

Approved: MARCH 24, 1998
Date

MINUTES OF THE SENATE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairperson Pat Ranson at 1:30 p.m. on March 17, 1998 in Room 531-N of the Capitol.

All members were present except:
Sen. Hensley was excused

Committee staff present: Lynne Holt, Legislative Research Department
Mary Torrence, Revisor of Statutes
Jeanne Eudaley, Committee Secretary

Conferees appearing before the committee:
Ron Hein, Pioneer Natural Resources, USA, Inc.
Don Schnacke, Kansas Independent Oil and Gas Association
David Dittmore, Director of Utilities, Kansas Corporation Commission

Others attending: See attached list

Sen. Ranson acknowledged a group of guests attending the meeting today from Pottawatomie County Farm Bureau and Labette County Farm Bureau Capitol Experience. She announced the pages assisting the committee today are from Baldwin.

Sen. Ranson announced the committee will hear testimony on the following:

SB 686-Refunds of rates and charges received for reimbursement of ad valorem taxes for the sale of natural gas

Mary Torrence briefed the committee on the bill and Sen. Morris explained events precipitating the bill. They are as follows:

- 1974 - Federal Power Commission ruled that ad valorem taxes may be included in tax base
- 1978 - That ruling was reaffirmed by Federal Energy Regulatory Commission
- 1983 - FERC examined the ruling and reaffirmed it
- 1986/87 - FERC looked at ruling and reaffirmed it
- 1993 - Northern Pipeline, Colorado Interstate and others filed case in Federal District Court asking for relief from ruling; required FERC to again look at ruling
- 1993 - Changed mind on ruling with decision that principal, penalties and interest be refunded to pipeline companies and customers

Sen. Morris explained that the decision was referred to the Supreme court, who refused to hear the case. Rep. Moran and Sen. Roberts have filed a bill which would delete the penalties and interest being refunded, but no action has been taken on it. **SB 686** sets out the procedure whereby the Kansas Corporation Commission would collect the money from legitimate claims and return it to the producers.

The following appeared on the bill:

Ron Hein, proponent, representing Pioneer Natural Resources USA, Inc. (Attachment 1)
Donald Schnacke, opponent, Kansas Independent Oil & Gas Association (Attachment 2)
Dave Dittmore, neutral conferee, Kansas Corporation Commission (Attachment 3)
Written testimony was submitted by Erick Nordling, Southwest Royalty Owners Association, (Attachment 4)

The committee questioned conferees regarding the bill. Specifically, Mr. Hein was questioned regarding identifying and locating the consumers of LDC's and setting up a mechanism to make the appropriate refunds. Mr. Hein expressed concern, because of the class action lawsuit, that the injured parties will not receive the refunds; he also told of the administrative nightmare in locating the injured parties during the 1983-88 years. He estimates that the Decision may cost Kansas producers \$500 million, with Pioneer putting several million in an escrow account. He stated the need to protect the royalty owners, and concluded by saying he supported the concept of returning the money to those entitled to refunds. Sen. Morris added that many of the small producers have gone out of business.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON UTILITIES, Room 531- -N, Statehouse, at 1:30 p.m. on March 17, 1998.

Mr. Schnacke stated the deadline, which was March 9, has already passed and his belief is that if argued legally, the bill would be held invalid. Sen. Morris argued that the money can be transferred to an escrow account until such time as the appropriate refunds can be made, and Sen. Pugh stated he thought refunds were to be paid to the state treasurer. Mr. Dittmore stated the concern the Commission has regarding conflicts between the bill and provisions set out by FERC. He cautioned the committee that passing the bill could result in litigation, since some companies could ignore the statute and follow FERC guidelines. He stated the interstate pipelines cannot keep the refunds, but are to pass them on to the end users. Sen. Barone asked if the individual user/consumer could get a windfall, and Mr. Dittmore stated some likely did not pay the tax but are likely to get credit for refunds, as he understands the utilities would blanket refund to consumers. He stated he has spoken to Kansas Gas Service and their intention is to pass it on to customers. Sen. Ranson asked who determines what the refund would be, and Mr. Dittmore stated his understanding is that after the money is received from the LDC's, the state regulatory agency is to determine how the refunds will be handled. He further stated the KCC will appeal the decision to the 10th Circuit Court and that it is their concern that the interstate pipelines would not comply, leaving the state regulatory agency trying to enforce the law. Sen. Morris stated it is difficult to work through the layers of bureaucracy, but the premise of the bill is to make it possible for those eligible for refunds to apply with the KCC for refunds; a concern has been that some companies will keep a portion of the refunds and not pass it along to the user/customer.

Mr. Dittmore referred to the last page of his presentation, which is refund procedures outlined by FERC. Sen. Ranson asked if FERC is in charge of the process and asked if there is some middle ground the state could pursue; when can the state intervene and what is the intent to retail consumers? Sen. Lee asked who controls the escrow account, and Mr. Dittmore answered that FERC oversees the escrow account. John Bell of the KCC stated the FERC order requires the producers to make refunds to the pipelines, who have to return it to the customer; that only the disputed amounts will go into the escrow account; that they can hold the refund for only 30 days before forwarding it on. Sen. Barone stated there must be a paper trail if there is \$336 million dollars in question, and Mr. Bell responded that there will be a release from FERC on the status of accounts within 60 days past the March 9 deadline. Sen. Ranson asked members of the Corporation Commission staff to bring a flow chart to committee meeting to try to clarify some of the questions committee members have.

Meeting adjourned at 2:30.

The next meeting is scheduled for March 18, 1998.

SENATE UTILITIES COMMITTEE GUEST LIST

DATE: MARCH 17, 1998

NAME	REPRESENTING
JOHN BELL	KCC
David D. Hemore	KCC
John Mc Nish	KCC
Martin Hawver	Hawver's Capitol Report
Mike Taylor	City of Wichita
J.C. Long	UtiliCorp United Inc.
Tom Laches	McGill's Asso.
Julie Elder	Pottawatomie County Farm Bureau
Sara Elder	" " "
Baroni Simpson	" " "
Denise Keller	" " "
Alicia Wilburn	Pottawatomie County Farm Bureau
Katie Glendening	" "
Michael Sunwehl	Pottawatomie County Farm Bureau
Scott Brooks	Pottawatomie County Farm Bureau
Opie Harraughty	Labette County Farm Bureau
Francesca Marsden	Labette County Farm Bureau
Candy Denton	Budget
Dick Carter, Jr.	Enron

HEIN AND WEIR, CHARTERED

ATTORNEYS AT LAW

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Attach. 1

Ronald R. Hein

Stephen P. Weir

Susan Baker Anderson

SENATE UTILITIES COMMITTEE

TESTIMONY RE: SB 686

Presented by Ronald R. Hein

on behalf of

PIONEER NATURAL RESOURCES USA, INC.

March 17, 1998

Madam Chairman, Members of the Committee:

My name is Ron Hein, and I am legislative counsel for Pioneer Natural Resources USA, Inc. Pioneer was formed from the merger of MESA and Parker & Parsley this past year. Pioneer is the second largest independent oil and gas exploration and production company in the United States based on total proved reserves.

As you probably already know, the Federal Energy Regulatory Commission (FERC) ordered that producers in Kansas pay back money that FERC ruled was overpaid by consumers of natural gas back in the 1980's. Kansas producers at that time, after a previous ruling by FERC that the ad valorem tax in Kansas was a form of severance tax, had passed through the ad valorem tax under the provisions of law at that time. Ultimately, that decision by FERC was challenged, and held to be improper, and ultimately FERC ruled that the Kansas producers had to repay those ultimate consumers the money which they had paid. In addition, the FERC order provided for interest and penalties.

Despite the apparent unfairness of that ruling, given the fact that the Kansas producers simply relied upon a previous FERC ruling, the FERC Refund Order was challenged and appeals were taken all the way to the U. S. Supreme Court. The end result was that the refunds were required to be made, costing Kansas producers approximately \$500 million, approximately two-thirds of which is interest and penalties.

Pioneer is one of the natural gas producers subject to the order.

The Kansas congressional delegation has introduced a bill in the Senate and a bill in the House to alleviate some of the problem by providing for the waiver of the amounts ordered to be repaid that constitute interest and penalties. So far, there has been no success with that legislation.

SB 686 is an effort to help ease the burden on Kansas producers necessitated by this unusual development at the federal level. Sen. Steve Morris, who asked for the

Senate Utilities
3-17-98
Attach. 1

introduction of this bill through Senate Ways and Means, desired for the State of Kansas to do something to remedy this situation. SB 686 is a step in the right direction.

I have attempted during the last few days to ascertain whether SB 686 or other types of legislation would be in contravention of the federal action. This is an extremely complicated issue, and SB 686 may or may not be the perfect solution.

The intent of the FERC order was to insure that those people who were ultimate consumers for the time period subject to the order received refunds on the monies that they overpaid. As a practical matter, it will be extremely difficult to locate those individuals. Between deaths, persons moving, records being destroyed as obsolete, and numerous other problems of even locating those persons that can be identified, finding the persons who are properly entitled to the money to be refunded is an administrative nightmare.

It appears it would be difficult for the State of Kansas to do anything about payments due to persons entitled to refund pursuant to the order, without being in contravention of the FERC order as upheld on appeal. However, there should not be a windfall to other persons who are not entitled to such refunds, whether they be other consumers, or other parties in the transfer of funds. If the ultimate consumers cannot be identified, any amounts that are left should be remitted to the producers rather than creating a windfall to other individuals or businesses who never paid the money in the first place.

Pioneer believes that the State of Kansas should do something to protect these Kansas producers from this seemingly unjust decision. Holding a hearing on SB 686 is a step in the right direction to finding the solution that will work. There is obviously a short period of time to get any type of legislation passed through the legislature. We would urge the committee to approve SB 686 and start moving legislation through the process.

In the meantime, Pioneer will offer the services of our legal staff and any outside experts that we can provide in the event that this legislation needs to be modified to insure that it will accomplish its intended goal. Between the resources available to the Governor, the legislature, and the private sector oil and gas industry in this state, I feel confident that we can draft legislation in this state that would help solve this problem.

In conclusion, I urge the committee to approve SB 686 favorably for passage.

Thank you very much for permitting me to testify, and I will be happy to yield to questions.

Attach. 2



KANSAS INDEPENDENT OIL & GAS ASSOCIATION

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800 S.W. JACKSON • SUITE 1400 • TOPEKA, KANSAS 66612-1216
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Statement of Donald P. Schnacke
Senate Utilities Committee
March 17, 1998
RE: SB 686

I am Donald P. Schnacke representing the Kansas Independent Oil & Gas Association and appearing in opposition to the passage of SB 686.

I believe I told this Committee when I appeared in favor of SCR 1616 that I have been involved in the issue of the application of the Kansas advalorem tax as authorized by the Federal Power Commission and subsequent orders by the Federal Energy Regulatory Commission since 1974. The authority to regulate the natural gas industry that is addressed in SB 686 was granted by the U.S. Congress and enforced by federal law.

We commend whoever instigated this proposed legislation; as it appears it was proposed with good intentions. However, in our opinion, and unfortunately, we believe the bill is too late and if enacted would be declared invalid, in that it encroaches on the federal government domain and jurisdiction.

The result of SB 686, if enacted would be to create even more problems and confusion. The U.S. Supreme Court refused to hear an appeal from the U.S. Circuit Court of Appeals for the District of Columbia resulting in affirming the original FERC order to the pipelines and the court mandated time schedule for the refunds to be made. That procedure is well underway at this time and unfortunately already the deadline for payment has passed. Requiring the same funds to be paid again to the Kansas State Treasurer as is contained in SB 686 is clearly an invalid procedure and in conflict with federal law.

Senate Utilities
3-17-98
2-1

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Testimony by Donald P. Schnacke
SB 686

When the adverse FERC order was issued reversing a 19 year federal policy, we have explored many legal and political solutions to nullify the devastating results. Governor Graves, Atty. Gen. Stovall and the State Corporation Commission have all assisted. We all filed briefs with FERC and the federal appeal court. We filed an amicus curiae brief with the U.S. Supreme court. None of us wanted to refund this tax, along with interest and penalties, which amounts to about \$500 million and may lead to bankruptcy of some small independent producers. For years we relied on federal governmental agency orders and are now being penalized for doing that. We are seeking relief in the U.S. Congress and that is the reason your committee and the Senate and the House approved SCR 1616. At this point in time passage of SB 686 will cause problems and confusion rather than help solve this issue. We would urge that you not pass SB 686.

Donald P. Schnacke

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**Comments on Senate Bill No. 686
Before the Senate Utilities Committee
David N. Dittmore
Director of Utilities
Kansas Corporation Commission
March 17, 1998**

Purpose of Comments

The purpose of my comments today are to apprise the Committee of potential conflicts between the proposed legislation (SB686) and certain provisions of the Federal Energy Regulatory Commission (FERC) orders regarding ad valorem refunds.

A fact that complicates the enactment of the proposed legislation is that the FERC ad valorem refund process has already begun. As of March 9, 1998 producers were to have paid to interstate pipelines refunds due. Some producers have complied with the March 9 deadline and made refunds to interstate pipelines, thus indicating their compliance with the FERC orders.

If this legislation is enacted it is possible that some parties that are subject to the FERC ad valorem refund orders would ignore the Kansas law and continue to follow the FERC guidelines. To the extent that certain parties did not comply with the Kansas law, but rather chose to comply with the FERC order, it would be up to the State of Kansas to enforce its statute, likely resulting in litigation.

Refunds from Producers to Interstate Pipelines/Kansas Treasury

FERC September 10, 1997 order requires producers to make refunds to interstate pipelines by March 9, 1998. Within 60 days of this date interstate pipelines must file a refund report to the FERC stating how much they have received from each producer. As mentioned above some producers have already paid refunds to interstate pipelines. Whether those refunds have been passed on to end users or still reside with interstate pipelines, it would be difficult for the State of Kansas to obtain those funds for deposit into the State Treasury. This could be a potential source of litigation.

SB686 requires KCC to determine amounts producers will refund to the State Treasury. There is a potential conflict between KCC and interstate pipelines with regard to KCC determination of refunds due. Since interstate pipelines are one of the parties that have the data on gas purchases, the KCC would likely have to petition the interstate pipelines for this data. Since interstate pipelines are not jurisdictional to the State of Kansas they could choose to not comply with our requests for sales data.

Payout of Refunds from Interstate Pipelines/Kansas Treasury

FERC order requires interstate pipelines to pass refunds received on to its customers (and thus retail end-users). Interstate pipelines are required to pass on refunds received within 30 days of receipt or face added interest charges on the refund received.

SB686 would require entities claiming a refund to petition the KCC for such refund. In addition to local distribution companies jurisdictional to the State of Kansas, this would include numerous out of state customers of interstate pipelines, since much of the gas sold during the 1983 to 1988 time period was delivered to end users outside of the State of Kansas. These out of state end users might perceive the Kansas law as detrimental to their current position under the FERC refund process. This could be a potential source of litigation.

Senate Utilities
3-17-98
Attach. 3

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APPENDIX E

C. Refund Procedures

1. Statement of Refunds Due

Within 60 days of issuance of this order, pipelines shall serve upon First Sellers a Statement of Refunds Due with respect to the Kansas ad valorem tax for the period October 3, 1983 through June 28, 1988. The Statement shall include the amount, including interest, that the pipeline believes is owing by each first seller. The pipeline shall file with the commission a copy of all such statements.

2. Procedures for Refunds by First Sellers

First Sellers who collected revenues in excess of the applicable maximum lawful price established by the NGPA as a result of the reimbursement of the Kansas ad valorem taxes for sales on or after June 28, 1988, shall refund any such excess revenues to the purchaser, including interest, in full. The refunds are due within 180 days after issuance of this order. However, each first seller may file a request, with appropriate supporting financial data, for permission to amortize the refunds over an extended period not to exceed five years.

3. Procedures for the Flowthrough of Refunds by Pipelines

Under the Natural Gas Act, the Commission has jurisdiction over the rates interstate pipelines charge their customers. We establish the following procedures for interstate pipelines to pass through any ad valorem tax refunds they receive from first sellers.

a. Method of Flowthrough by Interstate Pipelines

Due to the implementation of Order No. 636 [FERC Statutes and Regulations § 30,939], interstate pipelines have terminated their PGA clauses, which included a mechanism to pass through any refunds they received. Since this mechanism was used to reduce a pipeline's unrecovered purchased gas cost gas balance which would normally have been recovered from its customers over the next twelve-month period, this mechanism usually did not result in the flowthrough of refunds to customers in the same relative proportions of the actual overcharges because of changes in purchased gas patterns.

Since the PGAs have been terminated, ad valorem tax refunds can no longer be flowed through the PGA clause. In place of the PGA clause, pipelines implemented PGA close-out procedures. However, these close-out procedures may result in methodologies

that are even more divergent from the proportionate sales ratios reflected in the PGAs. Therefore, to ensure that ad valorem tax refunds will be made to customers who overpaid the pipelines and to avoid the problems of allocating these refunds to a pipeline's current customers, the Commission will require interstate pipelines to make a lump-sum cash payment to the customers who were actually overcharged. We will require pipelines to make refunds to the customers actually overcharged within 30 days after receipt of refunds from the producers. If a pipeline does not make refunds within this 30-day period, the interest provisions in section 154.67(c) will be triggered and interest must be paid from the date of the pipeline receives the refunds from the producers until the date the pipeline pays refunds to its customers.

The Commission believes that a pipeline should: (1) allocate the refunds between jurisdictional and non-jurisdictional customers; and (2) allocate the total refunds due to the jurisdictional customers who were actually overcharged based on the proportion of each customer's purchases during the refund period compared to the total jurisdictional sales during the refund period. Pipelines would then pay this refund to those customers in a lump-sum cash payment. In any event, pipelines are to process ad valorem tax refunds from other pipelines in the same manner as ad valorem tax refunds received from first sellers because this procedure will return such amounts to those customers actually overcharged.

Finally, the Commission notes that pipelines will not be required to be guarantors of refunds. However, the Commission urges interstate pipelines to actively pursue refunds owed by first sellers.

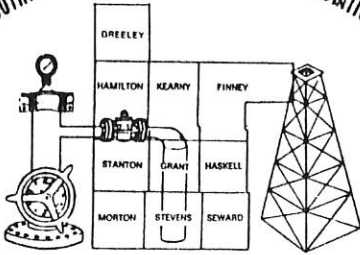
b. Pipeline Refund Reports

The Commission will require interstate and intrastate pipelines to file refund reports showing the amounts they received from producers (with principal and interest shown separately) and any producers who still owe refunds. The report must be filed 250 days after the date of this order and annually thereafter for the next five years.

The refund report filed by interstate pipelines must also describe the basis a pipeline used to apportion the refunds among its customers and be served on all of the pipeline's customers.

Intrastate pipelines shall also file copies of the refund report with the State regulatory agency having jurisdiction over such pipeline.

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**Southwest Kansas Royalty Owners Association
Statement before the Senate Utilities Committee
Senate Bill No. 686
March 17, 1998**

Dear Senator Ranson and Members of the Senate Utilities Committee:

The members of the Southwest Kansas Royalty Owners Association thank you for the opportunity to offer our support of Senate Bill No. 686.

We believe that it is in the best interest of the industry and consumers that the State of Kansas take an active role in the Kansas ad valorem tax refund process.

To their detriment, Kansas First Sellers relied on Federal Energy Regulatory Commission orders that approved passed-on rates and charges received for reimbursement of ad valorem taxes in connection with the sale of natural gas and now must reimburse unidentified consumers for such rates and charges. Because the refunds are retroactive to 1983 through 1988, it will be next to impossible to identify and locate those eligible end users due a refund.

We support Senate Bill No. 686 because it establishes a fair and equitable process that permits only those consumers due a refund access to their money and removes any impropriety or perceived abuses by any party.

We appreciate your consideration of this important legislation. Thank you again for this opportunity to be heard.

Respectfully submitted,

Erick E. Nordling
Executive Secretary
Southwest Kansas Royalty Owners Association

Senate Utilities
3-17-98
Attach. 4