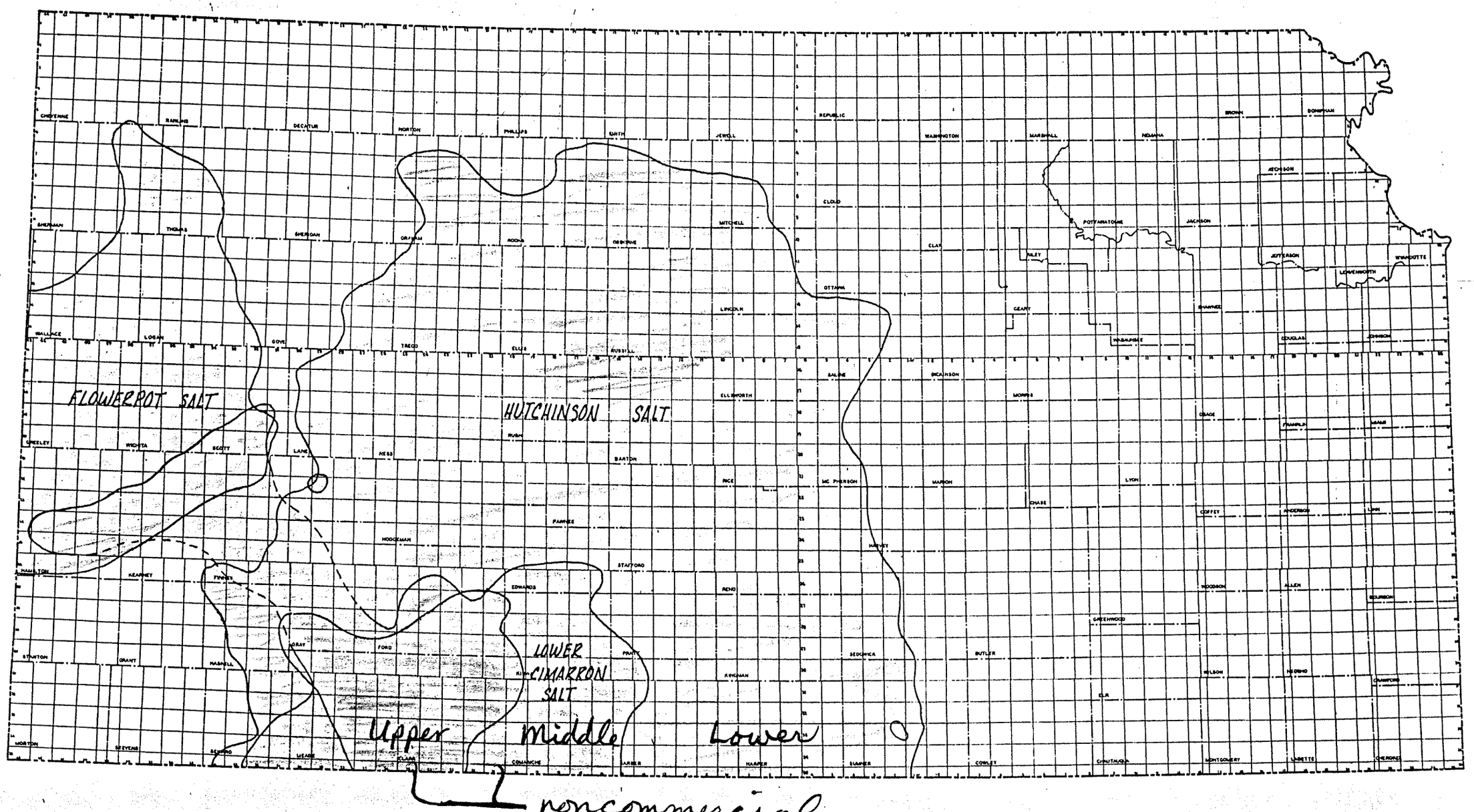
Noncommercial: 200 ft or less in thickness

Close to surface

KANSAS BLUE PRINT CO. INC.
BLUE PRINTING • PHOTOSTAT WORK • OIL MAPS & FORMS
ARCHITECTS AND ENGINEERS SUPPLIES
AM 4 9344 131 S. Lawrence • 154 N. Market • Wichita, Kansas

KANSAS

KANSAS



Don Bowman
Box 37
Codell, Kansas 67630

Members of the House
Capitol Building
Topeka, Kansas

Dear Members:

The 8% severance tax is too high for the quality of Kansas production, our production is relatively expensive to produce, most of my producion is 98% salt water, which means that the cost of producing oil is greatly increased, a large part of production in Western Kansas has salt water with it. The State has recognized this fact in its ad-valorem tax assessment form...I see no-where that this is now a consideration.

Some of the wells I have cost over $150.00 per day for electricity to lift fluid to the surface, this means that 7 barrels of oil a day must be used to purchase power, this is oil that is already heavily taxed, oil that the royalty owner is using to purchase machinery etc....must we be forced into plugging out these expensive to produce wells?

Since the price of oil has started declining a year and half ago, my employees have not had a raise, these employees work in the worst kind of weather, 360 days a year if there is work. Raises are being considered for State Employees, Teachers, some of whom only work 180 days a year, If my employees and myself are to underwrite the cost of State Government, we ask the same treatment for others.

An 8% tax on an already depressed industry, facing the stiffest of competition from worldwide production, wells that flow 10,000 barrels of high grade crude a day. This tax will cause massive unemployment in our area, an area that if you know the economics of Western Kansas will have almost no alternative means of employment. Families will be on welfare, men will be on unemployment (of which we just had to give a massive transfusion). I don't want to plug any of my wells or have to lay-off any of the good people working for me...we ask for your consideration.

Gentlemen, the man that came up with this massive severance tax is one heck of a politican, but his record leaves something to be desired in his business accumen....to tax one of Kansas biggest employers, largest taxpayers when it is already depressed with and 8% tax of its gross revenue, shows little concern for the employees and employers in the present and future of Kansas oil.

The attached sheet will show you a small part of where big oil is spending its money, what they are getting for it, and why Kansas oil is in trouble.

Very truly,

Don Bowman

FEB 15, 1983
OIL & GAS DIGEST

Industry Digest . . .

AREA ROUNDUP

AFRICA

Benin: Norway's Saga Petroleum commenced oil production from a small field offshore this West African state. The field has been under development for two years.

Egypt: Getty Oil, Deminex (West Germany), Shell and a group composed of Occidental, British Petroleum and Elf Aquitaine have concluded negotiations with the Egyptian General Petroleum Corp. for exploration in the Gulf of Suez and the Western Desert over the next six to eight years. Total value of the contracts was $200 million.

Nigeria: Texaco Overseas Petroleum Co., Chevron Oil Co. and the Nigerian National Petroleum Corp. announced discovery of oil in an exploratory well located nine miles offshore and about 90 miles west-southwest of Port Harcourt. The Sengana-3 flowed at a combined rate of 4,290 bpd of 43-degree API gravity crude from three zones within the uppermost formation below 11,824 ft. Tests in two lower formations below 12,630 ft resulted in recovery rates of 700 to 950 bpd of 46 to 49-degree API gravity crude. The well was drilled to a total depth of 13,054 ft in 50 ft of water.

AUSTRALASIA

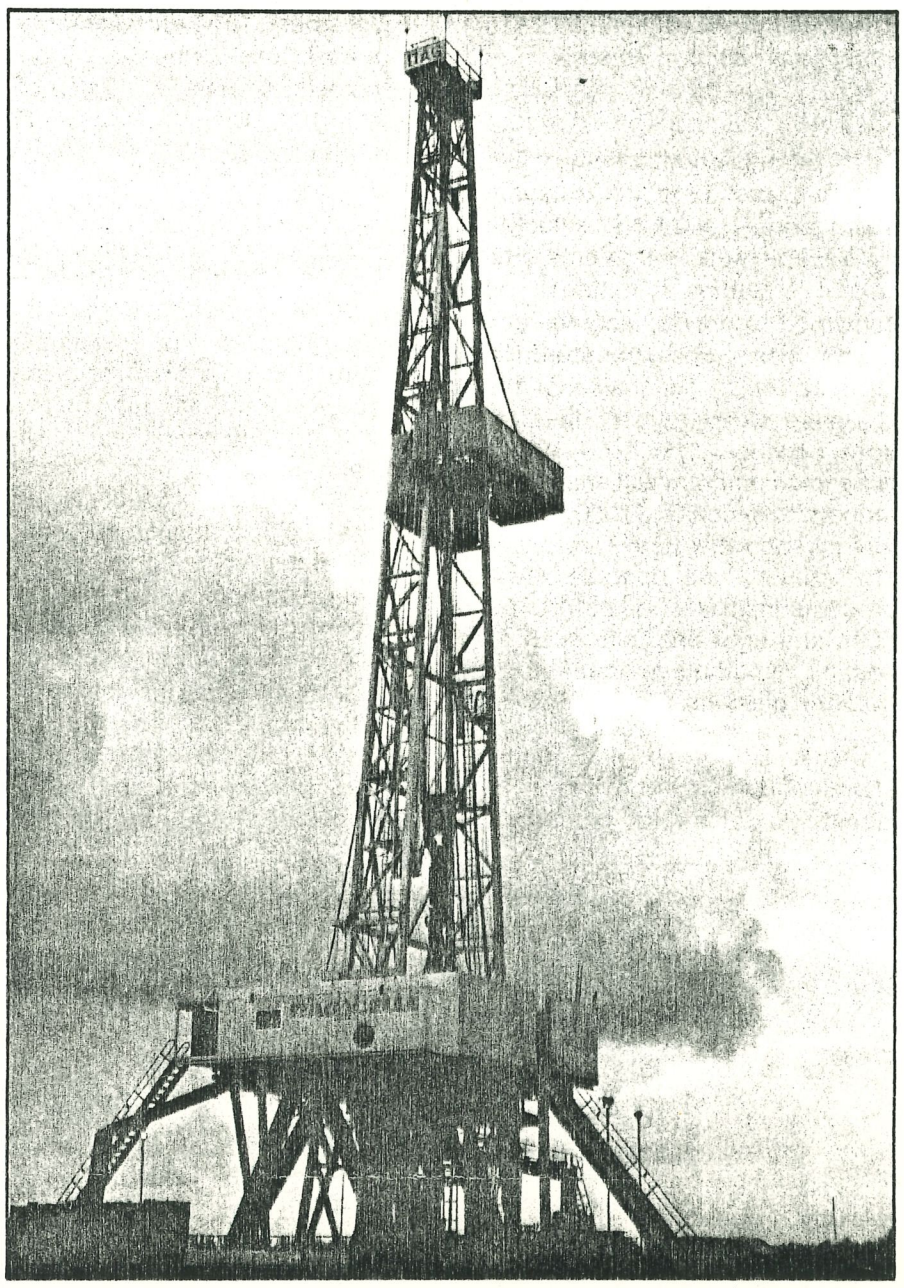
South Australia: Triton Energy Corp. announced production start-up in the Strzelecki field on the Nappacoongee-Murteree block of the Cooper Basin. The 10 wells being brought on production are producing at a combined rate of about 6,000 bopd. The oil is being pumped to Moomba for shipment to the Stony Point processing and port facilities.

EUROPE

Great Britain: Three new gas fields in the southern sector of the North Sea are to be developed at a cost of more than $1.58 billion as a result of supply contracts negotiated with British Gas Corp.

Hamilton Brothers Petroleum Corp. announced that a second successful appraisal well has been drilled from the Duncan platform in the British North Sea. The well, the No. 30/24-22, flowed at a rate in excess of 5,500 bopd from the Jurassic sands. Production was through a 1/2-in. choke with 1,300 psi wellhead pressure.

The Netherlands: The Amoco and Van Dyke Groups announced an oil discovery on the Netherlands Continental Shelf. The well, the No. P/9-2, is located 40 miles northwest of the Hague. It tested at rates up to 2,950 bpd of 30-degree API gravity oil from a depth of about 6,500 ft.



SWING LIFT RIG. The swing-type drilling mast and substructure was introduced to the international market in 1980. This rig, built by Branham Industries, Inc., is currently operating in West Germany.

Norway: An exploratory well in the Norwegian sector of the North Sea tested significant quantities of natural gas and condensate, according to Tenneco Oil Co., which holds a 25 percent interest in the well. The Statoil No. 30/2-1 flowed in three individual tests at rates of 24 to 36 MMcfgd and 1,950 to 2,596 bcpd through 1/2-in. and 3/4-in. chokes.

Mobil Exploration Norway Inc. began producing crude oil from the Statfjord B platform in the North Sea. The $2 billion platform is producing 55,000 bopd from three wells. Its production capacity of 180,000 bopd should be reached by late 1984. The platform stands in 500 ft of water and rises 400 ft above the water level. Oil production from the field is expected to reach 550,000 bopd in 1987. Estimated recoverable reserves stand at 3.3 billion barrels of oil and 3.4 trillion cu. ft of gas.

About 50 million tons of oil equivalents were recovered from the Norwegian Continental Shelf in 1982, according to Norinform, a Norwegian news agency. Production in 1983 is expected to exceed that number. New recoverable reserves of about 300 million tons of oil equivalents were discovered during 1982. (This does not include the Saga find.) Prospecting on the Norwegian shelf reached record proportions in 1982 with 50 exploration wells drilled from 14 platforms, and the Petroleum Directorate expects this activity to remain at the same level in 1983. Most of 1982's major finds were on the Tromsøflaket offshore north Norway, and on the Sleipner and Oseberg fields. A new oilfield located southwest of Stavanger, the Valhall field, came on stream in 1982.

Scotland: Britoil confirmed a discovery of a new oilfield in the North Sea about 40 miles north east of Peterhead. An appraisal well produced one of the highest test flow rates encountered by Britoil's exploration team, flowing at rates up to 9,200 bopd. The well was drilled to a total depth of 12,500 ft. Three separate intervals were tested; one produced 9,200 bopd while the other two produced 4,400 and 2,400 bopd, respectively. Natural gas was found in ratios of 360 to 480 cu. ft per bbl of oil.

SOUTHEAST ASIA

Thailand: Thailand began producing its own crude recently when wells north of Bangkok started flowing on a trial basis. An estimated 5,000 bopd is expected to be produced initially, increasing to 17,000 bpd within two years.

DRILLING / PRODUCTION

MERCEDES DOBBINS, VICE-PRES.
1427 VICKERS KSB&T BLDG.
WICHITA, KANSAS 67202
AREA CODE 316-267-7246

Strong's, Inc.

Oil Properties

JOE E. STRONG, PRESIDENT
FRANK THEIS
NASHVILLE, KANSAS 67112
PH. 246-5222

The thing that bothers me the most about the present consideration of the Severance Tax is that I do not hear anywhere what is a fair and proper amount to tax the oil and gas industry.

Governor Carlin says we need X number of additional dollars to fund the state budget and so he designed the Severance Tax that would develop that amount of money. He has never mentioned what is a fair tax and ignores totally the constitution that requires that taxes are to be uniform and equal.

In the last Governors' Campaign, Governor Carlin frequently used the illustration of what the Oklahoma Severance taxes were. However, he overlooks completely the fact that there is approximately a 4% tax generated in Kansas by county ad valorem taxes. Therefore, if he were patterning the Severance Tax in Kansas after the Severance Tax in Oklahoma, he would ask for less than one-half of what his present bill calls for.

Let's examine the Kansas oil and gas industry compared to Oklahoma to see if they should pay a comparable tax. Statistics are shown at the end of this statement from Petroleum Information Corporation, who nationally gathers information on the oil and gas industry. You cannot help but note of the ten leading producers in the United States, Kansas has the lowest success ratio of any. Not only is our success ratio lower than Oklahoma, but the average production of our wells is significantly lower than theirs. Can you honestly say that we should be taxed the same as Oklahoma from these statistics?

I have read articles in the paper where pro-Severance Tax people say that the low number of rigs operating in Kansas is brought on by intentional planning of the oil industry to make it look poor while they are being considered for a Severance Tax. This is not true. We are in the oil and gas leasing business and it is terrible also. Heavy leasing is normally followed with heavy drilling programs. By the same token, the low level of leasing is followed by low percentage of drilling in the future years. The low level of leasing activity has forced us to cut our staff in half and we are fortunate that none or our clients have gone bankrupt or are under reorganization. We have probably suffered less than some of the other lease brokers.

When you consider this Severance Tax, I ask you to consider what is a fair tax on this industry. Don't pick the amount of money you want to raise and design a Severance Tax to produce that amount of money. Let's look at the whole tax picture of all taxable property in the State of Kansas and try to arrive at something that is fair for everyone.

1982 U.S. Drilling
Ten Leading States
Ranked by Completions

RANK	STATE	OIL	GAS	DRY	TOTAL	% SUCCESS	FOOTAGE
1	Texas	14,209	4,517	8,171	26,897	69.6	138,281,589
2	Oklahoma	6,061	2,625	3,344	12,030	72.2	62,693,790
3	Kansas	4,042	739	3,860	8,641	55.3	28,028,545
4	Louisiana	1,549	1,597	2,160	5,306	59.3	35,212,243
5	Ohio	3,004	1,030	354	4,388	91.9	15,171,360
6	Illinois	1,702	9	1,303	3,014	56.8	7,950,325
7	California	2,495	95	342	2,932	88.3	9,336,084
8	West Virginia	385	1,879	115	2,379	95.2	9,926,415
9	New Mexico	746	1,145	412	2,303	82.1	12,594,827
10	Pennsylvania	803	1,370	49	2,222	97.8	6,385,113

Figure 3

March 15, 1983

Speaker Braden and members of the House:

I am a royalty owner from Butler County. I am against a severence tax on the oil industry or any other single segment of the economy, such as bankers lawyers, doctors, insurance companies, etc. I cannot understand why one part of the economy should be taxed so heavy for debts created by the government and the public in general. We all know a sales tax would be more fair but not as popular politically.

In 1980, with oil at $39, a severence tax might have been feasible. But with the imposing of the windfall profits tax and the price decline in oil of $10, and a possible four or five dollars more, we are looking at a price reduction of at least 30%. I believe this, with the high cost of operation, will place some independent producers in financial trouble.

While attending the Senate Committee meeting on the severence tax, it occurred to me that the royalty owners were not represented as they should be. My ad valorem tax as a royalty owner was 6½%, not 4% as you say the producer pays or no ad valorem tax as it is in Oklahoma. Our windfall profits tax was 21.3% for 1982 which is somewhat higher than some producers pay. we pay the same tax as major oil co.

We are taxed for an oil tax and windfall profits tax before we get paid. Then the ad valorem tax and income tax are deducted. We are already taxed four times, we don't need another tax.

I felt that these facts should be brought to your attention. Thank you for your time and consideration.

Eldon Phares
Route 1 Box 27A
Benton, KS 67017

ATTACHMENT XXI
(3-15-83)

(24)

TO: Kansas House of Representatives
Assessment and Taxation Committee
March 15, 1983

PREPARED BY: John V. Glades, Box 247, Yates Center, Kansas 66783

I am a private citizen concerned about the economic welfare of my county and its people. I am not a member of, and I am not representing, any oil or gas organization. My wife and I do not own any working interest in this county. We are landowners and do have royalty interests.

I am appearing with the knowledge and approval of local and county units of government, business and other groups.

I would like to briefly point out the disadvantages of an oil and gas severance tax on the economy of a small rural Kansas county. I live in Yates Center, the county seat of Woodson County, located approximately 80 miles south of Topeka on U.S. Highway 75.

We have tried for years to obtain industry in our area. To date we have had little success. We have one small industry that has approximately 75 employees. Most are women.

Oil was discovered in this county during World War I. Much of the production was small and of low gravity. Many of the wells were plugged and abandoned as time went on. In recent years as the price of crude increased, drilling and development increased. Jobs were created. Most of the wells were drilled with locally owned rigs. The majority of the leases are owned by Kansans - many by area residents.

Many of those employed in the oil fields are local farmers with large debts and mortgages and low farm prices. In addition to the jobs created, the landowners or mineral owners receive royalty payments. Most of the minerals in this area have remained with the land and have not been separated. This, again, has helped pay bills and increase the cash flow. This cash flow has helped local business and all citizens have benefited.

At the present time, according to the latest information available from the

ATTACHMENT XXII
(3-15-83)

County Assessor's office, Woodson County has 2,257 wells - 650 of these wells, or 29%, produce less than one barrel per day.

Oil and gas properties make up 40% of our county tax valuation. The tax value is determined by the annual number of barrels X price of crude X a factor determined by the State Property Valuation Department. This is just the valuation and tax on the hole in the ground. The royalty owner is taxed his proportionate share. Then the casing, rods, tubing, pump jack, lead lines, tank battery and other equipment are taxed separately.

There is also a federal tax taken off the top known as an excess profits or windfall profits tax. The producer and the royalty owner are not taxed equally in this instance. When this tax went into effect about three years ago, the Federal Government took almost one-third of each check received by the royalty owners. Changes have taken place. Here are three examples of tax on recent royalty checks - different leases, different owners:

GROSS	FED. TAX WITHHELD	NET
$ 477.56	$ 79.09 (16%)	$ 398.47
2855.29	495.81 (17%)	2,359.48
1084.05	202.02 (19%)	822.03

This tax is in addition to state ad valorem tax. If the minerals or any portion of them are separated from the land and there is no production, an ad valorem tax is levied.

No other business or industry in Kansas is taxed as high or taxed on gross sales before consideration is given to the return or interest on capital investment or before consideration is given to operating expenses such as repair and maintenance, labor, utility bills, etc.

In other businesses we might be eligible for subsidized loans from the Small Business Administration, low interest tax exempt revenue bonds, even exemption from real estate taxes for a period of time. Oil is the industry of my county. We do not have the aircraft industry like Wichita, the Capital like Topeka, or the industrial plans of Northeast Kansas, or the enterprise zones that many cities have established, giving business tax breaks.

Due to decreasing crude prices, high production costs (including taxes), and the increasing risk of failure, oil and gas exploration and developing is decreasing. In Oklahoma in 1982, approximately one-third of all bankruptcies were oil or gas related. Excessive taxation will contribute to the plugging of marginal wells.

The development of our oil and gas resources should be encouraged - not reduced by excessive taxation and unnecessary government interference. These natural resources can be used as an asset to attract other industries to Kansas, make jobs and increase our tax base for all Kansas, urban and rural.

It is unrealistic to believe that any one industry in Kansas can absorb a tax high enough to solve the finance problems of our highways and schools.

TOTAL VALUATION OVERVIEW
of
WOODSON COUNTY KANSAS
1982

1.	Rural Real Estate:	$ 9,933,990.	
2.	Rural Personal Property:		
	(a) Oil	$14,938,670.	
	(b) Farm Machinery	$ 1,722,985.	
	(c) Livestock	$ 1,312,945.	
	(d) Vehicles & other	$ 831,305.	
3.	Rural State Assessed:		
	(a) Railroads & Public Utilities	$ 4,054,946.	
TOTAL RURAL:			$32,794,841.00
4.	Urban Real Estate:	$ 2,974,915.	
5.	Urban Personal Property:		
	(a) Oil	$ 26,375.	
	(b) Farm Machinery	- 0 -	
	(c) Livestock	- 0 -	
	(d) Vehicles & Other	$ 84,185.	
	(e) Businesses	$ 723,155.	
6.	State Assessed - Urban:		
	(a) Railroads & Public Utilities	$ 589,831.	
TOTAL URBAN:			$ 4,398,461.00
TOTAL COUNTY VALUATION:			$37,193,302.00
Total Exempt Property:			
	(a) Rural	$ 980,185.	
	(b) Urban	$ 2,276,575.	
(8.75% of total valuation)			$ 3,256,760.00

FORTY PERCENT (40%) OF TOTAL COUNTY VALUATION IS FROM OIL

1981 Woodson County had 2,257 producing oil wells. 29% or 650 wells produced under one (1) barrel per day.

Information produced by Woodson County Assessor February 22, 1983

JOHN V. GLADES

SQUARE DEAL OIL CO., INC.

P.O. BOX 883 • R.R. NO. 3
CHANUTE, KANSAS 66720
316-431-9650

CRUDE OIL PRICE BULLETIN NO. 9

Effective 7:00 A.M., February 17, 1983, subject to change without notice and subject to the applicable rules and regulations of all governmental authorities and to the provisions of its Division Order and/or contract agreements, Square Deal Oil Company will pay the following prices per barrel of 42 U. S. gallons for marketable crude oil. The prices posted below for crude petroleum are based upon computation of volume by the use of 100% tables or mutually acceptable measuring equipment with deductions in full for all B. S. & W. and corrected for temperatures to 60 degrees F. in accordance with usual industry practice.

DISTRICT NO. 1		DISTRICT NO. 2 & 6	
Gravity	Price	Gravity	Price
40 & above	$29.00	40 & above	$28.70
39	28.85	39	28.55
38	28.70	38	28.40
37	28.55	37	28.25
36	28.40	36	28.10
35	28.25	35	27.95
34	28.10	34	27.80
33	27.95	33	27.65
32	27.80	32	27.50
31	27.65	31	27.35
30	27.50	30	27.20
29	27.35	29	27.05
—28	27.20	—28	26.90
27	27.05	27	26.75
26	26.90	26	26.60
25	26.75	25	26.45
24	26.60	24	26.30
23	26.45	23	26.15
22	26.30	22	26.00
21	26.15	21	25.85
20	26.00	20	25.70
19	25.85	19	25.55
18	25.70	18	25.40
17	25.55	17	25.25
16	25.40	16	25.10

NOTE: District No. 2 includes the following counties in Kansas: Chautauqua, Elk, Douglas, Johnson, Miami and Franklin

District No. 6 includes all counties in Missouri

NOTE:

This company purchases approximately 7,000 barrels of oil per day. Services approximately 1,000 leases. The average gravity purchased is 28. The different price between districts is due to the hauling distance.

KANSAS ASSOCIATION OF SCHOOL BOARDS

5401 S. W. 7th Avenue Topeka, Kansas 66606
913-273-3600

Testimony on
S.B. 267
to the
House Assessment and Taxation Committee
by
John W. Koepke, Associate Executive Director
Kansas Association of School Boards

Mr. Chairman and members of the Committee, we appreciate the opportunity to express the views of our 300 member district boards of education on the subject of the severance tax. Our members have never formally adopted a position in favor of or opposition to the severance tax itself. Opinion among our members is nearly evenly divided on the subject, as nearly as we can determine. As in the Legislature itself, opinions on the subject are strongly held.

However, during our most recent Delegate Assembly, held in November of 1982, our delegates did adopt a resolution with regard to the severance tax. A copy of that resolution is attached to this statement. The resolution dealt with a broad range of revenue issues, two of which relate directly to the severance tax discussion. They speak to aspects which ought to be included in any severance tax measure, if such a measure is to be passed.

The first consideration of our members is that any loss of revenue suffered by school districts where mineral wealth is located as a result of reduction in tax base should be made up from the severance tax revenue on a dollar for dollar basis. This is particularly important in those districts which are essentially rural and have already been hit with a significant tax base loss from the farm machinery exemption.

ATTACHMENT XXIII
(3-15-83)

The second concern of our members is that a portion of the revenue from any severance tax should be held in reserve in a trust fund to alleviate the tremendous variation in tax revenue from this tax source due to the volatitity of its price. Recent events in this area should adequately demonstrate the wisdom of this approach. We appreciate any attention which the committee may see fit to give to these concerns and thank you again for the opportunity to express them.

A Resolution adopted by the Delegate Assembly of the Kansas Association of School Boards, November 28, 1982. (All KASB Resolutions expire in one year after adoption by the Delegate Assembly.)

Taxation Implications for Proposed New State Revenue Sources.

WHEREAS, declining state revenues have created a crisis situation with regard to the budget of the State of Kansas,

WHEREAS, the decline in state revenues will result in the necessity to allocate state payment to local units of government, including school districts, unless significant new revenues are raised, and

WHEREAS, the passage of a severance tax will result in further erosion of local tax base for many Kansas school districts, and

WHEREAS, any such tax will not raise sufficient revenue to fully fund existing state budget commitments;

NOW, THEREFORE be it resolved, by the Delegate Assembly of the Kansas Association of School Boards, that any system of allotments on aids to local units of government be an across the board percentage on all payments subject to the allotment power; and

BE IT FURTHER RESOLVED, that a portion of the revenue from any severance tax be rebated back to local units of government where it is collected to compensate for the loss of local tax base; and

BE IT FURTHER RESOLVED, that a portion of the revenue from any severance tax be set aside in a trust fund to be held in reserve against the time when mineral production begins to decline; and

BE IT FURTHER RESOLVED, that the Association support an increase in the state sales tax early in the 1983 session of the Kansas Legislature; and

BE IT FURTHER RESOLVED, that the Kansas Association of School Boards opposes the diversion of any general fund revenue to any funds traditionally funded by user fees.

KANSAS-NATIONAL EDUCATION ASSOCIATION / 715 W. 10TH STREET / TOPEKA, KANSAS 66612

Testimony
House Assessment and Taxation Committee
Senate Bill 267
March 14, 1983

Mr. Chairman and Members of the Committee:

My name is Charles W. Johns, representing the Kansas-National Education Association. We have long had as one of our Continuing Resolutions on Tax Reform a position supporting fairness in taxation for revenue to finance quality public education and other services. There must be a method that would prevent excessive reliance on property or any other single tax source.

There must be a way to assure equitable distribution of the tax burden with those individuals and industries who can best afford to pay, assuming their fair share.

We feel that a severance tax meets these criteria.

We are not in favor of a tax that places an inequitable burden on one industry and puts it in a disadvantageous position. We do not feel the severance tax does that.

It is more important now than ever before to have a broad tax base to adequately provide quality education in Kansas. Schools have recently experienced a 4% cut in their budgets which had been promised by the state. The farm machinery exemption will cause some property tax levies in the state to increase 15 mills plus, thereby discouraging local school districts from levying their maximum budget authority. There is no current provision to fully fund special education classes which are mandated programs. The bill passed out of the Senate Education Committee last week doesn't even begin to address the needs of schools or teachers' salaries. And, finally, federal cutbacks are creating an additional state and local strain on needed educational funding.

We, as a proponent of the severance tax, state that we do definitely require additional revenue and that now is the time for the people of the state of Kansas to receive some benefit from these oil and gas deposits.

Noted educator Ernest Boyer speaking at Yale University a year ago stated, "The teaching profession is caught in a vicious cycle, spiraling downward, rewards are few, morale is low,

(continued)

ATTACHMENT XXIV (3-15-83)

Telephone: (913) 232-8271

The best teachers are bailing out and the supply of good recruits is drying up." This has just recently been confirmed in Kansas by an Emporia State University study. Boyer goes on to say, "Today's crisis is greater than the one confronted 25 years ago yet the response today is to reduce support for education."

In closing, let me say we have not attempted to elaborate on all the perceived and real technicalities inherent in a subject such as this. Statistics as you know can represent various viewpoints. What we have attempted to accomplish in this presentation is a real need to look at current and future educational funding.

I would like to express my appreciation to you for listening to our feelings on this issue.

Members of the House Assessment and Taxation Committee:

I am Rob Dietterich and I am from Ransom, Kansas. I graduated from Kansas State University in December, 1982 with a bachelor of science degree in geology. While still in my last semester of college I began sending out resumes to companies both in and out of Kansas. These resumes were sent to most of the major oil companies and to many smaller independent companies. Approximately 100 letters and resumes were sent to companies at this time. About 95% of the companies responded, and all of these with rejection letters.

After graduation I moved home to Ransom where I am employed by my father on his farm. In mid-January I began calling on geologists and oil companies in person, mainly in the Wichita area. I personally contacted 80 companies. Most of the companies were very willing to help, but none had any positions available for an entry-level geologist. I also contacted geologists and oil companies in Great Bend, Kansas and received the same response there. The general feeling of the oil companies and geologists was that they were waiting to see whether the severance tax would be passed or not, before making any employment decisions. They felt that if the severance tax was passed, the petroleum industry in Kansas would be depressed even more than it is presently.

From my experience, I feel that geologists now and future geologists graduating from universities in Kansas will have to go outside the state to find employment. Passing the severance tax would mean that employment opportunities in Kansas, for geologists such as myself, would deteriorate even more.

Robert J. Dietterich
R.R. #1
Ransom, Kansas 67572
(913) 731-2220

ATTACHMENT XXV
(3-15-83)

KANSAS OIL COMPANIES CONTACTED

Griggs Oil Inc.
Frontier Oil Company
Edmiston Oil Company
George R. Jones
Bankoff Oil Company
Falcon Exploration Company
Lario Oil and Gas Co.
Ram Petroleum Corp.
Koch Industries Inc.
Midco Drilling
Murfin Drilling Co.
Pickrell Drilling Co.
Gear Petroleum Company
F&M Oil Company
Mustang Drilling & Exploration Inc.
Associated Petroleum Inc.
Slawson Oil Company
Petroleum Inc.
Mid-Continent Energy Corp.
Abercrombie Drilling Inc.
K&E Drilling Inc.
Texas Oil and Gas Corp.
Woolsey Petroleum Corp.
Dunne-Gardner Petroleum Inc.
Texas Energies
Vincent Oil Corp.
Beren Corp.
American Energies Corp.
McCoy Petroleum Corp.
A&J Oil Company
Zenith Drilling Corp.
Penguin Petroleum
Stelbar Oil Corp.
Sage Drilling Co.
Pate-Dombaugh Petroleum
Viking Services
Banks Oil Co.
B&B Drilling Inc.
Bradley & Bradley
Sunburst Exploration Co.

Hummon Oil Company
Parrish Corp.
D.R. Lauck Oil Company
Aladdin Petroleum Corp.
Hellar Drilling Company
David P. Williams
Graham-Michaelis Corp.
Foxfire Exploration Inc.
Galloway Drilling Inc.
Landmark Energy Corp.
Leben Drilling Co.
A. Scott Ritchie
George Reed
Energy Exploration
Mid-Continent Energy Corp.
Imperial Oil Company
Rains & Williamson Oil Company
Range Oil Co.
Brandt Oil Company
Rockwood Petroleum Co.
Zorger Petroleum Co.
Palomino Petroleum
Cities Service Company
Aylward Drilling Co.
Petroleum Energy Inc.
Maurice L. Brown Co.
Sanders Oil Co.
Bergman Oil Co.
Landes Exploration Co.
Geosearch
Hinkle Oil Co.
Martin Oil Company
Mull Drilling Co.
Robert D. Dougherty
Strata Drilling Co.
Roxana Corp.
Lewis O. Chubb
Petro-Log Inc.
Brougher Oil Inc.
Energy Three Inc.

ROBERT J. DIETTERICH

Rural Route 1
Ransom, Kansas 67572
(913) 731-2220

OBJECTIVE

A position in the field of Exploration Geology.

EDUCATION

Bachelor of Science in Geology, Kansas State University, December 1982.
GPA: 3.75/4.0.

Attended Bethel College majoring in Geology, August 1978 to May 1980.
GPA: 3.75/4.0.

HONORS/ACTIVITIES

Sigma Gamma Epsilon, Geology Honorary
American Association of Petroleum Geologists
Kansas Honor Student
Semester Honors (4.0 GPA)
Music Achievement Scholarship
Class Valedictorian
Mid-Kansas Symphony Orchestra
Bethel Jazz 7 & 8
Williston Geology Club
Intramural Sports

WORK EXPERIENCE

August 1981-December 1981: Lab Assistant
Kansas State University - Manhattan, Kansas

Summers 1973-1982: Farm Laborer
John L. Dietterich Farm - Ransom, Kansas

PERSONAL DATA

Birthdate: 9/30/60
Marital Status: Single
Health: Excellent
Languages: German (3 years)
Available for Employment: January 1983

REFERENCES

Dr. Claude W. Shenkel, Professor of Geology, 105 Thompson Hall, Kansas State University, Manhattan, Kansas 66506 (913) 532-6724.

Dr. Henry V. Beck, Professor of Geology, 104 Thompson Hall, Kansas State University, Manhattan, Kansas 66506 (913) 532-6724.

Mr. Les Wurm, Senior Engineer, Panhandle Eastern Pipeline Company, 3444 Broadway, Kansas City, Missouri 64111 (913) 888-3428.

-TRANSCRIPT AVAILABLE ON REQUEST-

KACI

Legislative Testimony

Kansas Association of Commerce and Industry

500 First National Tower, One Townsite Plaza Topeka, Kansas 66603 A/C 913 357-6321

March 15, 1983

KANSAS ASSOCIATION OF COMMERCE AND INDUSTRY

Testimony Before the

HOUSE ASSESSMENT AND TAXATION COMMITTEE

REGARDING SUB. FOR SB 267

PRESENTED BY: RONALD N. GACHES

Thank you Mr. Chairman for this opportunity to present the position of the Kansas Association of Commerce and Industry regarding Sub. for SB 267, a proposal to impose a state severance tax on Kansas mineral production. I'm Ron Gaches, General Counsel and Director of Taxation for KACI.

The Kansas Association of Commerce and Industry (KACI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.

KACI is comprised of more than 3,000 businesses plus 215 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 55% of KACI's members having less than 25 employees, and 86% having less than 100 employees.

The KACI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

KACI continues its opposition to an in-addition severance tax. The need for tax equity and revenue stability leads us to the conclusion that a state severance tax should not be the source of additional revenue to meet state spending needs.

- MORE -

ATTACHMENT XXVI

(3-15-83)

The Kansas oil and gas industry makes great contributions in the form of taxes in support of local and state government. In 1982, the industry paid more than $117.5 million in local property taxes in support of local government. An additional $100 million was paid in other taxes and fees to the state. This has taken place at a time when the worldwide marketplace for oil has been subject to dramatic reductions in price and surplus supplies. Reduced Kansas employment and investment in this industry has been one result of changes in the world markets.

As many states have discovered, reliance on severance tax revenues is not the panacea to state general fund revenue problems. The revenues are not stable; continued revenue growth cannot be expected.

The taxing system in each of the 50 states is unique to that state. While there are many similarities, imposition of a severance tax in one state does not necessarily document the tax equity of imposing a severance tax in Kansas. Texas and Wyoming, which have been held up as models for a severance tax, impose no corporate income tax on their mineral industries. Similarly, Oklahoma imposes no local property tax on mineral production. Both the corporate income tax and the local property tax are imposed in Kansas on our mineral production industry.

It's important to note that I referred to our industry. The development of Kansas mineral production has been almost exclusively the work of Kansas independent producers. These producers have invested dollars at high risk in the development of our mineral resources. In so doing they have created thousands of jobs for Kansans and actually caused the importation of capital investment into our state. Imposition of a severance tax in-addition to current state and local taxes on the industry will discourage investment and eliminate current and future jobs for Kansans. The short-run revenue gains for the state general fund will be offset by reduced production, loss of jobs, and reduction in capital investment for Kansas in the long-run.

Looking beyond the political rhetoric, this important policy issue should center on the equity of asking one industry to bear the burden of additional financing for programs and services enjoyed by all Kansans. KACI believes that one industry, and business generally, should not be required to absorb that burden alone. Additional taxes on the business community are counter-productive to the economic development efforts of our state. To the extent additional business taxes can be passed on to the ultimate consumer, they become hidden taxes. Hidden taxes are a symptom of weak government. Taxpayers should not have the real cost of providing government services hidden from them in the form of additional business taxation.

For the reasons I have discussed we urge you to reject Sub. for SB 267 to impose a state severance tax on the Kansas mineral production industry.

TESTIMONY ON SUBSTITUTE FOR SB 267

BEFORE THE HOUSE ASSESSMENT AND TAXATION COMMITTEE

March 15, 1983

My name is Don Willoughby and I am here today representing Northern Natural Gas Company, as an interstate pipeline company, and Peoples Natural Gas, a retail natural gas distribution company.

Northern Natural Gas Company is a major natural gas pipeline company serving 1097 communities in the Upper Midwest. These 1097 communities have a total population of 6 1/2 million -- natural gas consumers total 1.7 million. Twenty one (21) of the communities that we serve are located in Kansas and these twenty-one communities have approximately 16,000 natural gas customers.

Peoples Natural Gas operates as a retail distribution company in eight (8) states including Kansas. The Kansas operation -- both as a distribution company and as an intrastate pipeline company -- supplies natural gas to approximately 35,000 customers.

We are opposed to Substitute for SB 267 under discussion today.

The cost of energy and natural gas is rising rapidly to all consumers and adding an additional burden in the form of an increased tax is inappropriate, especially when many low and fixed income natural gas consumers are having difficulty paying their bills now.

ATTACHMENT XXVII
(3-15-83)

Total cost to Northern's and Peoples' consumers will be approximately $9.5 million per year (systemwide) -- and Kansas consumers served by distribution gas utilities from Northern's pipeline will share in these additional costs to the company. We already reimburse Kansas natural gas producers for their ad valorem taxes at a rate of between 7-9 percent. Passage of this bill would produce a true severance in the range of 15-17 percent, the highest in the nation for natural gas. There is no way this rate can be construed to be in the best interest of Kansas consumers who will be forced to pay this tax through increases in their utility bills.

We feel that any additional increase in rates caused by a severance tax must be lobbied against. It is our mandate as a FERC regulated interstate pipeline company and a KCC regulated natural gas utility to provide the lowest possible rates to our customers -- and this would not be accomplished through the passage of a severance tax.

If you have any questions, I would be pleased to answer them.

FOR FURTHER INFORMATION PLEASE CONTACT:

DONALD E. WILLOUGHBY
REGIONAL PUBLIC AFFAIRS MANAGER
INTERNORTH, INC.
817 MERCHANTS NATIONAL BANK BUILDING
TOPEKA, KANSAS 66612
(913) 357-5121

STATEMENT TO THE
HOUSE ASSESSMENT AND TAXATION COMMITTEE

RE: "Severance" or Mineral Production Taxes
Substitute for SB 267
March 15, 1983
Topeka, Kansas

by
Paul E. Fleener, Director
Public Affairs Division
Kansas Farm Bureau

Mr. Chairman and members of the Committee:

We appreciate very much the opportunity to make a brief statement today. We appear before you in opposition to Substitute for Senate Bill 267, pertaining to the Severance Tax.

When the issue of a Severance Tax came up in early 1981 we did not have a position on the issue. We were directed to develop a "Severance Tax" Research Paper for our members in the 105 Kansas counties. Copies of that research paper were forwarded as a courtesy to all members of the Kansas Legislature.

In our policy development process our members examine the issues and direct, through their voting delegates at the Annual Meeting for Kansas Farm Bureau, the positions to be taken by our organization. This happened in the case of our 1981 research paper. The issue was discussed and debated by voting delegates at the December 6-8, 1981 Annual Meeting. After their discussion voting delegates did adopt a short, concise position regarding this issue. The issue was reexamined by voting delegates at the December 5-7, 1982 Annual Meeting. The result was the same, adoption of a policy position opposed to enactment of a Severance Tax. The statement is short. It is as follows:

Severance or Mineral Production Tax

We are opposed to enactment of a "severance" or mineral production tax at this time.

ATTACHMENT XXVIII
(3-15-83)

There are both philosophical and very practical reasons why our people are opposed to the imposition of a Severance Tax. As a practical matter this tax is going to be passed onto consumers. Farmers and ranchers are large users of energy. They believe they will bear the brunt of a pass-through tax, which proponents intend to extract from the "big oil companies," and the "big natural gas producers."

Information which we have seen, originating with the Kansas Corporation Commission and the Kansas Geological Surveys shows that as regards the production and use of crude oil in Kansas there was something over 145 million barrels of crude that went to the refineries in Kansas and something on the order of 8.2 million barrels exported from Kansas. That means we exported 7.4% of crude oil. Information on natural gas is similar, we had a total marketable production of natural gas on the magnitude of 797.7 million mcf, delivered 146.1 million mcf to other states. That is a total of 18.3% leaving the State.

Our farmers and ranchers, particularly in the producing counties, fear the erosion of the local tax base. Kansas already has a severance-type ad valorem tax which generates many millions of dollars for local units of government, including school districts which proponents of Severance Tax Legislation profess to want to assist. Our people are fearful that in a state-collected, locally shared tax there is going to be some slippage in the distribution formula that may be devised.

Our people are aware, as are you, that many petroleum based products are going to feel the effects of a Severance Tax. Estimates range from 90 cents to $3.50 per ton increase in the cost of anhydrous ammonia. That

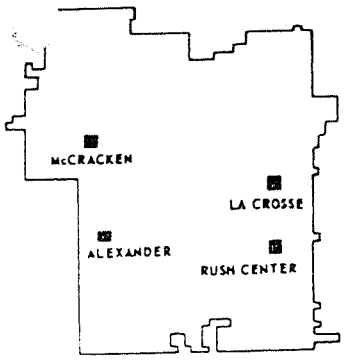
makes the estimated increase in the cost of anhydrous somewhere in the range $600,000 to $2.5 million per year. Our people believe that cost would certainly be passed onto them.

On the philosophical side of the question our people are concerned about a Severance Tax having an unfavorable impact on resource development. Any increase in the cost is going to be recovered by increasing the price of produced or processed items. Also on the philosophical side our farmers and ranchers believe the minerals are not irrevocably lost or destroyed when they are removed from the earth but are transformed into materials and goods that form a chain of taxable economic wealth and activity which would broaden the tax base and the economic well-being of the citizens of this State.

Mr. Chairman and members of the Committee since our policy position on this matter is so concise, I will share it with you once again:

We are opposed to enactment of a "severance" or mineral production tax at this time.

Thank you very much for the opportunity to make a brief statement in opposition to the bill before your Committee seeking to impose a Severance Tax . . . Substitute for SB 267.



La Crosse Unified School District No. 395

Dr. John S. Shaw - Superintendent

P.O. Box 790
La Crosse, Kansas 67548
(913) 222-2505

2/21/83

TO: Senate Assessment and Taxation Committee

FROM: Dr. John S. Shaw, Supt., USD 395

Reference: Testimony on the Severance Tax

Mr. Chairman and members of the Committee, we appreciate the opportunity to appear before the committee on behalf of USD 395 of La Crosse.

The severance tax question is a controversial issue which we believe will have a financial negative impact upon people of our school district. To us this tax is another way of reducing our tax base.

Our district's 1982 evaluation is $31,695,258 of which 30% is oil and gas ($9,428,761). Our district encompasses an area of 486 square miles in Rush, Ness, Trego and Ellis counties.

In looking at the oil and gas production in our district, we find the following facts: 204 producing oil wells and 11 gas wells. The oil wells produced 534,898 barrels in 1982, which averages 7.18 barrels per day. The 11 gas wells produced 10,441,000 cubic feet of gas, which is 2600.5 cubic feet per day average.

These 215 wells have an average evaluation of $42,637.95. Using USD 395 total mil levy of 45.86, the average well pays $1,955.38 to our district alone. By the same comparison the average quarter section of land in our district is assessed between $5900 and $6000, which means the average quarter section of land pays only $270.57 in school taxes. The range of production is from a low of 164 barrels per year to 19,261 barrels per year. At present there are 55 wells in our district producing less than 5 barrels per day.

From conversations with county assessors and the producers, we feel that should a severance tax be imposed, a conservative estimate would have 35 to 40% of these wells plugged. Should this occur we would lose 10 to 12% of our evaluation. This reduction would mean 4.5 or 5 mil increases, just to get back to where we are now.

This of course is compounded with our lost evaluations and taxes on farm machinery. The two added together means the people in USD 395 are facing a 8 to 9 mil increase without any additional budget increase. Some believe that this lost wealth will be made up in state aid. With the present formula the amount of state aid would be less than 1% of our total budget.

Education as well as other levels of government need help, but not in the form of a severance tax. A severance tax on gas and oil is just the beginning, what will be next?

Thank you for the opportunity to express our concerns.