Approved: 3/3/00
Date

MINUTES OF THE HOUSE TAXATION COMMITTEE.

The meeting was called to order by Chairperson Wagle at 9:00 a.m. on February 22, 2000, in Room 519-S of the Capitol.

All members were present except:

Committee staff present: Chris Courtwright, Legislative Research Department
April Holman, Legislative Research Department
Don Hayward, Revisor of Statutes
Ann Deitcher, Committee Secretary
Edith Beaty, Taxation Secretary

Conferees appearing before the committee: Bob Krehbiel, Ks Independent Oil & Gas Assoc.
Dick Brewster - BP Amoco
Pat Hubbell - ANADARKO
Ron Hein - Pioneer Natural Resources
Ron Gaches - Colorado Interstate Gas
Chuck Dehart -Williams Natural Gas Co.

The Chair announced the formation of a subcommittee to work **HB 2589** consisting of Rep. Edmonds, Chair; Rep. Aurand, Rep. Flora , Rep. Gatewood, Rep. Gregory, Rep. Minor and Rep. Ray.

Representative Kirk introduced a conceptual bill that would provide a severance package similar to the one given to former employees of Topeka State Hospital, for employees of the Division of Services for the Blind and the Kansas Reception and Diagnostic Center

Representative Kirk moved for the adoption of this bill. It was seconded by Representative Campbell and passed on a voice vote.

HB 2823 - relating to property taxation; concerning the valuation of producing gas well.

Bob Krehbiel of Kansas Independent Oil and Gas Association spoke as a proponent of **HB 2823**. (Attachment 1).

Next to speak in favor of **HB 2823** was Dick Brewster, Government Affairs Director of BP Amoco. (Attachments 2 and 3).

Representing ANADARKO was Pat Hubbel who spoke in support of **HB 2823**. (Attachment 4).

Ron Hein, representing Pioneer Natural Resources, appeared as a proponent of **HB 2823.** (Attachment 5).

Representative Minor said he'd heard that some appraisers were concerned about this change and wondered what was there to cause them this concern.

Dick Brewster said he felt that their concern would be taken care of if the additional wording that he'd suggested to **HB 2823** was agreed to.

Chairperson Wagle asked Don Hayward of the Revisor's office to have a look at the language offered in the amendment.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

Appearing as a opponent of **HB 2823** was Ron Gaches, representing Colorado Interstate Gas. (Attachment 6).

Chuck Dehart of Williams Natural Gas Co. spoke to the Committee in opposition of **HB 2823**. (Attachment 7).

Alan Steppat, of the Kansas Legislative Policy Group, an organization of county commissioners from 38 oil and gas producing counties in western Kansas. He said they had some concern regarding the language of **HB 2823** and the effect it had at the local level. (Attachment 8).

The Chair asked Mr. Steppat if he'd had the opportunity to look at the amendment to the bill. He said he had not but would take a copy with him back to his group and they would study it.

Jack Glaves of Panhandle Eastern said he wanted to advise the Committee of his company's offer of a proposed settlement that is pending with the FERC. It would involve a credit of $50 thousand per operator, trying to eliminate the small producers from the problem.

Representative Campbell asked if there would be value of property minus the production of oil. He said it seems like if **HB 2823** goes on they're stating that the only value of property is the production of oil. If this gets put on, what they've bought into is that the value of a piece of property is only worth as much as the production of the mineral.

Mr. Brewster said that if you have a piece of ground and there's an oil well or a gas well on it, you really have two items being assessed in taxes. You have real estate and you have the mineral lease. Absence of production means the mineral lease has no value and should not be taxed and wouldn't be taxed. That's apart from the real estate itself so there would be two different taxing items and they are separated out on the tax statement.

It was decided by the Committee to work **HB 2823** at the next meeting.

The meeting was adjourned at 10:40 a.m. The next meeting is scheduled for Wed., February 23, 2000.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

KANSAS INDEPENDENT OIL & GAS ASSOCIATION
105 S. BROADWAY • SUITE 500 • WICHITA, KANSAS 67202-4262
(316) 263-7297 • FAX (316) 263-3021

BEFORE THE HOUSE COMMITTEE ON TAXATION

STATE OF KANSAS-HOUSE OF REPRESENTATIVES

FEBRUARY 22, 2000

HEARING ON H. B. 2823

TESTIMONY OF ROBERT E. KREHBIEL, EXEC. V.P.

KANSAS INDEPENDENT OIL AND GAS ASSOCIATION

House Taxation
Date 2/22/00
Attachment # 1-1

TESTIMONY

- Thank you very much for the opportunity to appear. Since I have been working on the issue before you today for two years, I have been asked by the crafters of this bill to provide some background information which will, hopefully, make this bill more easily understood. Mr. Dick Brewster will then explain the Bill.

- You should know that HB 2823 is one of two bills which have been introduced this session to attempt to correct at the state level what has been described as "the worst tax atrocity ever perpetrated by a federal agency". This was in reference to the retroactive reversal by the Federal Energy Regulatory Commission of a 1974 Opinion requested by the General Counsel for the Kansas Corporation Commission which was relied on for 19 years by Kansas producers and Kansas royalty owners and which was relied on by the State of Kansas in passing the severance tax in 1983. Today, because of that reversal, an estimated 20,000 Kansas royalty owners have been sued in four separate court actions for sums estimated to total in the range of $60-90million, and thousands of Kansas working interest owners have been threatened with refunds in excess of $340 million.

- This is the most significant issue facing the members of my Association, an Association of small independent producers. Some are threatened with bankruptcy and some will have their operations signifcantly curtailed. The issue has the potential to consume the entire drilling budget for the State of Kansas for several years to come. It will significantly impact the entire state.

- I have worked on a second bill, SB 571, which has been introduced on the Senate side to address this issue and takes a very different approach to resolving this issue. The legislature can decide whether either or both bills should be passed.

- Most of you are familiar with the issue as it came before the legislature in 1998. To refresh your memory I have series of attachements to a historical chronology from which I will speak.. (See Attachment List-AP Articles by Lew Ferguson and Hutch News)

- In 1998 you unanimously passed a Senate Concurrent Resolution 1616 urging Congress to provide relief by passing legislation which had been introduced by the Kansas Congressional Delegation. A copy of SCR 1616 is attached.

- In 1998 the Kansas Legislature also passed H.B 2419, now found at KSA 55-1624, to clarify the statute of limitations to protect royalty owners and determine that their interests were not collectible by federal standards. A copy of KSA 55-1624.

- Our industry owes a debt of gratitude to the Kansas legislature for their complete support, to the Governor for writing to President Clinton urging action(copy attached), and to our entire Congressional Delegation led by the efforts of Senator Pat Roberts and Representative Jerry Moran. (Complete support from Sen Brownback and Reps Tiahrt,

Moore and Ryun)

- Senator Roberts and Senator Brownback succeeded in getting a bill passed the Senate only to face a massive lobbying effort in conference. Their press release dated May 14, 1999, vowing to continue to fight is attached for your information.

- After spending considerable time in Washington, D.C. and testifying before the Energy and Power Committee, I have come to realize that the power politics that play in that arena will most likely prevent this issue from being resolved at the federal level. This is a peculiarly Kansas issue with an estimated $350 million flowing from Kansas producers to the major interstate pipe lines and consuming states such as Wisconsin, Michigan, Ohio and Missouri. They are hungry to take our gas and our money and despite the best efforts of they have succeeded in defeating corrective federal legislation to date. This issue will have to be resolved in Kansas for Kansas.

- The attached pipeline map will show the location of major gas fields in the U.S.

- The Chronology will outline the history of federal regulation of Kansas natural gas production and describe significant events including the historical conflict between producing states and the major northeastern consuming states.

- Background paper attached discussing the private ownership of Land
  Mineral owners-farmers, ranchers, homeowners, churches, universities.
  Oil and Gas Lease
  Royalty interest-1/8th of production free of cost except royalty share of taxes
  Working interest-7/8th of production and all of the cost including 7/8 share of taxes

CHRONOLOGY

1938	Congress passed the Natural Gas Act to provide for the orderly development of interstate pipelines and to regulate their rates and charges as a public utility. The Natural Gas Act stated that "the Act shall not apply to the production or gathering of natural gas".
1954	In *Phillips Petroleum Co. v. Wisconsin*, 347 U.S.672 (1954), the United States Supreme Court ruled that the Natural Gas Act allows the federal government to control the price paid for natural gas at the wellhead if such gas is sold to an interstate pipeline. As a result, the Federal Power Commission (FPC) was forced to regulated thousands of individual producers as if they were public utilities. They could not handle the load on an individual producer basis and instead began to establish area rates by location and date of drilling and costs of production that could be recovered by producers.
1974	In FPC Opinion No. 699, the FPC allowed pipelines to be paid area ceiling rates pursuant to the Natural Gas Act and to recover the cost to producers of "production, severance, or other similar taxes."
1974	In Opinion No. 699-D, the FPC clarified its prior ruling at the request of the State of Kansas and stated that it was proper under Opinion 699 to increase the area ceiling rate to allow producers to recover their costs of the Kansas ad valorem tax.
1978	The Natural Gas Policy Act (NGPA) was passed codifying the FPC's treatment of the Kansas ad valorem tax continuing to allow producers to recover this cost. Section 110 of the NGPA allowed the recovery of production, severance and other similar taxes above the maximum lawful price charged for natural gas at the wellhead. The Joint Explanatory Statement to the Conference Committee Report accompanying the NGPA noted that this cost included any tax imposed upon mineral or natural resource production including an ad valorem tax or gross receipts tax.
1979	The Federal Energy Regulatory Commission (FERC) (successor to the FPC) affirmed the Opinion 699 and 699-D in *Independent Oil and Gas Association of West Virginia*, 7 FERC ¶ 61,094 (1979). This decision was based upon the policy and law prior to the NGPA.
1982	FERC again affirmed its Opinion 699 and 699-D in *Trio Petroleum*, 18 FERC ¶ 61,203 (1982). This decision was based upon the policy and law prior to the NGPA.
1983	The Kansas Legislature, **relying upon Opinion 699-D**, as reflected in the legislative history, passed the severance tax. The Kansas Legislature believed at the time that Kansas producers could recover the cost of the severance tax and the ad valorem tax.

1983	Nine Years after the Opinion 699-D authorized the recovery of the Kansas ad valorem tax, Northern Natural Gas Co. filed an application to FERC to "reopen, reconsider and rescind" Opinion 699-D.
1986	Three years later, FERC rejected Northern's request stating it was **clear beyond question**, that the Kansas ad valorem tax is based, in large part, on gas production," and reaffirmed its policy contained in Opinion 699 and 699-D. This decision was based upon NGPA.
1986	FERC reaffirmed its decision under the NGPA in *Sun Exploration and Production Co.*, 36 FERC ¶ 61,093 (1986).
1987	FERC reaffirmed its decision in Northern Natural Gas Co. and denied Northern Natural Gas Company's request for rehearing. 38 FERC ¶ 61,062 (1987).
1988	Colorado Interstate Gas Co. appealed the Northern decision to the Federal D.C. Circuit which, on June 28, held that FERC had not adequately explained its order and remanded the case to the Commission. *Colorado Interstate Gas Co. v. FERC*, 850 F.2d 769 (D.C. Cir. 1988)
1993	Five years pass before FERC issued an Order on Remand. **FERC reversed Opinion 699-D, thereby overturning 19 years of reliance on an opinion, which FERC previously described as "clear beyond question."** FERC also held the refund obligation resulting from this reversal should be retroactive to June 28, 1988, the date on which the D.C. Circuit remanded the case to the FERC.
1993	Section 110 of the Natural Gas Policy Act, 15 U.S.C. § 3320 repealed. The recovery of the ad valorem tax is not regulated. The recovery of the tax will be controlled by the contract terms between the purchaser and the producer.
1996	Colorado Interstate Gas Co. appealed the date the refund obligation started to the D.C. Circuit. The D.C. Circuit affirmed FERC's decision not to allow the recovery of the ad valorem tax but directed FERC to determine the refund obligation retroactive to October 4, 1983, the date which Northern's petition to re-open Opinion 699-D was published in the Federal Register. *Public Service Company of Colorado v. FERC*, 91 F.3d 1478 (D.C. 1996) (Judge Doug Ginsburg said that the Kansas Ad Valorem Tax which was levied primarily upon the value of recoverable natural gas reserves was not recoverable, but that the Wyoming ad valorem tax which was assessed upon the volume of natural gas removed from a well, and the Colorado ad valorem tax, which was assessed upon volume of natural gas removed from a well, was recoverable. Judge Ginsburg went on to say that "the apparent lack of detrimental reliance on the part of the producers is the crucial point"....and that "reliance (on Opinion 699-D) "would have been foolhardy".

1997 Kansas producers filed a petition for an adjustment under the NGPA requesting an adjustment to their potential liability to pay refunds back to October 4, 1983 and requested a generic waiver of interest on equitable grounds. Kansas producers sought relief under Section 502(c) of the Natural Gas Policy Act.

1997 FERC issued an order on September 10, 1997 denying the request for generic relief and established a procedure for the payment of the refunds. 80 FERC ¶ 61,264 (September 10, 1997). The State of Kansas and the Kansas Corporation Commission filed a petition for reconsideration requesting the opportunity to present evidence to support a generic equitable relief to all producers.

1998 FERC issued an order on January 28, 1998 denying reconsideration on the September 10 Order. 82 FERC ¶ 61,058 January 28, 1998). FERC gave no weight to the interest of the State of Kansas in the economic health of the gas producers in Kansas or the Kansas economy as a whole. FERC refused to consider any equitable claims existing to waive the assessment of interest.

1998 The State of Kansas and the Kansas Corporation Commission filed a petition for review with the 10th Circuit Court of Appeals on March 25, 1998. Other appeals were filed in the 10th Circuit and the Fifth Circuit of Appeals. All appeals of the September 10 and January 28 Orders were transferred to the D.C. Circuit of Appeals. Oral arguments were held before the D.C. Circuit on September 7, 1999.

1998 The Kansas Legislature unanimously passed SCR No. 1616 urging Congress to provide relief to Kansas natural gas producers by enacting legislation initiated by Senator Pat Roberts to eliminate interest on refunds. A massive lobbying effort by interstate pipelines and consuming states killed this legislation after it had passed the U.S. Senate.

1998 The Kansas Legislature unanimously passed H.B. 2419 in an attempt to utilize the statute of limitations to protect Kansas royalty owners from liability resulting from the 17 year retroactive reversal of FERC policy.

1998 Kansas producers petition FERC to waive the ad valorem tax refund liability based upon House Bill 2419 (now codified at K.S.A. 1998 Supp. 55-1624). FERC held that the statute of limitations enacted in House Bill 2419 did not render the royalty owner's share uncollectible and therefore did not justify a waiver of the refund liability. 85 FERC ¶ 61,176 (1998)

1999 The State of Kansas and the Kansas Corporation Commission seek rehearing of FERC's ruling on House Bill 2419. The State of Kansas and the Kansas Corporation Commission argued that FERC misunderstood the effect of the recently enacted Kansas law and that FERC unlawfully attempted to preempt a pre-existing Kansas statute of limitations. FERC

denied rehearing and referred to House Bill 2419 as an "ad hoc" piece of legislation. 86 FERC ¶ 61,163 (1999)

1999 FERC determines that gas purchasers, ANR and El Paso Natural Gas Company, not be required to refund the Kansas ad valorem tax to its consumers but can keep any refunds for their own benefit.

1999 On February 26, 1999, the State of Kansas and the Kansas Corporation Commission filed its second appeal in the Kansas ad valorem tax matters to the 10th Circuit. The 10th Circuit transferred the case to the D.C. Circuit. This appeal resulted in a remand to the FERC and included language that was unintelligible.

2000 The FERC could not understand the language of the D.C. Circuit Court remand and sought clarification from the Court. They did not receive any further intelligible clarification.

ATTACHMENTS

1. Associated Press Article by Lew Ferguson dated September 11, 1997 entitled "Kansas' natural gas producers receive order to refund millions.

2. Associated Press Article published March 6, 1999 in the Hutchinson News entitled "Tax battle rages over royalties.

3. Senate Concurrent Resolution No. 1616, Session of 1998.

4. A copy of K.S.A. 55-1624.

5. Letter dated April 6, 1999, from Governor Bill Graves to President William Clinton expressing concern about FERC ruling.

6. Senator Roberts and Brownback issue press release dated May 14, 1999, after their efforts at the federal level were overcome by greed, unfairness and a high priced lobbying firm.

7. August 26, 1974, request by the General Counsel of the Kansas Corporation Commission for Clarification of Opinion 699 and a Declaratory Order on Petition for Clarification issued October 4, 1974.

8. Extension of Remarks of Representative Dennis Moore dated July 27, 1999, with Letter dated June 18, 1999, from Senator Anthony Hensley to the Honorable John Dingell of Michigan attached. Attached to Senator Hensley's letter is a copy of Opinion 699-D and a copy of the Legislative Research Department's background paper on "Severance and Property Taxes on Oil and Gas" dated February 17, 1981.

9. Southwest Kansas Royalty Owner's Association Newsletter dated February 19, 1999, providing background on H. B. 2419, now found at K.S.A. 55-1624.

10. Southwest Kansas Royalty Owner's Association Newsletter dated August, 1999, discussing four major lawsuits in Kansas and estimating the impact on over 20,000 royalty owners to be in the range of $60-90 million.

11. Background paper on the basics of mineral ownership and the historical conflicts between producing states and the northeastern consuming states.

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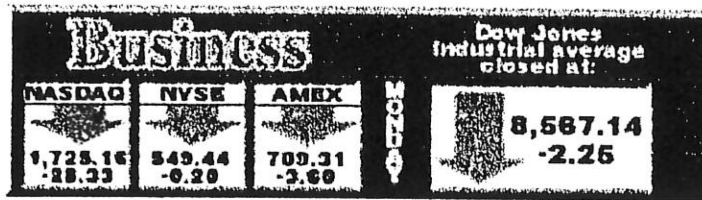

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Thursday, September 11, 1997

Kansas' natural gas producers receive order to refund millions

Last modified at 7:53 a.m. on Thursday, September 11, 1997

By LEW FERGUSON
The Associated Press

Kansas natural gas producers got the bad news on Wednesday: The federal government is ordering them to refund hundreds of millions of dollars to consumers.

The refunds are for property taxes paid on natural gas produced in Kansas during part of the 1980s. The tax costs were added to gas bills and thus passed on to consumers.

The Federal Energy Regulatory Commission said its long-awaited order amounted to a $500 million refund, but Kansas officials and industry spokesmen said the refund could be double that amount, when interest is added.

State officials, who opposed the refunds, also said it will be virtually impossible to identify consumers who should get the refunds. Some predicted the money would go largely to pipeline companies as identity of consumers from a decade ago can't be established.

"It's awfully, awfully disappointing," said former Lt. Gov. Shelby Smith of Wichita, who now represents a gas operator who works for multiple small producers.

"The industry has changed. There is no way they will identify the consumers. I think the pipelines are likely to get a windfall out of this thing. If they can't identify the consumers, they'll just keep it."

David Heinemann, chief attorney for the Kansas Corporation Commission, acknowledged the disappointment in the ruling, but he said he would need to read the FERC order before commenting.

"We will have a role to see that refunds are passed through to customers," Heinemann said.

He agreed with Smith that pipelines "may claim they didn't pass the tax through (to consumers), so the refund is owed to them."

Gov. Bill Graves and the state's entire congressional delegation had urged FERC to waive the refunds, contending it was unfair to order them made when the federal government more than 20 years ago approved the pass-through to consumers of property taxes paid on gas properties.

However, FERC Chairman James Hoecker said the commission's hands were tied by federal court rulings.

The refund was ordered for natural gas produced in Kansas and sold in other states at rates that included state and local property taxes.

The order affects Amoco Production Co., Anadarko Petroleum Corp., Mobil Oil Corp., OXY USA Inc., Union Pacific Resources Co. and hundreds of small producers in Kansas.

FERC ruled property taxes weren't eligible for inclusion in the lawful price for gas under the Natural Gas Policy Act of 1979.

The Federal Power Commission, the predecessor agency to FERC, held in 1973 that Kansas' property taxes were the same as severance taxes, which were eligible for the pass-through to consumers.

Wednesday's draft order, which becomes final after a period for accepting motions to reconsider or rehear the case, requires the producers to begin making the refunds within 180 days.

There are two conditions: They can make them over a five-year period, and FERC will consider waiving the refund requirement in hardship cases, on a case-by-case basis.

Hardships include producers now out of business, or operating on such a small margin that making the refund would put them out of business.

The refunds must be made to pipelines on gas produced between Oct. 4, 1983, and June 28, 1988 -- a 41/2-year period.

"Those refunds, in turn, will be flowed through to their their customers who paid the unlawful rates," said a FERC statement announcing the ruling.

"However, the commission recognized the potential burden on producers, and to assist in alleviating that burden has allowed for limited waiver of principal upon the property showing of hardship.

"In addition, under the same provisions, the commission will entertain requests to spread the payments over a period of up to five years."

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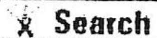

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1-10

file name: refund reports
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12/2/97

KANSAS AD VALOREM

REFUND REPORTS

LINE NO	INTERSTATE PIPELINES	PRINCIPAL REFUND IN MILLIONS	INTEREST REFUND IN MILLIONS	TOTAL REFUND IN MILLIONS
1	WILLIAMS NATURAL GAS	$45.7	$72.4	$118.1
2	KN INTERSTATE TRANSMISSION CO	$12.1	$18.8	$30.9
3	NORTHERN NATURAL GAS	$30.1	$50.2	$80.3
4	PAN HANDLE EASTERN	$20.0	$33.6	$53.6
5	COLORADO INTERSTATE GAS CO (1)	$13.3	$21.6	$34.9
6	EL PASO NATURAL GAS	$1.6	$2.0	$3.6
7	NATURAL GAS PIPELINE CO OF AMERICA	$0.08	$0.16	$0.2
8	ANR PIPELINE COMPANY (1)	$0.4	$0.8	$1.2
9	ANADARKO (2)	$5.4	$9.7	$15.1
10	**TOTAL**	**$128.7**	**$209.3**	**$337.9**

(1) Colorado Interstate and ANR are subsidiaries of the Coastal Corporation

(2) Anadarko is successor in interest to Cimarron River System, which is successor in interest to Centana Energy Corp.

1-11

The Hutchinson News
Hutchinson, KS

A4 Saturday, March 6, 1999

Tax battle rages over royalties

Feds enrage Southwest producers of natural gas with policy reversal

The Associated Press

TOPEKA – State Sen. Steve Morris calls it the worst taxation "atrocity" ever perpetrated by a federal agency.

BILL GRAVES

Gov. Bill Graves is worked up enough about it that he is writing to President Clinton, seeking his intervention.

Kansas Sen. Pat Roberts calls it "unjust, retroactive and punitive."

The object of this dismay: rulings by the Federal Energy Regulatory Commission and a federal court that Kansas natural gas producers and royalty owners cannot pass property taxes on to consumers as they did for two decades from the 1970s to the 1990s.

PAT ROBERTS

They decided producers and royalty owners owe refunds – plus interest – to gas consumers for a five-year period in the 1980s.

"This is the worst thing I've ever heard of any federal agency doing," Morris said. "It equates to the Internal Revenue Service suddenly saying you can't deduct home mortgage interest from your tax return, making it retroactive and telling you you've got to pay back taxes you owe because you deducted it when it was legal."

SAM BROWNBACK

A December 1993 ruling by FERC reversed a 1974 decision by its predecessor agency, the Federal Power Commission, allowing the pass-through, and it made the reversal retroactive to 1988.

In 1996, the federal circuit court for the District of Columbia set the retroactivity date back to 1983.

The old Federal Power Commission ruled a quarter-century ago that property taxes paid on gas property in Kansas were the equivalent of severance taxes, which could be passed on to customers as they are in Oklahoma, Texas and other states with oil and gas reserves.

JERRY MORAN

Reversal of that 1974 decision made Kansas producers and royalty owners liable for refunds to consumers, plus interest, of an estimated $500 million. Between $80 million and $100 million of that is believed owed by some 50,000 royalty owners.

Morris, a Republican state senator from Hugoton, in the heart of Kansas' largest gas field, said there are stories of royalty owners getting demands from pipeline companies to repay as much as $200,000.

In addition to allowing the pipeline companies to collect the pass-through taxes from royalty owners, FERC added salt to the wound by refusing to listen to Kansans' complaints and by ignoring a state law passed in 1998.

That law sought to forgive the property taxes collected between 1983 and 1988 on the grounds that the statute of limitations had run out and the money was uncollectable.

Morris and a delegation from the Southwest Kansas Royalty Owners Association met late last month in Washington with Graves, Roberts, Sen. Sam Brownback and U.S. Rep. Jerry Moran, whose western Kansas district includes the Hugoton Gas Field, once the largest known reserve of natural gas in the world.

The purpose of the meeting was to come up with strategies for getting some relief for small producers and royalty owners upon whom the burden of the refunds will fall most heavily.

Not only did none of the FERC commissioners attend, but the agency would not send a staff member to the meeting, Morris said.

"FERC would only agree to respond to written questions that they choose to answer," Morris said.

The court did provide for royalty owners to seek hardship waivers if they cannot pay the refunds and interest, but so far, FERC hasn't said how many have been granted, if any, Morris said.

If the refund and interest rulings stick, he said, many royalty owners will see no royalty payments for a decade or more because the pipeline companies have FERC permission to deduct what they owe from the payments they make to the royalty owners.

"Many of these are small royalty owners who depend on it for their livelihood, as a supplement to Social Security," Morris said.

Doug Smith of the royalty owners association said three-quarters of its 2,500 members are 60 or older.

Morris said Roberts and Brownback are contemplating federal legislation that would eliminate the obligation of small producers and royalty owners to pay back the pass-through taxes.

Senate Concurrent Resolution No. 1616

By Committee on Utilities

2-4

9 A CONCURRENT RESOLUTION urging the Congress to enact legis-
10 lation providing relief from the order of the Federal Energy Regulatory
11 Commission requiring Kansas natural gas producers to pay penalties
12 and interest on certain refunds to customers.
13
14 WHEREAS, Since 1974, the Federal Energy Regulatory Commission
15 (FERC) and its predecessor, the Federal Power Commission, had al-
16 lowed natural gas producers in Kansas to include the cost of state property
17 taxes in their rates; and
18 WHEREAS, In 1983 a petition challenging the inclusion of the costs
19 of property taxes in rates was filed with FERC and FERC affirmed its
20 prior rulings allowing recovery of those costs; and
21 WHEREAS, In 1993, after the D.C. Circuit Court ordered FERC to
22 review its rulings, FERC reversed itself and ordered the payment of re-
23 funds retroactive to the year 1988; and
24 WHEREAS, Kansas producers paid the refunds ordered, including
25 interest, but in 1996 the D.C. Circuit Court reversed the FERC decision
26 and required instead payment of refunds, including interest, back to 1983,
27 the time of filing of the initial petition in the case; and
28 WHEREAS, The retroactive reversal of a practice that had been legal
29 for 19 years places an unjust and punitive financial burden, possibly ex-
30 ceeding $500 million, on the Kansas natural gas industry; and
31 WHEREAS, The ordered refunds threaten serious financial harm not
32 only to the Kansas natural gas industry but to the state and local econo-
33 mies and governmental budgets that rely on the industry's economic base:
34 Now, therefore,
35 *Be it resolved by the Senate of the State of Kansas, the House of Rep-*
36 *resentatives concurring therein:* That the Kansas Legislature urges the
37 Congress to enact S. 1388 and H.R. 2903, providing relief from penalties
38 and interest that FERC has ordered Kansas natural gas producers to pay
39 on refunds for property tax costs included in natural gas rates, retroactive
40 to 1983; and
41 *Be it further resolved:* That the Secretary of State be directed to send
42 enrolled copies of this resolution to each member of the Kansas Con-
43 gressional Delegation, to the chairperson of the United States Senate

1 Committee on Energy and Natural Resources and to the chairperson of
2 the United States House of Representatives Committee on Commerce.

55-1624. FERC-ordered refunds of tax reimbursements; recovery. (a) As used in this act, royalty interest owners include overriding royalty interest owners and royalty interests include overriding royalty interests.

(b) On and after the effective date of this act, no first seller of natural gas shall maintain any action against royalty interest owners to obtain refunds of reimbursements for *ad valorem* taxes attributable to royalty interests, ordered by the federal energy regulatory commission.

(c) It is hereby declared that under Kansas law:

(1) The period of limitation of time for commencing civil actions to recover such refunds attributable to reimbursements of *ad valorem* taxes on royalty interests during the years 1983 through 1988 has expired and such refunds claimed to be owed by royalty interest owners are uncollectible;

(2) first sellers of natural gas are prohibited from utilizing billing adjustments or other set-offs as a means of recovering from royalty owners any such claimed refunds; and

(3) first sellers of natural gas took every opportunity to protect their rights involving Kansas *ad valorem* tax reimbursements attributable to royalty interest owners.

(d) Upon entry of a final order by a court having jurisdiction, or a final order of a governmental authority having jurisdiction, that requires first sellers to make refunds of reimbursements for *ad valorem* taxes on royalty interests during the years 1983 through 1988 notwithstanding this section or if this section is determined to be unconstitutional, in whole or in part, nothing in this section shall be construed to have affected the rights and remedies available to any party under the laws of the state of Kansas, including those applicable in any action that a first seller of natural gas may bring against a royalty interest owner to obtain such a refund.

History: L. 1998, ch. 122, § 7; Apr. 30.

Article 17.—TASK FORCE ON GAS GATHERING

55-1701.

Revisor's Note:

The text of this section has been omitted since it expired on July 1, 1997. For text hereof, see L. 1996, ch. 147, § 2.

STATE OF KANSAS

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OFFICE OF THE GOVERNOR

April 26, 1999

President William Clinton
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

Dear President Clinton:

I am writing to express my concern about the ramifications of a 1997 Federal Energy Regulatory Commission (FERC) ruling against Kansas natural gas producers that can only be described as patently unfair. In short, FERC allowed Kansas natural gas producers to pass through the Kansas ad valorem tax to consumers for nearly 20 years. Then in 1993, FERC decided that the Kansas ad valorem tax was not eligible for recovery under the Natural Gas Act after all. Natural gas producers exhausted their appeals when the United States Supreme Court refused to hear the case in mid-1997.

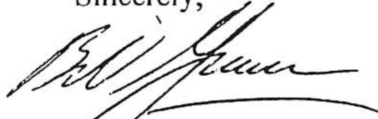
FERC has ordered Kansas natural gas producers to repay ad valorem taxes that were passed through to consumers between 1983-1988, as well as penalties and interest. We estimate this will cost Kansas producers and royalty owners nearly $400 million, two-thirds of which are penalties and interest. I believe regulated entities are entitled to rely on final Commissions decisions. Further, as Governor of Kansas, I find it very difficult to accept the proposition that those who invested in the exploration for and development of the natural resources of our state, for the benefit of citizens of Kansas and other states, would find themselves penalized because the form of taxation was different in Kansas. I have urged the FERC to waive interest on the refund, but to no avail.

The largest natural gas field in North America and the second largest in the world is located in southwest Kansas. Economically, this gas field is Kansas' most important natural resource. In 1997, it generated approximately 692 million Mcf of natural gas valued at more than $1.5 billion. In the face of soft natural gas prices over the past year, we estimate that the Kansas economy has lost $46 million in earnings and 3,380 jobs. The FERC ruling adds to this already declining situation and will have devastating impacts on Kansas producers, royalty owners and the state as a whole.

Royalty owners are also impacted by this unfair FERC ruling. Elderly Kansans, widows and out-of-state decedents are receiving letters from FERC and pipeline companies demanding payment. In fact, some pipeline companies have stated they will withhold amounts due from current royalty payments. In most cases, these are people on fixed incomes, their royalty payment is decreasing because of falling prices and they have no idea what has transpired at the FERC.

As a former Governor I am confident you appreciate the unfairness of this situation in which Kansas producers relied on federal agency rulings only to be told nearly two decades later that the agency was wrong and they must pay penalties and interest for the agency's mistake. Any assistance you could provide to remedy this extremely unfair situation is appreciated.

Sincerely,



BILL GRAVES
Governor

BG:jca

United States Senate

WASHINGTON, DC 20510

TO: Tom Doggett
2 pgs.

CONTACT: Betsy Holahan (Roberts) 202-224-4774
Erik Hotmire (Brownback) 202-224-6521

FOR IMMEDIATE RELEASE
May 14, 1999

Senators Roberts and Brownback to Request GAO Study on Energy Agency

Senators Vow to Continue to Fight for Kansas Gas Producers

WASHINGTON, DC — U.S. Senators Pat Roberts and Sam Brownback today pledged to continue fighting for Kansas natural gas producers and royalty owners hit with a $340 million bill when a government agency went back on its word.

The two senators said they will seek a General Accounting Office (GAO) study of how any refund money is collected and distributed.

"This is a matter of fairness and justice for the Kansas gas industry," Senator Roberts said. "We will explore all alternatives to correct this injustice."

Conferees on major budget legislation Wednesday dropped from the bill an amendment by Senators Roberts and Sam Brownback that would have granted partial relief to the Kansas producers and royalty owners.

Senator Roberts said this action "is the result of misinformation spread by a high-priced Washington lobby firm paid by those who hope to line their own pockets at the expense of Kansas. Simply put, greed overcame fairness."

During the era of price controls two decades ago, Kansas producers were told by the Federal Regulatory Energy Commission (FERC) that they could pass through the cost of a state tax. The Kansas producers relied on this and subsequent FERC rulings for more than 18 years, only to be told in 1993 that the government had changed its mind.

1-17

Worse, the federal government told Kansas producers they would have to pay back the value of the tax, plus interest accrued over nearly two decades. The bill for interest alone was about $200 million. The Roberts-Brownback bill would have forgiven the interest.

"The bottom line here is fairness. Americans should be able to count on the word of a government agency. They should not be penalized for following the rules," Brownback said. "There have been a small number of cases like this in recent years and each time Congress has granted relief."

The FERC flip-flop has created chaos in oil and gas circles and threatens to bankrupt many independent producers. In addition, royalty owners and their heirs are being harassed by FERC for payment of the interest and penalties.

Senator Roberts said there are numerous examples of elderly individuals on Social Security being harassed by FERC collectors. "Some Kansas hospitals are being solicited by firms who will — for high fees — try to get a share of the $340 million," he added.

The senators said there are serious questions about who stands to benefit from any collection of the money. "It will be extremely difficult to send these payments back to original consumers after all these years," Senator Roberts said. "There is the real possibility that some private and public individuals and organizations intend to line their own pockets at the expense of those who were literally duped by their government. That explains the expensive lobby effort against our amendment."

The senators warned that some producers and royalty owners are in no financial shape to pay thousands of dollars the government says they owe.

"Individuals, private firms and states like Missouri and Colorado may think they have just won the lottery, but they shouldn't count their chickens yet. Remember, the money has not been collected."

-30-

Frank Gilman -
Bob Perdue -
Rm 8100 -

UNITED STATES OF AMERICA

FEDERAL POWER COMMISSION

Just and Reasonable National Rates for Future Sales of Natural Gas From Wells Commenced On Or After January 1, 1973.	))))	Docket No. R-389-B

REQUEST FOR LETTER OF CLARIFICATION IN REGARD TO OPINION NO. 699

JAMES E. WELLS
GENERAL COUNSEL

Richard W. Niederhauser
Assistant General Counsel

Attorneys for

State Corporation Commission
of the State of Kansas
Fourth Floor
State Office Building
Topeka, Kansas 66612

Dated: August 26, 1974.

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

RATES-INDEPENDENT PRODUCER

Before Commissioners: John N. Nassikas, Chairman;
Albert B. Brooke, Jr., Rush Moody, Jr.,
William L. Springer, and Don S. Smith.

Just And Reasonable National Rates For Sales Of Natural Gas From Wells Commenced On Or After January 1, 1973, And New Dedications Of Natural Gas To Interstate Commerce On Or After January 1, 1973)	Docket No. R-389-B

Opinion No. 699-D

DECLARATORY ORDER ON PETITION FOR CLARIFICATION

(Issued October 9, 1974)

The State Corporation Commission of the State of Kansas (Kansas) on August 29, 1974, filed a request for clarification of Opinion No. 699 concerning the right of producers making jurisdictional sales in Kansas covered by that opinion to adjust upward the national rate prescribed therein by the amount of the Kansas *ad valorem* tax.

Opinion No. 699 provides in Ordering Paragraph A(3) (mimeo p. 141) that the national rate established there "shall be adjusted upward for all State or Federal production, severance, or similar taxes * * *". The question presented is whether the Kansas *ad valorem* tax is a similar tax within the meaning of the above provision. A number of other states also have an *ad valorem* tax, and our determination here will not be limited to the Kansas *ad valorem* tax, but will apply to *ad valorem* taxes in general.

CONTINUED ON BACK

As Kansas points out, the bulk of the Kansas *ad valorem* tax is based upon production factors, and, as such, is in fact, a severance or production tax merely bearing the title "ad valorem tax". The *ad valorem* tax in some other states is also similar to a production or severance tax inasmuch as it is based on the amount of production and the revenues therefrom. Consequently, we conclude that it is proper under Opinion No. 699 for producers to adjust the national rate upward for a state *ad valorem* tax where such tax is based on production factors.

The Commission orders:

Under Ordering Paragraph (A) (3) of Opinion No. 699, mimeo p. 141, if a state *ad valorem* tax is based on production factors it shall be deemed to be included as a "similar tax" as that phrase is used therein, and the producer may adjust the national rate upward for such tax.

By the Commission.

(S E A L)

Kenneth F. Plumb,
Secretary.

FEDERAL POWER COMMISSION
WASHINGTON, D. C. 20426
EQUAL OPPORTUNITY EMPLOYER

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1-21

CO[illegible]E ON BANKING AND
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AND PAPERWORK REDUCTION
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Congress of the United States
House of Representatives

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MIAMI COUNTY
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EXTENSION OF REMARKS
REPRESENTATIVE DENNIS MOORE [KS – 03]
JULY 27, 1999

RELIEF FROM INTEREST AND PENALTIES ON FERC REFUNDS

Mr. Speaker, on July 29, the House Commerce Subcommittee on Energy and Power has scheduled a hearing on H.R. 1117, legislation introduced by my colleague from Kansas, Jerry Moran, and cosponsored by the entire Kansas House delegation.

This legislation would provide relief from unfair interest and penalties on refunds retroactively ordered by the Federal Energy Regulatory Commission. For two decades, FERC allowed gas producers to obtain reimbursement for payment of the Kansas ad valorem tax on natural gas. In a series of orders, FERC repeatedly reaffirmed the rights of gas producers to collect the ad valorem tax, rebuking various challenges to this practice. In 1993, however, FERC reversed 19 years of precedent and ruled that the ad valorem tax had not been eligible for reimbursement. FERC has since ordered all producers operating during a five-year period in the 1980s to refund both principal and interest associated with the reimbursement of the ad valorem tax.

With this legislation hopefully headed toward consideration by the full House of Representatives, I am taking this opportunity to place in the Record a letter recently sent by Kansas Senate Democratic Leader Anthony Hensley to House Commerce Committee Ranking Democrat John Dingell, concerning the legislative history of ad valorem and severance taxes in Kansas. This background will be very helpful to our colleagues as they review this issue in the weeks ahead.

1-23

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State of Kansas

Senate Chamber

ANTHONY HENSLEY
STATE SENATOR, NINETEENTH DISTRICT
SHAWNEE, DOUGLAS & OSAGE COUNTIES

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Office of Democratic Leader

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LEGIS. POST AUDIT
STATE FINANCE COUNCIL
UTILITIES
WORKERS COMPENSATION FUND OVERSIGHT

June 18, 1999

Honorable John D. Dingell
U.S. House of Representatives
Committee on Commerce
Room 2125-Rayburn House Office Building
Washington, DC 20516-6115

Re: Kansas Ad Valorem Tax refund detrimental reliance on federal law

Dear Congressman Dingell:

On June 8, 1999, the House Energy and Power Subcommittee held a hearing on the Kansas Ad Valorem Tax refund issue. This issue is extremely important to the State of Kansas and one of our most important industries, the production of oil and gas. As a 23-year veteran of the Kansas Legislature and as the Minority Leader of the Kansas Senate, I am writing to request your support of Congressman Jerry Moran's legislation to alleviate what I believe is a serious miscarriage of justice.

I was a member of the Kansas Legislature in 1983 when Governor John Carlin promoted and obtained passage of a severance tax on oil and gas. Prior to 1983, Kansas did not have a severance tax, only an ad valorem tax. At that time, the ad valorem tax took approximately 3.1% of the value of production and was revenue used by counties and local school districts. Oklahoma and Texas, on the other hand, had severance taxes in place for many years equal to 7.085% to 7.5% of the value of gas production. Wyoming had in place a 4% severance tax on oil and gas "in addition to" a 6.5% property tax on oil and gas for a total tax burden of 10.5%. Likewise, Colorado had a severance tax on gas ranging from 2%-5% "in addition to" a 5.4% property tax, for a total tax burden of 7.4% to 10.4%.

As you know, federal law allowed purchasers to add all of these taxes on to the Federal Power Commission's (FPC) maximum lawful price when purchasing gas. In Wyoming and Colorado, both a severance tax and a property tax were permitted to be added to the maximum lawful price. Texas had both a severance tax and a property tax, however, because of the way its property tax was structured, it was allowed to add on only the 7.5% severance tax to the FPC maximum lawful price. The Kansas Attorney General requested clarification from the FPC to determine whether Kansas' ad valorem tax could lawfully be added to the FPC maximum lawful price. In 1974, Opinion 699-D clarified this issue and did allow the Kansas ad valorem tax as a lawful addition to the price.

In 1981, the State of Kansas needed additional funding for education, roads and infrastructure, and Governor Carlin began studying the potential for a severance tax. One of our state's most valuable natural resources was being depleted and consumed out of state, pipelines were strewn across Kansas, drilling equipment was taking its toll on Kansas roads and infrastructure, and little benefit was being derived by Kansas government. The price of gas at the wellhead, sold in interstate commerce, was being controlled by the federal government at prices far below fair market value, resulting in the transfer of enormous wealth from Kansas to out of state consumers. Texas, Oklahoma, Colorado, Wyoming and other states were collecting taxes on oil and gas at over twice the Kansas tax rate.

Governor Carlin proposed a severance tax which, when added to the existing ad valorem tax, would be comparable to the taxes on oil and gas production collected in other producing states. The legislature studied various severance tax proposals for three years. Oil and gas severance and property tax in neighboring states were studied carefully. A comparative chart used by the Senate Tax Committee in passing the severance tax is enclosed with the attached Memo of Severance and Property Taxes prepared by the Kansas Legislative Research Department during the 1981 severance tax debate.

One of the issues raised during legislative debate was whether both a severance tax and an ad valorem tax on gas could be added to the maximum lawful price of gas as established by the Federal Energy Regulatory Commission (FERC). We were advised that this was allowed in Wyoming, Colorado and other producing states, and that FPC Opinion 699-D allowed the pass through of the Kansas ad valorem tax. This Opinion had been specifically requested by the Kansas Attorney General and the Kansas Legislature relied on Opinion 699-D without further question.

Finally, in 1983, the KansasLegislature passed a severance tax "in addition to" the existing ad valorem tax. A credit against the severance tax for ad valorem taxes paid was added to the bill resulting in a 7% severance tax on gas and a 4.33% tax on oil. Clearly, tax policy for our state was based on the Legislature's reliance on FPC Opinion 699-D. Were it not for our reliance on Opinion 699-D, the severance tax would not have passed without amending our state's ad valorem tax to conform to federal requirements for pass through of both the severance and ad valorem taxes as was done in Wyoming and Colorado.

When Kansas passed the severance tax in 1983, Northern Natural Gas Company asked the FERC to reconsider its Opinion 699-D to prohibit Kansas producers from passing through both a severance tax and a property tax. They were denied twice by the FERC. In 1988, Colorado Interstate Gas Company appealed the FERC decision to the Washington, D.C., Circuit Court of Appeals. I am sure you are familiar with the whole scenario that has followed. Nineteen years after Opinion 699-D was issued, the FERC, with incentive from the Washington, D.C., Court in the Colorado Interstate Case, reversed itself. Later the court would require retroactive refunds to 1983 based on notice of hearings published in the federal register. Now, because the Kansas Legislature relied on Opinion 699-D to pass a severance tax without adjusting the methodology by which the Kansas ad valorem wax was calculated, many Kansas independent oil and gas producers are devastated.

What could the Kansas Legislature have d. er to determine the reliability of Opinion 699-D? Should we have asked for a second ruling on the same issue? Would that have allowed Kansas to rely on the Opinion? Would three, four or five opinions have allowed Kansas to rely on the ruling? Was there someone the State could have sued to get final determination that we could rely on before we passed the severance tax? How can a state ever rely on a federal regulatory ruling if a court can in the future retroactively change the law and require innocent victims who complied with the law to refund large sums of money with interest?

Certainly Kansas producers have done their part to pro consumers with an abundant supply of clean, cheap fuel. But why are consumers up in arms? In 1998, the price of natural gas paid to producers at the wellhead in Kansas averaged less than $1.96 per mcf. The price of natural has at the residential burner tip, however, averaged $6.82 in the U.S.A., with prices ranging from less than $5 to over $12 per mcf from time to time. Since FERC Order 636 passed, the price of natural gas paid to producers at the well head has gone down while the price of natural gas paid by residential consumers has gone up. The middlemen's share of the residential consumer's dollar has increased from 59% to 73% while the producer's share has decreased from 41% to 27%. Both producers and consumers are losers in this environment while the giant interstate pipelines and local distribution companies have seen profits rise dramatically.

Now, I understand, the primary beneficiaries of deregulation - the interstate pipelines and local distribution companies - are before the En and Power Subcommittee the name of consumer protection. How much of the refund will ultimat ach the consumer is unde ned at this time, but I am advised that any residential consumer likely wi ve no more than $15 over a period of time. However, the total of these de minimis refunds, and what is not passed through to the consumer, equals the estimated drilling and exploration budget for all of Kansas for the next three and one-half years.

As Democrats, we need to stand up for what is right and fair in America. Consumer protection is an enormously powerful political force but honest, hardworking producers deserve no less. Kansas producers were perhaps the only innocent parties in this entire scenario, caught between consuming states whose people believe they have a right to cheap fuel, and the governments of producing states who believe they have a right to tax oil and gas producers into oblivion.

This is not a consumer protection issue. I do not believe that consumers in Kansas, Missouri, Colorado, Michigan or any other state will benefit in any way from this restorative reversal of law by the Federal Energy Regulatory Commission. A minuscule refund to a long lost consumer cannot offset the losses which will result from the destruction of honest, hardworking, productive citizens. Exploration in Kansas is almost totally dependent on small independent operators who provide an invaluable resource to consumers across this country. The destruction of this vital Kansas industry is not in anyone's best interest. I strongly urge you to support Congressman Moran's legislation to eliminate this serious injustice.

Sincerely,

Anthony Hensley
Kansas Senate Minority Leader

cc: Congressman Jerry Moran
Congressman Dennis Moore

On Or After January 1, 1973, And New Dedications Of Natural Gas To Interstate Commerce On Or After January 1, 1973)

Opinion No. 699-D

DECLARATORY ORDER ON PETITION FOR CLARIFICATION

(Issued October 9, 1974)

Syllabus

If a state *ad valorem* tax is based on production factors it shall be deemed to be a "similar tax" as that phrase is used in Opinion No. 699, Ordering Paragraph (A)(3). P. 5-514

Before Commissioners: John N. Nassikas, Chairman; Albert B. Brooke, Jr., Rush Moody, Jr., William L. Springer, and Don S. Smith.

The State Corporation Commission of the State of Kansas (Kansas) on August 29, 1974, filed a request for clarification of Opinion No. 699 concerning the right of producers making jurisdictional sales in Kansas covered by that opinion to adjust upward the national rate prescribed therein by the amount of the Kansas ad valorem tax.

Opinion No. 699 provides in Ordering Paragraph A(3) (mimeo p. 141) that the national rate established there "shall be adjusted upward for all State or Federal production, severance, or similar taxes * * *". The question presented is whether the Kansas ad valorem tax is a similar tax within the meaning of the above provision. A number of other states also have an ad valorem tax, and our determination here will not be limited to the Kansas ad valorem tax, but will apply to ad valorem taxes in general.

As Kansas points out, the bulk of the Kansas ad valorem tax is based upon production factors, and, as such, is in fact, a severance or production tax merely bearing the title "ad valorem tax". The ad valorem tax in some other states is also similar to a production or severance tax inasmuch as it is based on the amount of production and the revenues therefrom. Consequently, we conclude that it is proper under Opinion No. 699 for producers to adjust the national rate upward for a state ad valorem tax where such tax is based on production factors.

1-26

Kansas Legislative Research Department

February 17, 1981
Revised March 18, 1981

SEVERANCE AND PROPERTY TAXES ON OIL AND GAS

Background

This memorandum presents an overview of the severance taxes and property taxes levied on oil and gas properties in the major producing states and the states surrounding Kansas. A summary of the severance tax rates and property taxes in such states is contained in Table 1.

Severance Taxes. A severance tax is a tax imposed on the production, or the "severing," of a mineral from the earth. The production of the mineral may be measured either by the value or the volume of the mineral produced. Among states basing a severance tax on the value of production, some tax the gross value of production, while others tax a net value figure, allowing deductions for expenses such as transportation costs, federal or state royalties, losses from evaporation or uneconomic production, and disposal of useless byproducts such as salt water. The rate of severance taxes based on value may be a fixed percentage of value or may be graduated to apply lower rates to low-income or low-production wells.

The rationale usually presented for imposing a severance tax is that the state should be compensated for the irretrievable loss of a nonrenewable resource and for the cost to the state's residents resulting from the development of that resource. States which have imposed severance taxes have used those tax receipts for various purposes, including school finance, property tax relief, highway finance, creation of trust funds, and distribution to local governmental units.

A severance tax may be either "in lieu of" or "in addition to" property taxes on oil or gas properties. An "in lieu of" severance tax exempts oil and gas properties from the general property tax.

Property Taxes. Taxes on real and personal property have traditionally been a major source of funding for the activities carried on by state and local governments. Applying a property tax to oil and gas properties typically involves determining the value of minerals in the ground and the value of the production equipment. States imposing property taxes have usually chosen one of three methods to value the minerals: value of production; formula valuation; or token assessment.

Annual production assessment applies the property tax levy to the value of production, which might be either gross or net value.

Formula valuation attempts to value reserves by estimating the average life of a well, rate of discount, and the estimated value of future production.

Token assessment would apply the property tax to a minimal amount of value, either per acre of lease or per well.

National Summary

Severance taxes on oil and gas have been enacted in 27 states, including states such as Kansas which have enacted relatively minor severance taxes based on the volume of production for regulatory, rather than revenue, purposes. Seventeen of those 27 states have enacted "significant" severance taxes — a tax at the rate of 2 percent or more of value. Six of the 17 states with significant severance taxes impose their tax in lieu of the property tax.

Kansas

Oil and gas leaseholds, including royalty interests and equipment used in production, are assessed as tangible personal property in Kansas. Guides for assessing oil and gas properties have been prescribed by the Director of Property Valuation, Department of Revenue, for use by county appraisers. After appraised values are determined, the properties are assessed at 30 percent of such values and are subject to the total general property tax rate according to the situs of the property.

According to Table 3, prepared by the Department of Revenue, Division of Property Valuation, oil and gas properties paid almost $95 million in property taxes in 1980, up from $60.5 million in 1979.

According to the Kansas Geological Survey, oil and gas production in Kansas for the last two years was as follows:

		1979		1980	
	Unit	Quantity	Value $(1,000)	Quantity	Value $(1,000)
Oil	1,000 barrels	56,995	$1,245,015	60,140	$2,049,581
Gas	million cubic feet (m.m.c.f.)	804,535	548,693	772,998	643,134
Natural Gas Liquids	1,000 barrels	33,888	292,791	34,000	352,512
			$2,086,499		$3,045,227

Thus, using the above oil and gas property tax figures, property taxes statewide averaged 3.1 percent of value and 2.9 percent of value in 1980 and 1979, respectively. Of course, the ratio of property taxes to value varies from lease to lease and county to county.

The biggest factor in the increase in property taxes between 1979 and 1980 was the increase in the price of oil. The calculation of the value of the gross reserves of oil is the most important step in valuing the oil lease. This value is calculated by multiplying the total annualized production for the previous year times a net price figure times a present worth factor. In the 1979 Oil and Gas Appraisal Guide, the highest price of stripper oil was $16.10; in 1980, this same oil sold for approximately $38, and the net price figure used in the 1980 Guide was $31.56. These price figures reflect actual selling prices of oil and the world-wide increases in prices. The 1981 net price figures are not yet available.

Equipment values shown in the 1980 Guide were also higher than those in the 1979 Guide. This increase was due to the fact that the equipment values had not been updated for several years and reflected the increase in the value of equipment that has accompanied the increase in the price of oil. The number of years of income considered was raised from five to eight years; this also raised the valuation of the property.

Several changes reflected in the 1980 Guide would have had the effect of lowering values. These changes were raising the discount factor and changing the low production credit. The discount factor reflects the present value of money to be received at a specified time in the future. The low production credit is a reduction for wells with very low production levels.

Changes in the 1981 Guide include accounting for differences in production quality and expenses between eastern and western Kansas wells. One such difference is that the 1981 Guide will consider a 5 year income for the shallow eastern Kansas wells, while an 8 year income will be used for the deeper western Kansas wells.

In addition to the property tax, oil and gas producers, like other businesses, also pay sales and income taxes. Oil and gas producers also pay taxes or fees for anti-pollution and conservation activities of the state. The oil and gas production tax, for pollution control, is levied at the rate of \$.001 per barrel for each barrel of oil and \$.00005 for each one thousand cubic feet of gas produced. The conservation assessment is \$.003 per barrel of oil and \$.0008 for each one thousand cubic feet of gas.

The Federal Energy Regulatory Commission has ruled that the Kansas property tax is essentially based on production and has allowed this tax to be "passed-on" to consumers. More than one production tax on natural gas (the only type of energy production whose price is still controlled) may be passed on. Both the property tax and the two regulatory taxes in Kansas are currently being passed on. Other states and the F.E.R.C. have also reported that natural gas producers are able to pass-on more than one production tax, as long as intrastate and interstate sales of natural gas are taxed equally.

A severance tax, if enacted in Kansas, would have an impact on oil and gas property tax appraisals by lowering net prices figures used in the Guide. The Guide uses the price actually paid to the producer on January 1 of the assessment year less state and federal wellhead taxes levied on value or volumes produced, and less applicable transportation charges. Thus, the federal Crude Oil Windfall Profit Tax (WPT) was deducted from the sales price of oil. (Appended to this memorandum is a summary of the Windfall Profit Tax.) An 8 percent severance tax could lower the net price figure per barrel for oil from \$31.70 to \$29.16, as follows:

$38.00 current sales price - 1 barrel of oil
-17.00 base price for WPT
21.00 windfall profit for WPT
x 30% WPT rate for independents on stripper oil
6.30 WPT liability

$38.00 current sales price - 1 barrel of oil
-6.30 WPT liability
$31.70 net price with WPT

$21.00 windfall profit for WPT
-1.68 WPT severance tax adjustment (8%)
19.32 net windfall profit
x 30% WPT rate for independents on stripper oil
5.80 WPT liability

$38.00 current sales price - 1 barrel of oil
x 8% severance tax
$ 3.04 severance tax liability

$ 5.80 WPT liability
+3.04 severance tax liability
$ 8.84 WPT and severance tax liability

$38.00 current sales price - 1 barrel of oil
-8.84 WPT and severance tax liability
$29.16 net price with WPT and 8% severance tax

The Legislat ve Research Department is not yet able to estimate the effect of a severance tax on property tax appraisals. A reduction in the net price figures does not necessarily mean that assessed valuations of oil and gas properties will fall — but it does at least mean that such valuations would not be as high as they otherwise might be if no severance tax were enacted. Decontrol of all oil prices, and rising prices for oil and gas are some factors that could lead to increases on oil and gas valuations, even if a severance tax were enacted.

At least two opinions of former Kansas Attorneys General have stated that either an "in addition to" or "in lieu of" severance tax could be constitutionally enacted in Kansas. Article 11, Section 1, of the Kansas Constitution specifically authorizes the legislature to classify "mineral products" for purposes of taxation. In an opinion dated September 13, 1954, the Attorney General concluded:

> ". . . it is our opinion that a gross production or severance tax would probably be constitutional if levied to the exclusion of property taxes or if levied in addition to property taxes on mineral products. We do not believe that a provision exempting the equipment and other property used in production would be constitutional."

The above opinion was confirmed in another opinion, dated June 5, 1969:

"We have studied the (1954) opinion and agree with his conclusion stated therein. We are unable to find any recent case which would alter that conclusion. However, we would again emphasize that a severance tax act could not exempt the equipment and other property used in the production of oil and gas from ad valorem taxes."

A 1 percent severance tax on oil and gas production was enacted on the last day of the 1957 Session. This tax was an "in addition to" severance tax. During the first six months after enactment, over $2 million was collected. This tax was held to be invalid by the Kansas Supreme Court, however, in the case State, ex. rel. v. Kirchner, 182 Kan. 437 (1958). The Court held that the bill enacting the tax was unconstitutional because the subject of the act was not clearly expressed in its title.

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OIL AND GAS SEVERANCE AND PROPERTY TAXES IN MAJOR PRODUCING AND NEIGHBORING STATES

	Severance Taxes (not including regulatory taxes)				
State	Oil Severance Tax Rate	Severance Tax In Lieu of Property Tax	Exemptions or Lower Rates	Other Minerals Taxed	1980 Property Tax as Estimated Percentage of Value of Production
Alaska	12.25%	No	No	Gas-10%	NA
California	—	No	No	—	3.8% (includes equipment)
Colorado	2%-5%	No	Yes[1]	Gas-2%-5%; Coal-60 cents per ton, indexed to price; oil shale-4%; metallic minerals	5.4% (percentage does not include tax on equipment)
KANSAS	—	—	—	—	3.1% (includes equipment)
Louisiana	12.5%	Yes	Yes[2]	Gas-7 cents per m.c.f.; coal-10 cents per ton; gravel; marble; ores; salt; sand; shells; stone; sulphur; timber	—
Mississippi	6.0%	Yes	No	Gas-6%; salt	—
Nebraska	2%	No	No	Gas-2%	NA
New Mexico	3.75% plus privilege tax of 2.55%	No	Yes[3]	Gas-11.1 cents per m.c.f. (includes surtax tied to C.P.I) plus privilege tax of 2.55% of value; Coal-$.57 per ton plus surtax tied to C.P.I.; Uranium; other minerals	1.6% (includes equipment)
North Dakota	5% plus 6.5% oil extraction tax	Yes	Yes[4]	Gas-5%; coal-85 cents per ton; indexed for inflation	—
Oklahoma	7.085%	Yes	No[5]	Gas-7.085%; asphalt; lead; zinc; jack; gold; silver; or other ores	—
South Dakota	4.5%	No[6]	No	Gas-4.5%; coal-4.5%	NA
Texas	4.6%	No	No	Gas-7.5%; sulphur; cement	2.0% (percentage does not include tax on equipment)
Wyoming	4.0%	No	Yes[7]	Gas-4%; Coal-10.5%; Uranium; Trona; Oil shale-2%	6.5% (percentage does not include tax on equipment)

SOURCE: State Tax Guide, Commerce Clearing House, and conversations with state officials.

1) Tax on oil and gas is based on "gross income," defined as market value at wellhead or the value of the severer's income as computed for Colorado and federal income tax depletion purposes, whichever is higher.

Gross Income	Rate of Tax
Under $25,000	2%
$25,000 and under $100,000	3%
$100,000 and under $300,000	4%
$300,000 and over	5%

Stripper oil wells (less than 10 barrels per day) are exempt. A credit is allowed for 87.5 percent of all property taxes paid during the tax year, excluding property taxes upon equipment and facilities.

2) Oil: Wells incapable of producing more than 25 barrels of oil per day which also produce at least 50 percent salt water per day, 6¼ percent; wells incapable of producing more than 10 barrels of oil per day, 3 1/8 percent; natural gas liquids, 10 percent; gas at 15.025 pounds per square inch pressure, 7 cents per m.c.f.; gas from oil well at 50 pounds per square inch pressure; 3 cents; gas from well incapable of producing average of 250,000 cubic feet per day, 1.3 cents. Working interest owners in an oil or gas well that discover a new field are exempt from 50 percent of all severance taxes for the first 24-months, up to a certain amount.

3) A severance tax credit is allowed if a contract entered into by producer prior to 1-1-77 or a federal regulation does not allow the producer to obtain reimbursement from the purchaser for all or part of the increased severance tax (rates were revised July 1, 1980). When computing the value of oil for the severance tax or the value of oil and gas for the privilege tax, a deduction is allowed for royalties paid to the United States, the state of New Mexico or any Indian or Indian tribe, as well as for the reasonable expense of trucking any product to market.

4) Oil: stripper oil and a limited amount of royalty interest oil is exempt from the oil extraction tax.

5) Former lower rates on low-producing oil or gas wells were repealed in 1980.

6) Mineral reserves are not subject to property tax. No personal property is taxed in South Dakota, so only oil and gas equipment forming a part of realty is subject to the property tax.

7) Oil: stripper oil taxed at 2 percent rate.

TABLE 2

SUMMARY OF PROPERTY TAXES IN STATES LISTED IN TABLE 1

California. Valuing oil and gas properties in California has been reported to be the "biggest problem under Proposition 13." State uses a formula valuation procedure, using 1975 values, plus 2 percent increase per year. Property tax treatment of oil and gas is currently under legislative study.

Colorado. Oil and gas assessed at 87.5 percent of the value of production; stripper at 75 percent of value. Mill levy is then applied to assessed value, averaging 62 mills in the highest producing counties. Equipment is assessed at 30 percent of 1973 market value, with the use of a state appraisal guide.

KANSAS. Uses formula valuation for appraisal, assessed at 30 percent, then mill levy applied to assessed value.

Nebraska. Uses same basic appraisal technique as Kansas.

New Mexico. Has an ad valorem production and an ad valorem equipment tax.

South Dakota. Oil and gas reserves are not taxed. No personal property is taxed. Therefore, the property tax on oil and gas applies only to equipment forming a part of the realty.

Texas. Property currently appraised by each taxing unit. In 1982 appraisal will be done by one countywide appraisal using a standard appraisal guide. Reserves valued on formula valuation method. Equipment valued separately as personal property.

Wyoming. Property tax on reserves is calculated by applying mill levy to full market value of production. Equipment above ground is valued at 25 percent of its 1967 replacement cost; in 1982 the base year for equipment values may be 1981 replacement cost.

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February 19, 1999

SWKROA EXECUTIVE SUMMARY ON AD VALOREM TAX REFUND ISSUE FROM A ROYALTY OWNER'S PERSPECTIVE

Background - House Bill 2419

The controversial ad valorem tax refund issue continues to be a high priority concern for our members. As reported in earlier issues of the SWKROA newsletter, the 1998 Kansas legislature passed important legislation, House Bill 2419, which was an acknowledgment by the Kansas lawmakers that the statute of limitations governing the recovery of ad valorem taxes on royalty interests during the years from 1983 through 1988 had expired, and that any claim for refunds to be owed by royalty interest owners were uncollectible. Governor Graves signed this bill into law at a ceremonial signing on April 20, 1998 at the 50th Annual meeting of the Association, and became effective April 30, 1998.

Such legislation was specifically targeted at the September 10, 1997 Federal Energy Regulatory Commission which ordered first sellers of natural gas to make refunds of reimbursement for Kansas ad valorem taxes paid from 1983 to 1988, including reimbursements attributable to royalty interest owners. The legislation declared that ".... no first seller of natural gas shall maintain any action against royalty interest owners to obtain refunds of reimbursements for ad valorem taxes attributable to royalty interest (including overriding royalty interests), or by the Federal Energy Regulatory Commission(on September 10, 1997)."

Further, the legislation declared that under Kansas law that: "The period of limitation of time for commencing civil actions to recover such refunds attributable to reimbursements of ad valorem taxes on royalty interests during the years 1983 through 1988 has expired and such refunds claimed to be owed by royalty interest owners are uncollectible;" and that "first sellers of natural gas are prohibited from utilizing billing adjustments or other set-offs as a means of recovering from royalty owners any such claimed refunds..."

FERC action on House Bill 2419

Wichita attorney, Ralph R. Brock, who represents several independent gas producers and who has been active on this issue, recently opined the position of the gas producers in an article declared that, "FERC has no jurisdiction over the royalty owners to order them to refund tax reimbursements because they did not sell the gas. They are not first sellers who violated MLPs (the maximum lawful prices under federal pricing schemes) The only exception would be if they took their gas in kind and then sold it. Since the sales are made by the working interest owner, he is liable for the refund of the working interest gas sold by him, including the royalty attributable to his working interest. However, by receiving tax reimbursements which have to be refunded, the royalty interest owner has been overpaid on his royalty and the working interest owner has a claim against him to recover the overpayment when the working interest owner makes the refund."

On May 19, 1998, in order to determine whether FERC would honor this legislation by finding that it renders recovery of royalty refunds uncollectible from the royalty owners and thereby grant a waiver of those refunds, a number of producers filed a Motion in all of the pipeline dockets for a waiver of their royalty interest refunds or alternatively for a generic waiver as to all refunds attributable to royalty interests. Public Service Company of Colorado, et al., Dockets Nos. RP97-369, et al. This Motion attracted numerous interventions, answers, and comments, both in support and opposition. The Motion was vigorously opposed by the pipeline and gas distribution companies.

On November 2, 1998 FERC denied the Motion. On the question of whether the Commission should waive the royalty owner amount of the refund obligation on a generic basis, on the basis of the statute of limitations provision of the newly enacted Kansas legislation, the Commission found that, "the recent Kansas legislation does not justify waiver of the producer's obligation to refund the royalty owner's share of the refund." The Commission stated that the purpose of Kansas House Bill 2419 appears to have been to trigger the Commission's Wylee (Wylee Petroleum Corp., 33 F.E.R.C. (CCH) 61,014 (1985)) standard for finding the refunds attributable to the royalty owner to be uncollectible, thereby leading the Commission to waive the producer's obligation to refund those amounts to their customers.

The Order of Denial concluded that "This order only addresses the issue of whether Kansas House Bill No. 2419 justifies waiver of ad

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valorem tax refunds. The Commission recognizes that there may be other Kansas statutes of limitation, such as the general contract statute of limitation in K.S.A. § 60-511, which might satisfy the Wylee uncollectibility statutes of limitation in this order, since they have not been raised by the parties."

A request for rehearing was filed. Kansas State Senator Stephen R. Morris, Hugoton, who introduced the original bill (Senate Bill 685) which eventually became House Bill 2419, was very concerned by FERC's decision. In a sworn declaration before FERC on the rehearing, he stated that,

> "Based on my discussions with my senate colleagues on the Ways and Means Committee, our intent in introducing SB 685 was to simplify, clarify and codify existing Kansas law, so that the public would have full knowledge that the five-year statute of limitations on bringing actions on contractual matters set forth in K.S.A. 60-511 applies to oil and gas refund matters. Thus, it would specifically apply to first sellers' attempts to collect ad valorem tax reimbursements from royalty owners, regarding ad valorem taxes paid from 1983 to 1988. SB 685 was not intended to create a new and different statute of limitations, and SB 685 does not do so. I also explained this need for SB 685 at a hearing held on the bill before the Senate Energy and Natural Resources Committee on March 23, 1998. Based upon my discussions with my senate colleagues on the Energy and Natural Resources Committee after receiving testimony, both written and oral, the committee also believed that the existing five-year statute of limitations in K.S.A. 60-511 prohibits first sellers from bringing an action against royalty owners for all claims that are greater than five years old. I and my colleagues were concerned that royalty owners may not be aware of the relevant statute of limitations...A conference committee report on HB 2419 was adopted by the Senate on April 2, 1998 by a vote of 38 yeas and 0 nays, and by the House of Representatives on April 8, 1998 by a vote of 120 yeas and 0 nays. The governor signed the bill on April 20, 1998.
>
> "The purpose of simplifying, clarifying and codifying the existing five-year statute of limitations on actions in contractual matters, so that it specifically applies to first sellers' attempts to collect ad valorem tax

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> reimbursements from royalty owners, was to prevent unnecessary litigation on such matters. Litigation by each royalty owner over claims which are barred by the statute of limitations would needlessly expend substantial resources of Kansas citizens and courts."

However, in spite of the clear indication of the intent of the legislation, on February 16, 1999, FERC denied rehearing on its November 2, 1998 opinion regarding the Kansas statute. FERC stated that, "nowhere in the motion (for rehearing) was there any reference to K.S.A. 60-511." Further, in discussing the statute of limitations arguments FERC opined that, "for example, there is the question of when the producers' cause of action arose against the royalty owner which commenced the running of the statute of limitations' five year period. Since the refunds cover payments in the 1983-1988 period, payments to the royalty owners undoubtedly took place more than five years ago, and royalty interest owners could assert that K.S.A. 60-511 bars any recovery from them. However, if the cause of action for recovery from the royalty owner were deemed to have arisen only when the Court issued the 1996 ruling that the add-on was illegal back to 1983, K.S.A. 60-511 would not bar recovery. <u>These issues are for a court to determine.</u>" (Emphasis ours)

FERC seems to have clearly ignored the spirit and intent of House Bill 2419 by declaring that when the Commission adopted the Wylee standard for uncollectibility it did not contemplate a specifically created, ad hoc statute of limitations such as Kansas House Bill 2419, crafted to apply to a specific situation.

<u>Aftermath of FERC decisions</u>

<u>The "breakdown " of the process at the FERC level</u>. Association General Counsel, <u>Gregory J. Stucky</u>, summarizes the impact of the FERC decision. On or about March 9, 1998, producers had to pay over money attributable to unlawful ad valorem tax payments, including sums attributable to their royalty owners, to the pipeline companies or place the money into escrow if there was a dispute about the amount of money due pipeline companies from producers. Although the escrow procedures were intended only to be used when amounts actually were in controversy, many, if not most, producers, both large and small, used the escrow "loophole" to pay virtually all the money which the pipeline companies claimed they owed into escrow, because the producers wanted to preserve every possible defense. The FERC now has before it a multitude of issues from a multitude of producers that it must deal with in

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connection with the escrowed money. With only a couple of staff members working on the project, it could take months, if not years, to resolve all the disputes.

The only deadline which the producers are working against at the moment is March 9, 1999, the date that producers have to notify the FERC of any amounts that are not collectible from royalty owners. Brock believes that date may not be a "drop dead" date, if the producer can show some justifiable excuse for missing that date.

The Secretary's office has had numerous calls and letters from members regarding demands which they have received from their producers for payment of the ad valorem refund. Several members have even received demands for payment directly from FERC.

Some companies are threatening to deduct the ad valorem tax from a royalty owner's current production payments, while some other companies have already set off against royalty payments to recoup the tax refund. These actions are of great concern to our members and your Board of Directors.

SWKROA Position

FERC itself created the problem by first determining that the Kansas ad valorem taxes could be passed through to pipeline companies, and then later changing its mind, thus creating the problem that royalty owners presently face.

This appears not to be a struggle between royalty owners and the ultimate consumers of the gas, because in many instances pipelines, not their consumers, have been determined by FERC to be entitled to the proceeds by virtue of settlements previously approved by FERC in connection with take-or-pay disputes, which release language now has the unintended result of letting pipelines keep the money.

There is also concern that if a producer sets off from current royalty that it will impact the income tax for the royalty owner. The company would likely include the recouped amount within the gross royalty, which means that you would be paying income tax on amounts you did not receive.

Most of the money at issue is interest, which has been accruing at rates that royalty owners could not make from their own investments. Although waiting will only mean that interest will continue to accrue, and with each day, the amount that producers

may claim against royalty owners may grow, our members should not voluntarily pay amounts attributable to those refunds.

As stated in previous SWKROA newsletters, it is and has always been the Association's position that FERC does not have jurisdiction over the royalty owner under federal law. Further, Kansas law would govern the statute of limitations applicable to the FERC ad valorem tax refund issue. As stated above, Kansas lawmakers specifically addressed and declared, in House Bill 2419, the issue that the statute of limitation had already expired and the ad valorem tax refund is uncollectible due to the expiration of the statute of limitations.

Members should not volunteer to pay the refund, or allow the refund to be taken from current royalty payments without a decision by a Kansas Court which addresses whether such refund is due by a Kansas royalty owner, including determination of the applicable statute of limitation, and the right of the producer to set off such tax refund from royalty. Such royalty owner should also advise his or her gas producer if they would fall within one of the other defenses available under Wylee mentioned above. The Association continues to advise members to consult with their attorneys on this important issue.

Litigation likely to be necessary to resolve issues.

SWKROA officials have been actively pursuing all means to forestall, reduce or eliminate the potential impact on Kansas royalty owners on the ad valorem tax refund issue. The concerns raised in previous editions of the SWKROA newsletters have caused the industry to be cautious about taking self help actions against royalty owners. SWKROA actively worked with gas producers, in a cooperative spirit, and with the Kansas Legislature on the passage of House Bill 2419.

Many of the gas producers have been sympathetic to the plight of the royalty owners, and have been active in seeking generic relief from FERC to relieve them from the burden of collecting the ad valorem tax refund from royalty owners. Obviously, these efforts if successful would also directly benefit royalty owners by relieving royalty owners from paying the ad valorem tax refund.

Nevertheless, because of the FERC decisions, both the producers and the royalty owners are forced to looking to the Courts to resolve the issues, including the statute of limitations and the rights of the producers to use self help by setting off the ad valorem tax

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refund against current royalties. These options are seriously being considered by Association officials.

SWKROA goes to Washington, D.C.

On Monday, February 22nd, Senator Pat Roberts, Kansas, has graciously agreed to host a meeting with SWKROA officials at his office to discuss the ad valorem tax refund issues. Also attending the meeting will be Representative Jerry Moran, Kansas, Kansas Governor Bill Graves, and State Senator Stephen R. Morris, Hugoton. Representatives from the Kansas Corporation Commission (KCC) also plan to attend the meeting. Those planning to attend on behalf of SWKROA are: Phil Dick, President; John Crump, Vice-President; Erick Nordling, Executive Secretary; and our lobbyist Doug Smith, of Pinegar-Smith, Topeka. FERC officials have been invited to attend, but at press time have not committed to attend.

On Thursday, February 25th, Senator Pat Roberts will host another meeting requested by Anadarko Petroleum Corporation to discuss a legislative initiative designed to implement waiver of interest and uncollectibility of amounts of Kansas ad valorem taxes paid on behalf of royalty owners. Representatives from SWKROA and KIOGA have been invited to attend. Executive Secretary Nordling will attend on behalf of SWKROA.

One of the problems for a Congressional solution is the perception that the issue only effects Kansans, even though there are probably more nonresident Kansas royalty owners than there are resident royalty owners.

Erick E. Nordling
Executive Secretary

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SWKROA

SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION

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We apologize for the delay in getting this newsletter to you but have waited to report the latest developments on the Kansas ad valorem tax refund issue.

LAWSUITS FILED BY PRODUCERS AGAINST ROYALTY OWNERS SEEKING KANSAS AD VALOREM TAX REFUND

Within the past few days, lawsuits have been filed by three major Kansas producers against their royalty owners claiming refund for Kansas ad valorem taxes paid on behalf of the royalty owners by the producers from 1983 to 1988. These lawsuits bring to a head the controversial ad valorem tax refund issue which has been pending for months and which has been the subject matter of numerous SWKROA newsletters during that period of time. A brief summary of each of the three suits follows:

Plains vs. First National Bank in Lamar

On July 28, 1999, Plains Petroleum Company filed a class action in the District Court of Kearny County, Kansas, in Case No. 99C13, entitled, PLAINS PETROLEUM COMPANY and PLAINS PETROLEUM OPERATING COMPANY, Plaintiffs vs. FIRST NATIONAL BANK IN LAMAR, Successor Trustee of the Carl B. Campbell Living Trust; BRADNER A. TATE; ALBERT A. THORNBROUGH; KANSAS MASONIC HOME, a Kansas corporation; H. E. L. TOOMBS; THOMAS JANES; MORGAN EXUM PRICE; BANK ONE TEXAS, N.A., Trustee of the Hugh Exum Price Trust; THE LANDOWNERS OIL ASSOCIATION, a Delaware corporation; and OLIVIA F. RAMSAY & COMPANY, a Colorado general partnership; Against Themselves and All Others Similarly Situated, Individually and As Class Representatives, Defendants.

Plains brings this class action to recover from named Defendants and members of the class overpayments of royalties and overriding royalties based on Kansas ad valorem tax payments reimbursed by Plains' gas purchasers from October 1, 1984, through December 31, 1986. The proposed class includes all persons who received, directly or indirectly, royalty overpayments from Plains during the relevant period pursuant to natural gas leases and third party agreements entered into with Plains. There are approximately 800 members in the class.

In its petition, Plains alleges it has refunded in excess of 4.25 million dollars to its gas purchasers, plus interest on the principal amount of reimbursement as ordered by FERC, and has placed in an interest-bearing escrow account the sum of approximately 1.2 million dollars, all refunds, plus interest, attributable to the royalty interest of defendants and members of the class, as permitted by FERC orders.

The amount of recoupment sought by Plains against each of the named defendants ranges from $2,219.20 to $20,901.20, exclusive of interest. (Secretary's Comment: The amount of interest assessed could double the principal amount claimed to be due and owing. For example, the interest on the principal amount of $20,901.20 claimed to be owing by one of the named defendants could be $40,000.00 or more, for a total refund obligation of over $60,000.00!)

Amoco vs. Youngren, et al.

A second petition seeking reimbursement of Kansas ad valorem taxes paid on behalf of royalty owners was filed by Amoco Production Company in the District Court of Stevens County, Kansas on August 2, 1999, in Case No. 99C41, entitled, AMOCO PRODUCTION COMPANY, Plaintiff, vs. VINCENT YOUNGREN, Jr., and ROBERT LARRABEE, individually and as representatives of persons or concerns similarly situated, Defendants.

Amoco brings this action against defendants, Vincent Youngren, Jr., and Robert Larrabee, individually and as representative parties on behalf of members of the class described as follows: "Persons or concerns situated similarly to defendants, as owners of mineral interests in lands burdened by oil and gas leases owned in whole or in part by Amoco Production Company, gas production from which was sold by Amoco to Williams Natural Gas Company under the terms of the 1950 contract.

The petition does not state the number of class members but it is estimated that royalty owners affected by the suit could total well over 5,000.

OXY vs. Littell, et al.

The third class action was filed by OXY USA, Inc. on August 2, 1999, in the District Court of Stevens County, Kansas, in Case No. 99C42, entitled, OXY USA, Inc., Plaintiff, vs. OPAL LITTELL, individually, BONNIE BEELMAN, individually, GILBERT H. COULTER, individually, ELIZABETH S. LEIGHNOR, individually, and OPAL LITTELL and CHERRY RIDER, Co-Trustees of the Opal Littell Family Trust, and as representative defendants on behalf of persons or concerns similarly situated, Defendants.

The defendant class consists of "all persons or entities who own, or during the relevant time period, owned royalty interests under oil and gas leases to OXY and who received royalty payments, directly or indirectly, from OXY on or in connection with natural gas produced from wells located in the Kansas Hugoton Field in the State of Kansas which payments were made in the form of either (a) royalties paid on proceeds from ad valorem tax reimbursements, or

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(b) pa… ts to the proper taxing authorities by OXY, on the behalf of the royalty owners, with the ad valorem taxes levied by the State of Kansas against the royalty owners during the relevant period."

OXY brings this class action to recover from class members overpayments of royalties in connection with natural gas produced and sold by OXY from wells located in the Kansas Hugoton Field. OXY claims it made the overpayments based on Kansas ad valorem tax payments that were reimbursed by OXY's gas purchasers from October 4, 1983, through December 31, 1987 (the "relevant period").

The petition alleges that class members number between 14,000 and 15,000, and that during the relevant period OXY owned an interest in approximately 1,500 natural gas wells in the Kansas Hugoton Field.

The petition further alleges that as required by FERC's orders, OXY has refunded in excess of $12,000,000 to its gas purchasers, plus interest on the principal amount of reimbursement as ordered by FERC. In addition, OXY claims it has placed in an interest bearing escrow account, as permitted by FERC orders all refunds and FERC prescribed interest therein attributable to the royalty interest, including approximately six million dollars attributable to class members. OXY alleges this amount will be held in escrow while it attempts to recover a like amount from its royalty owners as required by FERC.

Additional Allegations by Plaintiff Producers

The petitions of both Plains and OXY are very similar and recite that during the relevant period referred to in each petition, the price paid for natural gas by their customers consisted of two components: (a) the maximum lawful price for the gas as established by federal law; and (b) an add-on to the maximum lawful price to reimburse the producer for Kansas ad valorem taxes levied against the producer and its royalty owners. Royalties were then paid on the same basis.

Each separate petition of Plains, Amoco and OXY alleges in substance that as a result of federal court decisions and orders issued by the Federal Energy Regulatory Commission (FERC), producers were ordered to refund that portion of natural gas prices paid in excess of the maximum lawful price attributable to the Kansas ad valorem tax reimbursements, plus interest, during the relevant period as defined in each petition, including that portion of the reimbursement attributable to the royalty interest owners.

Each of the producer plaintiffs in their respective petitions makes reference to K.S.A. 1998 Supp. 55-1624 (HB 2419 passed by the 1998 Kansas legislature). HB 2419 provided that the statute of limitations governing the recovery of the ad valorem taxes on royalty interests from 1983 through 1988 had expired, and that any claim for refunds to be owed by royalty owners was uncollectible.

Both Plains and OXY allege that K.S.A. 1998 Supp. 55-1624 does not bar the plaintiff from setting off or recouping the overpayments, plus interest, against current and future royalty payments that would otherwise be owed to class members. It is also alleged that if the court determines that this statute bars the plaintiff from taking such action, there should be a determination whether such Kansas law is constitutional. On the other hand, Amoco alleges that K.S.A. 1998 Supp. 55-1624 is invalid, illegal and unconstitutional.

Three Counts Included in Each Petition

Each petition contains three counts. In Plains' petition, Count One is an action for unjust enrichment; Count Two seeks a declaration that the action and Plains' right of set-off is not barred any general statute of limitations; and Count Three seeks a declaration that the action and Plains' right of set-off are not barred by K.S.A. 1998 Supp. 55-1624, but if the court determines that the statute bars Plains from such right to set-off or recoup its overpayments, Plains seeks a declaration that K.S.A. 1998 Supp. 55-1624 violates the Kansas and United States constitutions. The counts in OXY's petition are almost identical.

The counts in Amoco's petition are the same except it seeks a declaratory judgment that K.S.A. 1998 Supp. 55-1624 is invalid, illegal, unconstitutional and ineffective to prevent Amoco from exercising its right to collect either through judicial action or non-judicial action ad valorem tax reimbursements paid to the defendants for the years of 1983 through 1988, together with interest, as ordered by FERC.

Coulter vs. Anadarko

The Kansas ad valorem tax refund issue is also pending in a fourth case originally filed on October 7, 1998, in the District Court of Stevens County, Kansas, in Case No. 98-CV-40, entitled, GILBERT H. COULTER and ELIZABETH S. LEIGHNOR, individually and as representative plaintiffs on behalf of persons or companies similarly situated, Plaintiffs, vs. ANADARKO PETROLEUM CORPORATION, Defendant.

This class action was brought by royalty owners who claim, among other things, that Anadarko has failed to properly and fully account for royalty payments due to members of plaintiff class in accordance with the express and implied covenants of the leases by wrongfully allocating production costs and the cost of placing gas in a marketable condition ("marketing costs") so as to reduce such royalty payments to which member of plaintiff class are entitled or by unilaterally selecting an improper lower price on which royalty payments are calculated.

After the suit was filed, Anadarko gave notice of removal and the case was removed to the United States District Court in Wichita, and is now pending there in Case No. 98-1413-WEB. Anadarko has filed an Answer and Counterclaims. In its Answer and Counterclaims, Anadarko has raised the Kansas ad valorem tax refund issue and alleges that it is entitled to recoup from its royalty owners from future royalties on the basis of unjust enrichment.

Anadarko claims that the defendant class has been unjustly enriched in an amount exceeding 3.6 million dollars. Plaintiffs have replied to the counterclaim, stating as a defense that Anadarko's counterclaim is barred by the applicable statute of limitations, including K.S.A. 1998 Supp. 55-1624 and K.S.A. 60-5011, 512, and 513, under the doctrine of latches or under other such principles of law or equity.

State of Kansas Allowed to Intervene in Anadarko Case

On July 9, 1999, the State of Kansas, by and through Attorney General Carla J. Stovall, filed an Unopposed Motion to Intervene in Coulter vs. Anadarko, and the Federal District Court allowed such intervention on July 26, 1999.

The requested intervention of the State of Kansas is for the specific and limited purpose of moving for certification of questions of law to the Kansas Supreme Court concerning the

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applicability and effect of the Kansas statutes of limitation in question.

In its motion to intervene, the State recites that FERC's order requiring refund of the Kansas ad valorem tax brings into issue the recovery of refunds of an estimated 395 million dollars from Kansas producers and royalty owners. The State further recites that the Plaintiff royalty owners are relying on the Kansas statutes, and the Kansas Attorney General has the constitutional and statutory responsibility for enforcement of its laws. The issue of the validity of K.S.A. 1998 Supp. 55-1624 (HB 2419), has been raised and no judicial determination has been made by any Kansas court to determine the applicability and effect of the statutes of limitation in question.

Plaintiff royalty owners have filed a motion to remand the case to the District Court of Stevens County, Kansas, and the Court has granted Anadarko's motion for additional time within which to respond to the motion.

Many SWKROA Members Affected by Litigation

Obviously, with the filings by Amoco, Anadarko, OXY, and Plains raising the Kansas ad valorem tax refund issue, many of our members are affected by the litigation and have a stake in its outcome. Mobil is the single largest major Hugoton producer not presently involved. It is estimated that substantially more than half of the affected Kansas Hugoton production is covered by these lawsuits. The estimated impact to royalty owners on the Kansas ad valorem tax issue, if collectible, is between 60-90 million dollars. Taken on an individual basis, any potential refund obligation could possibly represent several months or even a year or longer of current royalty payments.

A special SWKROA Board of Directors meeting has been called for this Thursday, August 19, 1999, to determine the steps needed for the Association to take to assist its members affected by this litigation. It is anticipated your SWKROA Board will take appropriate action to protect its members and will need your financial support more than ever. A solicitation letter will follow.

LEGISLATION PENDING BEFORE CONGRESS FOR AD VALOREM TAX RELIEF

Earlier this year, Senators PAT ROBERTS and SAM BROWNBACK introduced Senate Bill No. 626 providing relief from unfair interest and penalties on refunds retroactively ordered by the Federal Energy Regulatory Commission. A similar bill, House Bill 1117, was introduced on the House side of Congress by Representative JERRY MORAN, R-Kansas supported by Kansas Representatives DENNIS MOORE, JIM RYUN and TODD TIHART.

Senators PAT ROBERTS and SAM BROWNBACK were successful in amending the appropriations bill to include a repeal of some 200 million dollars in interest and penalties levied against Kansas gas producers by FERC. However, the interstate gas pipeline companies, through their lobbyists, were equally successful in having the amendment removed. In order to gain public support necessary to defeat the amendment, the pipelines argued that the refunds were to go to the consumers even though several of the pipeline companies involved have petitioned FERC to keep the money.

House Bill 1117

Hopefully, HB 1117 will not have a similar demise. Representative JERRY MORAN secured a hearing on this issue before the House Commerce Sub-committee on Energy and Power. The first hearing was held on June 8, 1999, in Washington D.C. JOHN MAJERONI of Ithaca, New York, Director of Cornell University's Real Estate Department graciously agreed to testify on behalf of the Southwest Kansas Royalty Owners Association and on behalf of Cornell University. Cornell is a member of SWKROA.

Majeroni, a West Point graduate who has been managing Cornell's oil and gas properties for 18 years, did an outstanding job and was well received by the Sub-committee. He eloquently addressed the concerns of royalty owners about the unfair and unjust impact of the FERC decision to retroactively rule that producers of natural gas should not have been allowed to pass the Kansas ad valorem taxes through the pipeline companies to the consumers.

In his summary page, Majeroni urged that royalty owners should be granted relief from paying refunds and interest on taxes dating back to 1983-1988 for the following reasons:

1. It is unfair to punish them for flip-flops in decision making at FERC.
2. Royalty owners had no control over any decisions relating to the issue and continue to have no control.
3. Royalty owners were already in a less-than-equitable position financially.
4. The interest charged on the amount due is punitive.
5. Those who benefitted will not be the same as those who are being punished, and collection will be uneven and equitable.
6. The ruling creates a situation where there are no real winners, but plenty of real losers.
7. FERC's jurisdiction does not include royalty owners and the ruling improperly impacts them.
8. FERC has ignored statute of limitations considerations.

Majeroni's testimony was very effective. He and Cornell represented royalty owners from the East. This pointed out to the Sub-committee members that not only Kansas royalty owners but royalty owners throughout the nation were adversely affected by FERC's retroactive order for the Kansas ad valorem tax refund.

Also testifying in support of the bill were Rep. JERRY MORAN, Kansas Attorney General CARLA STOVALL who testified on behalf of the State of Kansas, and ROBERT KREHBIEL who testified on behalf of Kansas Independent Oil and Gas Association (KIOGA). SWKROA Executive Secretary Erick E. Nordling was present at the hearing and later filed a written statement on behalf of the Association at a subsequent hearing held on July 29, 1999.

SWKROA Members Urged to Contact Representative on Sub-Committee

The following Representatives are members of the House Sub-committee on Energy and Power: Hon. JOE BARTON, R-Texas, Chairman; Republicans: Hon. MICHAEL BILLRAKIS, Florida; Hon. CLIFF STEARNS, Florida; Hon. STEVE LARGENT,

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Okla...a; Hon. RICHARD BURR, North Carolina; Hon. ED WHITFIELD, Kentucky; Hon. CHARLIE NORWOOD, Georgia; Hon. TOM COBURN, Oklahoma; Hon. JAMES E. ROGAN, California; Hon. JOHN SHIMKUS, Illinois; Hon. HEATHER WILSON, New Mexico; Hon. JOHN B. SHADEGG, Arizona; Hon. CHARLES W. "Chip" PICKERING, Mississippi; Hon. VITO FOSSELLA, New York; Hon. ED BRYANT, Tennessee; Hon. ROBERT L. ENRICH, JR., Maryland; Hon. TOM BLILEY, Virginia; and

Democrats: Hon. RALPH M. HALL, Texas, Ranking Democrat; Hon. KAREN McCARTHY, Missouri; Hon. THOMAS C. SAWYER, Ohio; Hon. RICK BOUCHER, Virginia; Hon. FRANK PALLONE, JR., New Jersey; Hon. EDWARD J. MARKEY, Massachusetts; Hon. SHERROD BROWN, Ohio; Hon. BART GORDON, Tennessee; Hon. BOBBY L. RUSH, Illinois; Hon. ALBERT R. WYNN, Maryland; Hon. TED STRICKLAND, Ohio; Hon. PETER DEUTSCH, Florida; Hon. RON KLINK, Pennsylvania; and Hon. JOHN D. DINGELL, Michigan.

If you are a SWKROA member from any of the states listed above, we respectfully request you write or call your Representative to urge support of HB 1117 granting relief from unfair interest and penalties on refunds retroactively ordered by FERC. Addresses will be furnished upon request. It would be most helpful if you could report to us any contact made.

Congress has adjourned for the summer but will reconvene following Labor Day weekend next month. We suggest you make your contact before that date. We are certain that the pipeline companies will again do everything they can to defeat this legislation by using the ruse of consumer protection. Any help you could give us in support of the bill will be greatly appreciated.

ZERO PRESSURE APPLICATIONS FILED WITH KCC BY PIONEER NATURAL RESOURCES

In March, Pioneer Natural Resources USA, Inc. (Pioneer) filed applications with the Kansas Corporation Commission (KCC) in each of two separate dockets requesting the Commission to grant to Pioneer the approval to operate and produce the allowable from 21 wells in the Panoma Council Grove Field and 40 wells in the Hugoton Field at a flowing casing pressure of less than 14.4 psia.

Pioneer in its applications indicated there are no provisions contained in the Basic Proration Orders (BPOs) relating to the Hugoton and Panoma Council Grove Fields that would prohibit Pioneer from operating and producing the allowable for wells in the fields at a flowing casing pressure of less than 14.4 psia. However, there remains a question as to whether Pioneer needs to obtain permission from the Kansas Corporation Commission (KCC) before it can operate the wells at a flowing casing pressure of less than 14.4 psia under K.A.R. 822-3-131 which deals with vacuum pumps. Pioneer asserts that its applications do not seek to change or modify any of the provisions of the basic proration orders.

(Secretary's Comment: 82-3-131 reads in part as follows: "(a) Upon application, the installation and use of vacuum pumps in fields which are nearly depleted and the installation and use of high volume pumps may be permitted by the Commission.....")

In each application, Pioneer asserts that because of the uncertainty regarding the application of KCC's vacuum rule to the wells in question, Pioneer has had to significantly curtail the wells. It is currently "pinching" the wells, either at the wellhead or at the compressor, in order to maintain the flowing casing pressure wells above 0 psig. Pinching of the wells is substantially curtailing production from the wells and is having a detrimental financial impact on Pioneer and its royalty owners.

SWKROA has filed a petition to intervene in the proceedings. Petitions for leave to intervene were also filed by Amoco Production Company (Amoco), Anadarko Petroleum Corporation (Anadarko), Kansas Natural Gas, Inc. (KNG), Mobil Exploration and Producing US, Inc. (Mobil), and Plains Petroleum Operating Company (Plains).

Mobil filed a protest to the procedural schedule proposed by Pioneer, contending that the schedule does not provide either the intervenors or the Commission sufficient time to completely and properly evaluate the merits of Pioneer's application and for intervenors to prepare testimony and other evidence relating to the 61 wells in issue.

In its Motion for Prehearing Conference, Mobil states that the issues presented by its application are extremely important to both the Commission and all operators in the Panoma Field. If Pioneer's applications are granted, the Commission may receive similar applications from other operators in the fields trying to "keep up with" Pioneer's vacuum-aided production. Amoco and OXY supported Mobil's position with reference to the prehearing schedule while Anadarko supported Pioneer.

In late June, the KCC staff filed a Motion to Intervene, a Motion to Consolidate Dockets for Hearing, and a Motion for Prehearing Conference.

Position of KCC Staff

The Commission Staff basically supported Mobil's position, stating that K.A.R. 82-3-131 is the relevant regulation in determining the installation and use of vacuum pumps in fields which are nearly depleted. The Basic Proration Orders for both the Hugoton and Panoma Council Grove Fields did not contemplate the use of vacuum pumps and are therefore silent as to their use and how such operation such as testing and assignment of allowable would be regulated under the current proration orders for these fields.

It was the belief of the Commission Staff that the potential outcome of the hearing would impact all producers of the two fields and could potentially create problems that conflict with the Commission's charged duties of prevention of waste and protection of correlative rights.

After the Commission's Staff filed its motion in each of the two pending dockets, Pioneer informally served notice to the Commission to withdraw the applications and offered to file a formal motion to withdraw the applications if the Commission felt such application appropriate. On July 28, 1999, the KCC granted Pioneer's request to withdraw its applications but retained jurisdiction of the subject matter and the parties.

SWKROA ANNUAL MEETING REPORT

The program for this year's annual meeting attracted more than 250 SWKROA members and guests who attended the 51st annual meeting of the Association in Hugoton on Saturday, April 17, 1999. Many of those in attendance were vitally concerned with the Kansas ad valorem tax issue which was extensively covered in the afternoon session. PHILLIP R. DICK, of Garden City, SWKROA President presided.

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SHERRY GOERING, Hugoton Hermes editor, covered the annual meeting on behalf of the Association. Excerpts from her news story are included in this report.

Workings of KCC Explained

The morning session was highlighted with informative talks given by BRIAN J. MOLINE, of Topeka, Commissioner of the Kansas Corporation Commission (KCC), and by M. L. KORPHAGE, of Wichita, KCC Oil and Gas Conservation Director. Moline explained the role the Kansas Corporation Commission plays in regulating the oil and gas industry and public utilities. In addition to other powers and duties provided by law, the state corporation commission is charged with the duty to develop a comprehensive state energy conservation plan to conserve energy, protect correlative rights and prevent waste of energy resources. The Commission has adopted rules and regulations toward meeting this end.

MOLINE advised that economic regulation of what basically is a private industry has been based on two assumptions. The first assumption is that where there is no competition or no effective competition, regulation has to be placed in position for a price determination. However, secondly, when true competition emerges in these industries, then the need for regulation recedes and ultimately disappears. He said that when you actually do have competition, the role of the regulator, at least in the short term, is to monitor and encourage competition, ensure a level playing field with controlled pricing, and try to make certain that the traditional monopoly provider does not exercise its marketing power to throttle competition.

Moline announced that he has been told we can expect zero pressure in the Hugoton Field in 2010. The website address for the KCC is: ***http:/www.kcc.state.ks.us/conservation/conservation.htm.***

KORPHAGE discussed oil and gas production in Kansas. He said oil and gas production has been established in 91 of the 105 Kansas counties. Southwest Kansas remains the major area of production with 78% of the state's oil and gas production. The Hugoton Field produces 65% of the total gas output, with the Panoma Field at 15% and the Greenwood Field at 1.8%. The discouraging news is that during 1998, the state experienced an overall decline in oil and gas production resulting in a reduction of exploratory drilling and well plugging. Natural gas production declined approximately 8.3%, and the average wellhead price declined 12.8%. The decline in oil production is more dramatic at 19.1% and the average price for crude oil has declined 37%! "These figures are not very encouraging," he concluded.

Salt Water Disposal and Injection Controls

Korphage also spoke about the disposal of salt water and underground injection controls. The Commission tests about 20% of the state's wells every year, making it a 100% coverage every five year. Each year 2,800 wells are tested. The Environmental Protection Agency pays the KCC $340,000 annually to test wells. There are 15,800 injection wells in Kansas, which is the fifth largest number in the nation. The lowest percentage of injection wells are in Southwest Kansas.

Korphage explained there is a development of a new kind of well drilled with coiled tubing technology called "WD640". All the casing is cemented top to bottom with 2 3/8" fiberglass tubing inside. There have been 17 completions of this type of well so far. This technology may extend the life of marginal gas wells, he said. It is also cost effective.

Value of Mineral and Royalty Interests

RONALD L. COOK, of Prairie Village, Kansas, a petroleum engineer with Petroleum Consultants, Incorporated, made an informative presentation on mineral appraisals. He gave the definition of a mineral appraisal and the purpose of appraisals.

COOK declared, "Generally, I would recommend you not sell your minerals, especially natural gas." The Hugoton Field is declining, he said, but demand for natural gas is still there. "If gas isn't there, prices go up." According to Cook, there are areas in the Hugoton and Panoma Fields that still have approximately 30 years of life. There are other areas, however that may have only 10 years or less.

The decision to sell will depend on the offer. If the offer is above market value and exceeds the value from appraisal methods a person might consider selling. Cook warned, "Get an independent opinion of the value of your wells before selling. You need to consider the amount of the purchase up front versus the amount of future income to be received over the remaining life of the property." Cook then explained the various methods of appraising minerals and the information needed to for a mineral appraisal. He pointed out there are four methods of appraising minerals: (a) multiple annual income (number of times net income); (b) value per mineral acre; (c) in place value (sale price divided net to the RI remaining reserves); and (d) income approach or discounted cash flow (dcf). Cook's cost per well valuation is $165.00 per well.

A general technique for computing mineral value is to take a 12 to 36 month average, then multiply that figure by 5 to 9 times for gas values and by three times for oil values. (Secretary's Comment: This is the multiple annual income method and a good rule of thumb.)

Outlook for Natural Gas

As for the national picture for natural gas, Cook stated it looks better for gas than for oil. "We have better control of gas prices because we are self-sufficient. We have no foreign competition. Demand is still there. In fact, there is more demand for gas than the reserves we have. I think we'll see an increase in gas prices." Alternate fuels will be needed in the future.

Cook was asked to comment about the effect vacuum pumps being installed in the Hugoton Field will have on the Field. He indicated the impact will be good. "They're going to recover more gas." That means more income for the royalty owner. If the vacuum units which are now installed are to drain the deeper zones, these zones do not require KCC permits to have them installed. He mentioned the current applications pending before the KCC of Pioneer Natural Gas Company for installation of 61 vacuum units in the Hugoton and Panoma Fields.

The final question dealt with the liability of closed estates for the ad valorem taxes. The response was that if the parents owned the well at the time the claimed obligation refund was incurred and are since deceased, FERC cannot collect the refund.

Kansas Ad Valorem Tax Refund Issue Discussed

The Kansas ad valorem tax refund issue was thoroughly discussed in the afternoon session. Appearing on the panel were State SENATOR STEVE MORRIS (R), of Hugoton; DONALD PITTS, of Topeka, Assistant Kansas Attorney General; DAVID

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HEINEMANN, of Topeka, Executive Director, KCC; DOUG SMITH, of Topeka, Pinegar-Smith Company, L.L.C., Association lobbyist; GREGORY J. STUCKY, of Wichita, Association General Counsel; and Association Executive Secretary, ERICK E. NORDLING. SWKROA President PHILLIP R. DICK acted as Moderator.

DAVID HEINEMANN, former KCC Executive Director and recently named as Special Assistant in the Department of Revenue, explained the history of the Federal Energy Regulatory Commission reversing its own orders after 19 years of enforcement which had allowed the Kansas ad valorem tax to pass through to the consumer. The producers and royalty owners were ordered to refund 337.9 million dollars. Two-thirds of that amount is accrued interest on the original principal over the 19 years FERC was enforcing its original order back to what Heinemann referred to as "The Day of Infamy - October 4, 1983."

STUCKY briefly reviewed the legal background of the problem. He explained that in 1988 to 1989, gas prices began to be decontrolled and the "pass through" opportunity was no longer available to producers and they could no longer recover ad valorem tax payments. Consequently, royalty owners began to pay the ad valorem taxes assessed against the royalty interest. However, the taxes in issue now are those paid from 1983 to 1988. Stucky explained, "You never saw any of those taxes. They were all paid by the producer. Now FERC is saying, "Royalty owner, pay up those taxes.....that's where we are. It's a no win situation for producers. The FERC is trying to force producers to recover those payments from the royalty owners even though FERC doesn't have any jurisdiction over the royalty owners."

SENATOR MORRIS explained the efforts made last year to correct the injustice created by FERC's order for the refund. A team consisting of Executive Secretary NORDLING, Association General Counsel STUCKY, SWKROA lobbyist DOUG SMITH, HEINEMANN, MORRIS and other legislators did some "fancy footwork" to try to divert the "travesty". HB 2419 was crafted in a mere three days time. After considerable effort, the bill passed and Governor BILL GRAVES signed it into law last year. The measure was a statutory confirmation that the Kansas statute of limitations had expired and would negate FERC's order for the royalty owners to pay the refund.

Morris complained, "This (FERC order) is like the IRS telling you after you've had a homeowners' deduction for interest for twenty, thirty years all of a sudden saying you can no longer take that deduction - you've got to repay all that with interest".

Since the passage of HB 2419, FERC has ruled it will not recognize what the Kansas legislature had passed.

The panel then reviewed the efforts made by Governor BILL GRAVES and his staff, the Kansas Corporation Commission, Senators PAT ROBERTS and SAM BROWNBACK, Rep. JERRY MORAN by seeking relief from FERC's order through Congressional legislation (These efforts are referred to above and in the February and April 1999 SWKROA newsletters). SWKROA members coming from states other than Kansas were encouraged by Secretary Nordling to write their Congressman supporting such legislation. This should counteract the perception that the issue is a "Kansas problem." He added, "the producers are working quite hard to knock out the royalty owners' payments too because it also helps them."

Panelist DONALD PITTS, who is Assistant to Kansas Attorney General CARLA STOVALL, and who handles oil and gas, water, and natural resources litigation, pledged the support of the Attorney General's office. Pitts added, "The main issue we have to accomplish is to get some kind of a Kansas state adjudication which makes it clear that the statute of limitation bars the ad valorem tax repayment obligations from royalty owners." He pointed out that the Kansas Department of Wildlife and Parks is a royalty owner, and that the state, through some of its agencies, is in the same position as the royalty owners. It is facing a $27,000 refund obligation.

Pitts advised that a speedy solution to the problem is being sought. He pointed out that if a federal court case has an issue involving state law, the question can be certified to the Kansas Supreme Court which is required to move it to the top of the docket. If that case is heard in a Kansas court, the chance of a ruling in the royalty owner's favor is more likely.

Stucky advised members to challenge letters from some small producers requiring them to pay the contested refund amount. He pointed out that to date (the annual meeting) the majority of big producers have not tried to demand payment.

The meeting adjourned following the report of the nominating committee on the election of SWKROA directors at large and approval of county directors.

ELECTION OF DIRECTORS

The election results for county directors of SWKROA were announced with two changes. KAY MURRAY moved from county director to director at large for Stevens County while JIM KRAMER replaces Floyd Gillespie as county director in Stevens County. Other directors include Haskell - ROGER KELMAN, Finney - ROBERT L. JONES, Kearny - WALTER WAECHTER, Grant -JOHN STEPHEN ALFORD, Stanton - TED JULIAN, Seward - JOE LARRABEE, Morton - HADEAN FINK, Hamilton - TERRY BOY and Greeley - JOHN LAWSON.

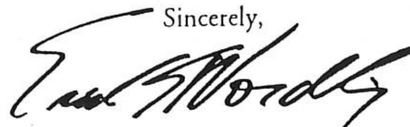
The Directors at Large registered one change with GLEN TEETER replacing Joseph Byers for Stanton County. Other directors are: Morton - RON DEGARMO, Haskell - PATRICK ROONEY, Finney - PHILLIP R. DICK, Kearny - JOHN CRUMP, Grant - DALE STEVENSON, Stevens - KAY MURRAY, Seward - PAUL BOLES, Hamilton - DAN BRADDOCK and Greeley - ARLISS WINEINGER.

Eulogy for Ted Julian

We are saddened to report the death of SWKROA director TED JULIAN on August 2, 1999. Ted was a longtime member and Association director since 1986 representing Stanton County. Ted was a fourth generation Julian to farm in Stanton County and was involved in farming and ranching. Ted's father, STANLEY JULIAN, now deceased, was one of the incorporators of the Association in 1948 and was a valuable Board member until his retirement in 1986 when his son, Ted, took over the duties of Stanton County director. We will miss Ted and his valuable support and faithful service.

If you have any questions or comments, please call or write.

Sincerely,



Erick E. Nordling
Executive Secretary

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BACKGROUND

I. Mineral Owners, Royalty Owners and Working Interest Owners:

In 1895, the U.S. Supreme Court wrote in Brown v. Spilman, 155 U.S. 665, that "petroleum gas and oil are substances of a peculiar character...they belong to the owner of the land, and are part of it, so long as they are on it or in it, or subject to his control". Thus thousands of Kansas farmers and other land owners across America had their mineral ownership confirmed by our nation's highest court. The right to explore, produce and develop oil and gas belonged to the owner of the land and was theirs and theirs alone. If you are a landowner, unless the minerals have been severed and sold apart from the surface, you are a mineral owner.

Normally farmers and other landowners do not actually explore, produce and develop the minerals in or under their land. Instead they will enter into an oil and gas lease to confer, pursuant to the terms of their agreement, the right to explore, produce and develop upon a lessee. The lessee is typically a geologist or oil and gas company with the knowledge, skills and the access to risk capital necessary to explore for oil and gas.

Typically the oil and gas lease will provide that the lessor, ie., the farmer, landowner or whoever the mineral owner happens to be, will be paid a "bonus" or fixed sum of money by the lessee, ie., geologist or oil and gas company, to induce the mineral owner to enter into an oil and gas lease. The lease will further provide that if production is obtained the lessor will receive a 1/8th cost-free share of production or lessor will be paid 1/8th of the proceeds from the sale of oil and gas, or, 1/8th of its fair market value at the wellhead as a "royalty". By entering into an oil and gas lease, the mineral owner becomes the "royalty owner". The Lessee geologist or oil and gas company becomes the "working interest owner" who pays 8/8ths of the costs (except for certain costs such as the Kansas Ad Valorem Tax and Severance Tax) to receive 7/8ths of the production.

There are thousands of "royalty owners" in Kansas and across the United States. They are typically farmers and other landowners, their children, heirs and devises. Many institutions are royalty owners, including charitable organizations, hospitals, churches and universities. The University of Kansas is a significant royalty owner as are many other of Kansas' institutions of higher education.

Likewise, there are thousands of "working interest owners" in Kansas. There are about 2500 licensed oil and gas operators and uncounted thousands of non operators who are Kansas working interest owners. Some of the working interest owners are very large producers such as Amoco, Mobil, OXY and Anadarko. But many others are very small independents. I am a working interest owner. My Dad is a working interest owner. Joel T. Strohl and other individuals from my home town of Pretty Prairie, Kansas, are working interest owners. It is very common for individuals who have grown up and live in the oil patch to be working interest

owners. We are producers of oil and gas. We are geologists, engineers, landmen, lawyers, farmers looking for other sources of income, and many others. We are hardworking, productive Kansas citizens.

Today, because the Federal Energy Regulatory Commission, at the request of two major interstate gas pipeline companies (Northern Natural Gas Company, now Enron, and Colorado Interstate Gas Company, a subsidiary of Coastal Corporation), retroactively reversed an Opinion it issued to the State of Kansas in 1974, many of these royalty owners are being sued. The Southwest Kansas Royalty Owners Association estimates that well over 20,000 royalty owners are being sued in three separate class action law suits with some royalty owners facing potential refunds of over $60,000 dating back to royalties paid as long as 17 years ago, from October 3, 1983, through June 8, 1988. The total impact on Kansas royalty owners, if collectible, was estimated to be between 60-90 million dollars by the Southwest Kansas Royalty Owners Association.

Also as a result of the FERC retroactive reversal, over 400 Kansas operators and uncounted thousands of Kansas working interest owners are being threatened with potential liabilities estimated to be in excess of $340 million with interest running since October 3, 1983.

II. How can this be? A brief history of Federal Regulation of Gas sold in Interstate Commerce:

Much of our nation's natural gas resources were first discovered to exist in Kansas, Oklahoma, Texas, New Mexico, and Louisiana. The Hugoton Gas Field was the largest in the world. Wyoming, North Dakota, and other mid western and western states also have significant resources. These remain the most important producing states with significant production coming from the Gulf of Mexico and Canada.

The large gas reserves of the western producing states were coveted by the eastern consuming states. (Producing states tried unsuccessfully to prevent the export of this resource. An Oklahoma law prohibited the transportation of natural gas to any point outside the State of Oklahoma in order to conserve the gas for its exclusive use within the state. The U. S. Supreme Court, however, ruled the Oklahoma law violated the commerce clause. West v. Kansas Natural Gas Co., 221 U.S. 229 (1911)).

Because of the need for orderly development and because of the clear potential for a monopoly that an interstate pipeline might possess the U.S. Congress passed the Natural Gas Act of 1938. The purpose of the Act was to regulate (as a utility) rates and charges by any natural gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the commission. The Act clearly stated that **"the Act shall not apply to the production or gathering of natural gas".**

Because of this clear exception to federal jurisdiction for production and gathering, producers in Kansas and in other producing states believed that they could sell the gas which they produced at the well head to a gatherer or pipeline at free market price. Producers believed that the federal

jurisdiction did not extend to production and gathering. Thus much of the gas in the giant Hugoton gas field was sold at the well head in Kansas to Inter state pipelines.

In 1954, however, one Oklahoma producer, Phillips Petroleum Company, decided to try to renegotiate its contract with an inter state pipe line to raise the price it was paid at the well head from 3 cents per mcf to 4 cents per mcf. This increase in the price of natural gas angered consumers in Wisconsin. The State of Wisconsin sued Phillips Petroleum Company contending that the Natural Gas Act of 1938 did extend jurisdiction of the Federal Government to production and gathering allowing the Federal Power Commission to control even the sale of natural gas at the well head if such gas was sold to an interstate pipeline. The U.S. Supreme Court in Phillips Petroleum Company v. Wisconsin, 347 U.S. 672, held for the State of Wisconsin, stating that the "primary aim of the Natural Gas Act was the protection of consumers against exploitation at the hands of natural gas companies". The above described exception to federal jurisdiction of production and gathering was rendered meaningless by this decision. (It is interesting to note that the consuming states of Wisconsin, Michigan, Minnesota, Iowa and Nebraska, along with the consuming cities of Detroit, Milwaukee and Kansas City, Missouri lined up on the briefs against the producing states of Kansas, Oklahoma, Texas, New Mexico, Louisiana, Mississippi, North Dakota and Wyoming.)

As a result of the Phillips decision, the Federal Power Commission was forced to regulate thousands of gas producers as public utilities. Because the Phillips decision did not extend federal jurisdiction to gas sold within the state, ie. in intra state commerce, producers reacted to this decision by attempting to quit selling their gas to inter state pipelines. The court reacted by saying that once their production had been sold in interstate commerce and acreage was committed to an interstate contract, it could not be withdrawn from interstate commerce without commission approval.

Kansas producers could not get their acreage released from interstate contracts and now any Kansas gas dedicated to inter state pipe lines could be withdrawn from Kansas at whatever price the Federal Power Commission determined appropriate. The net effect of this decision was that natural gas was now being drained from producing states at virtually billions of dollars below fair market value, all for the benefit of Eastern consuming states. (As an aside, this triggered a series of lawsuits in Kansas filed by royalty owners against producers. The royalty owners argued that the producer working interest owners had agreed to pay them 1/8th of the fair market value of gas sold at the well head and that since the Phillips decision they were not getting paid fair market value. The producers argued that the federal government had taken control of their production and fixed the price and they could not be held to pay fair market value when the federal government controlled the price).

To implement the Phillips Decision, the FPC attempted to use the traditional cost of service rate making approach applied to interstate pipelines as public utilities. They soon found this to be impossible to manage. They shifted instead to an area-wide rate making. In a nutshell, a maximum lawful price was established based upon the area in which a well is located and the date the well was drilled.

In 1974 the FPC issued Opinion 699 which stated that the area ceiling rate for natural gas could be increased to allow producers to recover the cost of "production, severance or other similar taxes". This language was a bit unclear as some states, such as Kansas, did not have severance taxes, but had ad valorem property taxes. Some states such as Oklahoma did not have ad valorem taxes but had severance taxes. Other states like Texas, Colorado and Wyoming had both severance and property taxes. Did ad valorem taxes constitute an "other similar tax" as described in Opinion 699?

To answer this question, on August 14, 1974, counsel for the Kansas Corporation Commission filed a request for clarification of Opinion 699-D with the Federal Power Commission. On October 9, 1974, the FPC issued Opinion 699-D stating that it is proper under Opinion 699 to increase the area ceiling rate to allow producers to recover their costs of the Kansas ad valorem tax.

Because federal regulation was extended to include Kansas producers in the Wisconsin v. Phillips decision in 1954 Kansas producers simply quit selling natural gas in interstate commerce. Instead production from any new wells which were drilled were sold to the intra state markets wherever possible. The result of this practice was that the interstate pipelines began running short of gas and the eastern consuming states were growing concerned. This led Congress to pass the Natural Gas Policy Act of 1978 which provided for significantly higher prices more in line with free market prices at the time.

Opinion 699-D was perpetuated by the passage of the Natural Gas Policy Act of 1978. Section 110 of the NGPA allowed the recovery of production, severance and other similar taxes above the maximum lawful price paid for natural gas at the wellhead.

In 1981 Governor John Carlin proposed, and in 1983 the Kansas Legislature passed, a new severance tax in addition to the existing ad valorem tax. The Kansas Legislative Research Department correctly advised the Senate Tax Committee during hearings on the Severance Tax that the FPC had allowed the pass through of the Kansas Ad Valorem Tax pursuant to Opinion 699-D and that other states were allowed to pass through both a severance tax in addition to an ad valorem tax. Thus it was believed that both the severance tax and the Kansas ad valorem tax could be added to the maximum lawful price and would not burden Kansas producers and royalty owners. Clearly, the Kansas legislature relied on Opinion 699-D in passing the severance tax.

No sooner had the ink dried on the Governor's signature on the severance tax than Northern Natural Gas Company scurried to the Federal Energy Regulatory Commission to request that Opinion 699-D be rescinded. A notice of a hearing on this request was published in the Federal Register on October 3, 1983.

Nearly three years later, in 1986, the FERC rejected Northern's request stating it was "clear beyond question" that the Kansas ad valorem tax could be added to the maximum area rate, reaffirming its policy contained in Opinion 699 and 699-D. Northern requested a rehearing which, in 1987 was denied.

The issue appeared to be finally resolved until in 1988 Colorado Interstate Gas Company appealed the Northern denial to the Federal Circuit Court in Washington, D.C. The Court held that the FERC had not adequately explained its Opinions and remanded the case back to the FERC for further consideration.

The case rests at the FERC for five years with nothing happening. Then, shortly after a new commission majority is appointed the FERC reverses Opinion 699-D thereby overturning 19 years of reliance on an opinion which FERC previously described as "clear beyond question". FERC stated that the Kansas ad valorem tax which exceeded the maximum lawful price should be refunded back to June 28, 1988, the date the D.C. Circuit Court issued its decision. That date had very little or no financial impact on most Kansas producers and so the reversal was not challenged by producers. Refunds were made and it was believed the case was over. Not so.

Colorado Interstate Gas Company appealed the date the refund obligation started. The D.C. Circuit accommodated Colorado Interstate Gas Company by directing the FERC to determine the refund obligation retroactive to October 4, 1983, the date which Northern's petition to re-open Opinion 699-D was first published in the Federal Register. In this case, Public Service Company of Colorado v. FERC. 91 F 3d 1478 (D.C. 1996) Judge Doug Ginsburg said that the Kansas Ad Valorem Tax which was levied primarily upon the value of recoverable natural gas reserves was not recoverable, but that the Wyoming ad valorem tax which was assessed upon the volume of natural gas removed from a well, and the Colorado ad valorem tax, which was assessed upon the volume of natural gas removed from a well was recoverable. Judge Doug Ginsburg went on to say that "the apparent lack of detrimental reliance on the part of producers is the crucial point"...and that reliance on Opinion 699-D would have been "foolhardy".

The State of Kansas was not present in the D.C. Court on that day to tell Judge Doug Ginsburg that the entire Kansas Legislature had relied on Opinion 699-D when they passed the severance tax in Kansas in 1983 and that it was the understanding and intention of the State of Kansas that the new severance tax could be passed on as a cost of production by producers being regulated as public utilities, in addition to the existing ad valorem property tax. The intention of Kansas tax policy was subverted by the retroactive reversal of Opinion 699-D.

1-53

Hearing on

House Bill 2823

Before the

House Committee on Assessment and Taxation

February 22, 2000

Comments by:

Dick Brewster
BP Amoco

House Taxation
Date 2/22/00
Attachment # 2-1

Madam Chairperson, members of the Committee, for the record, my name is Dick Brewster and I am Government Affairs Director for BP Amoco. I am appearing today in favor of passage of House Bill No. 2823. I sincerely appreciate the opportunity to speak with you about the purpose of and need for this legislation.

The bill is intended to clarify the nature of the Kansas property tax, or *ad valorem* tax as it is applied to Kansas gas and oil producing properties. The definition, or characterization of this tax is a very important issue for gas producers and owners of gas royalty interests in Kansas. Let me briefly explain why this is so:

First, there was the Federal Power Commission, (FPC) which administered a system of "national rates" for natural gas. Then in 1979, a successor agency, the Federal Energy Regulatory Commission (FERC) which administered the Natural Gas Policy Act (NGPA).

In 1974, in Opinion 699-D, the FPC accepted the argument, offered by the Kansas Corporation Commission, that the Kansas property tax is "... based on production factors, and as such is in fact a severance or production tax...."

Then in 1979, the NGPA created the FERC, which administered the NGPA, and established "maximum lawful prices' for natural gas. The ceiling price for gas depended on the type or category of well the gas came from. Under the NGPA, a producer could not get more than the ceiling price for the gas from the purchaser. And, in most cases back then, the purchaser was an interstate pipeline. However, "production" or "severance" taxes were allowed to be added to the ceiling price and passed on through the pipeline to the ultimate consumer.

Under FPC Opinion, 699-D, the Kansas property taxes were added to the maximum lawful price when the gas was sold to the pipelines. Then in 1986, FERC rejected a petition to rescind this order, and continued to allow the tax pass through. In upholding 699-D, the Commission declared that "there are valid reasons for treating the Kansas tax as a tax 'similar' to a severance tax."

That order was appealed and on June 28, 1988, the DC circuit of the U. S. Court of Appeals remanded the case back to FERC, stating that FERC's decision allowing the Kansas property tax to be added on to the ceiling price, "fell short of reasoned decision making." The Court did NOT direct FERC to rescind 699-D, but rather to more rationally explain its reasoning in allowing the pass through.

In 1993, FERC, apparently unable to develop what it thought to be a sufficiently adequate rationale basis, rescinded 699-D, and said the Kansas property tax was NOT a severance type tax and could not be passed through under the ceiling price structure, which by the way, is now a thing of the past. FERC disallowed the pass through from June 28, 1988 forward.

The FERC decision as to that date was appealed and in 1996, the DC Court said the pass through was disallowed from October 4, 1983. So, rather than refund the tax passed through back to 1988, the Court said producers had to refund the tax collected back to 1983. The FERC date was based on the idea that producers got a clear signal that there was a problem with the pass through in 1988, when the Court was critical of FERC's rationale in allowance of the pass through.

The Court's date, 1983, was based on the date an interstate pipeline asked FERC to disallow the pass through. I find it hard to see how we could rationally be expected to take an interstate pipeline's expression of displeasure with a Federal agency order as a clear signal that we could not rely on the order any longer.

Frankly, Madam Chair and members of the committee, we believe Kansas producers and royalty owners were deceived. We relied on the word of Federal agency. And now, the gas producers and royalty owners in Southwest Kansas are expected to repay some $400 million in taxes, interest and penalty

Hence, House Bill No. 2823. This bill is an attempt to clarify in the statute what we thought to be the case. As you have heard already, most of us in Kansas thought the property tax was sufficiently akin to a "production" type tax that it could be added to the ceiling price of gas sold by Kansas producers.. Most of the members of the House and Senate which passed the Kansas severance tax thought so too. We all thought that, as the FPC said in 1974 at the urging of the Kansas Corporation Commission, "the Kansas advalorem tax is based on production factors, and, as such is in fact a severance or production tax merely bearing the title 'advalorem' tax."

The late Tim Hageman for many years was a contract appraiser for most of the major gas producing counties in Southwest Kansas. A State Certified County Appraiser, Tim worked for the county appraisers in appraising gas and oil producing properties in those counties. At the hearing before FERC which resulted in the reaffirmation in 1986 of the right to pass through the property tax as a "production based" tax, Tim offered an affidavit outlining the method used for appraising production properties. In that sworn statement, Tim stated, "The amount of remaining recoverable reserves are not taken into consideration." The outline he presented clearly indicates the value of the production is the primary factor in determining the value of the oil or gas property being taxed.

We do not expect or desire that the language in subsection 1 (d) of the bill would change the way *ad valorem* taxes are assessed or collected on our gas producing properties, only to clarify the method. Section 1 (a) of this bill is current law, and it allows the appraiser to take into consideration a number of factors, only some of which are listed. However, the primary factor in determining the value of a gas producing property in Kansas is, and has been for decades, the volume and price of the gas produced.

Subsection 1 (b), also current law, is telling on this point. It sets out the method of determining the value of a property which was producing only part of a year, after July 1 of

the year in question. It directs the appraiser to determine "the quantity of oil or gas such property would have produced during the entire year preceding **the year in which such property is first assessed upon the basis of the actual production** in such year...." (Emphasis added.)

In other words, this section contemplates that once a property is producing for its first full calendar year, and subsequent years, it is "...assessed upon the basis of the actual production." That is to say, its value is determined by its production. Said another way, production is the basis of valuation of oil and gas properties, just like the FPC said in 1974 and FERC said in 1986, and just as we all thought when the Kansas Severance tax was adopted.

The assessment ratio itself is based on an oil or gas property's production. If an oil well produces five barrels or less a day, or a gas well produces 100 mcf a day, the ratio is 25%. If production is higher, the ratio is 30%. Again, production is an important factor.

I'm aware that there is concern that this bill may change the characteristic of the property tax as it applies to oil and gas properties. Such a change is not our intent. In fact, changing the nature of the tax would damage our position that it was proper to allow the pass through of the tax in the first place.

Proposed subsection (d) merely states that it is and always has been the intent of the Kansas Legislature that the value of oil and gas properties are based primarily on production. And the property tax is based on that value. We are simply hopeful that subsection (d) will make that clear, even to the DC Court. The property tax is a tax on the value of the property being taxed. In the case of an oil or gas property, that value is based on the value of actual production, or production factors, and not on recoverable reserves.

At the present time, there are appeals and settlement discussions all going on at the same time. I'd urge you to approve House Bill No. 2823, but to amend Section 3, to make it effective on publication in the Kansas Register, so it can affect the unfair position Kansas producers and mineral owners have been placed in, and can state clearly what the legislative intent has always been..

Thank you again for your time and attention. I'll be glad to answer any questions you might have.

Respectfully submitted,

Dick Brewster
BP Amoco
4334 N. W. Expressway, Suite 275
Oklahoma City, OK 73116
405-848-0657

Amendment to H. B. No. 2823, proposed by Dick Brewster, BP Amoco.

After the period in line 10, page 2, insert the following:

"Nothing in this sub-section shall be construed to alter the basis upon which valuation of oil or gas properties has or will occur."

House Taxation
Date 2/22/00
Attachment # 3

Statement of Patrick Hubbell
On Behalf of Anadarko Petroleum Corporation
In Support of HB 2823
Before the House Taxation Committee
February 22, 2000

Thank you for allowing me to testify today in support of HB 2823. The bill addresses a gross injustice dealt Kansas's natural gas producers at the hands of the Federal government. Your passage of HB 2823 could rectify that and ultimately save Kansas producers and the state of Kansas several hundred millions of dollars.

A quick review of Anadarko's history and involvement in the state of Kansas will help you understand why Anadarko is so interested in the bill. Anadarko has been a part of the economic and social landscape here for more than 40 years. Those ties go back even farther than that-to the birth of the local energy industry itself. The well that discovered the Hugoton Field, the lifeblood of a number of communities for more than three-quarters of a century, is still operating on land that is now an Anadarko lease. The company has quite literally grown up with the oil and gas business in southwest Kansas.

While the company has expanded the scope of its operations significantly over the past 14 years, Anadarko's roots are in Kansas and the state is still the home of one of its largest asset concentrations. Throughout the Hugoton Embayment, Anadarko controls about one million acres and approximately 2,700 wells. Production from the area in 1999 was more than 72 billion cubic feet of gas and roughly one million barrels of oil and condensate. Through its ongoing commitment of capital to the area, Anadarko has continued to find new reserves that have helped extend the life of this mature hydrocarbon basin and provide the energy necessary to meet the country's needs.

As you can see, Kansas remains crucial to the company, which is why the proposed legislation before you is so important.

At its most basic level, the issue addressed by HB 2823 is whether Anadarko and other Kansas producers should be punished for following rules promulgated by the government. If you'll indulge me for just a moment, I would like to briefly summarize the events that have led us to this point.

The Natural Gas Policy Act of 1978 contained a provision that allowed producers to add a "severance, production or similar" tax to what was the maximum lawful price for natural gas at that time. The Federal Energy Regulatory Commission ("FERC") ruled that the Kansas ad valorem tax qualified as such a tax, so Anadarko, along with other producers, collected it from purchasers of its gas.

In 1983, a request to reverse FERC's ruling regarding the ability of producers to

collect the Kansas tax was submitted and three years later denied by FERC. The decision was then appealed to the U.S. Court of Appeals for the District of Columbia Circuit which, in 1988, sent the case back to FERC -- not to reverse FERC, but to have FERC explain its decision. Five years later, in 1993, FERC reversed its previous pronouncements and ordered producers to refund, with interest, the Kansas ad valorem taxes collected after 1988. FERC reached this result by determining that the Kansas ad valorem tax was not based on production. The ruling was later modified by the D.C. Circuit Court in 1996 requiring refunds of tax reimbursements collected **as far back as 1983**. In May of 1997, Anadarko joined with other producers in filing a petition that would have granted them relief from the interest portion of the refund. The petition was denied by FERC four months later.

The proposal before you today simply seeks to clarify the Kansas legislature's original intent as to how the value of oil and gas properties is determined for tax purposes. It is clear that on producing wells, the ad valorem tax has always been determined based upon production of the oil or gas actually severed from the earth. Therefore, the tax should be deemed, in accordance with the Natural Gas Policy Act of 1978, similar to a production tax and would qualify as an appropriate add-on cost under FERCs former rules. That is what the legislature intended and that is what HB 2823 would make clear.

Your support for this proposal is crucial, not only to the state's oil and gas producers, but to the communities in which they operate. Under FERC's existing order, Anadarko may be responsible for refunding more than $46 million, almost two-thirds of which is for interest payments alone. That's money that would otherwise be available for drilling and development programs, as well as community initiatives.

Anadarko's impact on the state's economy is undeniable. At year-end 1999, the company's Liberal Division employed more than 200 workers representing a payroll of more than $9 million. Another 2,000 people work for companies contracted by Anadarko. In 1999, the company paid in excess of $9 million in royalties and more than $12 million in Kansas property and oil and gas severance taxes.

In conclusion, FERC's actions over the 17-year history of this case have been indecisive and punitive. The decision to make the refunds retroactive was harsh enough -- especially considering that producers were in good faith following the government's directions; imposing interest on top of that is draconian. Your support for HB 2823 will help ensure that money and resources continue to be directed to promoting a strong oil and gas economy in our state.

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Ronald R. Hein
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*Admitted in Kansas & Texas

House Taxation Committee
Testimony re: HB 2823
Presented by Ronald R. Hein
on behalf of
Pioneer Natural Resources U.S.A., Inc.
February 22, 2000

Madam Chairman, Members of the Committee:

My name is Ron Hein, and I am legislative counsel for Pioneer Natural Resources USA, Inc. Pioneer is one of the largest independent exploration and production oil and gas companies in North America, with major operations in the United States, Canada, Argentina and South Africa. Pioneer's headquarters are in Irving, Texas.

Pioneer supports the passage of HB 2823. This bill is an effort to correct a manifest injustice that resulted from a retroactive decision that was made by the Federal Energy Regulatory Commission (FERC) which reversed an earlier opinion of the Federal Power Commission (FPC) which was the predecessor to FERC. In the 1970s, FPC had ruled that the property tax in Kansas was, in essence, a severance tax. As you have heard from other conferees, FERC reversed this position in the 1990s, and made their decision retroactive. Therefore, those natural gas producers that had relied upon the earlier FPC ruling (which passed the cost of the property tax paid in Kansas to the consumer) were required to repay retroactively the amount of the tax that was passed on, plus interest and penalties. Ultimately, this injustice has been, to date, upheld by the courts.

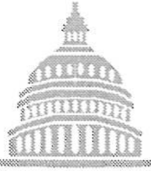
I was in the legislature at the time the FPC made its earlier ruling, and was very actively involved in the legislative process when the state enacted a severance tax as an add on to, what everybody thought at that time, was the existing severance tax on gas and oil.

Since the ad valorem or property tax was assessed pursuant to a formula that looked at the production from the well, it was always perceived to be a production based tax rather than a "classic" type of property tax.

HB 2823 clarifies what the legislature thought was the intent and effect of the ad valorem tax on oil and gas during that time frame. Had the law been worded in this manner originally, rather than totally relying upon prior interpretations, the manifest injustice which occurred with the FERC retroactive order would never have occurred in the first place.

Pioneer would respectfully request that the committee approve HB 2823 for passage. Thank you very much for permitting me to testify, and I will be happy to yield to questions.

House Taxation
Date 2/22/00
Attachment # 5

McGILL
GACHES
& ASSOCIATES INC.

GOVERNMENT AFFAIRS & PUBLIC RELATIONS

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Testimony of Colorado Interstate Gas Company

Presented by Ron Gaches
McGill, Gaches & Associates

Before the House Taxation Committee

Regarding House Bill 2823
An Act Concerning the Valuation of Producing Gas Wells

Tuesday, February 22, 2000

House Bill 2823 seeks to rename the Kansas ad valorem tax levied on gas producing properties. Through the use of language, the tax would be characterized as a severance tax, dating back to the inception of the tax. This is an attempt to cause the property tax levied on producing properties to become acceptable for reimbursement under the Natural Gas Policy Act of 1978, the NGPA.

The various pricing regimes of the NGPA were in effect from 1978 until they were repealed by the Wellhead Decontrol Act of 1989. As everyone is learning, a major issue has arisen regarding the application of the Kansas property tax on gas production and who should bear the financial burden of the tax.

The U.S. Court of Appeals for the District of Columbia Circuit and the Federal Energy Regulatory Commission (FERC) have ordered gas producers operating in Kansas to pay back reimbursements of the property tax, reimbursements that they received from pipelines on behalf of consumers during the years 1983 through 1988. Both the Federal Court and the FERC have found that Congress did not intend for producers to add this tax to their NGPA prices.

The obligation to pay back the reimbursements is a large dollar amount, approaching $400 million, and falls directly on the many gas producers, both large and small, that originally sold the gas to the pipeline companies. Many gas producers, in turn, have informed their royalty owners from this time period that they are liable for a portion of the refund.

The vast majority of the refund will directly compensate gas consumers in several states for the original pass through of the Kansas tax. In the state of Kansas alone, gas consumers stand to receive $60 million to $80 million in tax refunds from gas producers. House Bill 2823 is an attempt to undo the whole issue back at least 22 years, to 1978, by claiming that the Kansas property tax on gas is not a property tax at all but a severance tax.

Colorado Interstate Gas Company believes that any attempt to thwart the federally ordered refunds is bad public policy. Consumers were overcharged for gas as a result of the tax pass through, and the Federal Court and the FERC have demanded that they be paid back.

In Kansas, there are large numbers of royalty owners, and small producing and working-interest owners who might claim that the federally-ordered refund is an undue hardship. These parties, while large in number, do not represent the majority of the required refunds. The overwhelming majority of the refunds will come from the coffers of very large national or multi-national companies headquartered outside of Kansas.

The issue of relief against the repayment order for Kansas royalty owners and small producers should be addressed much more narrowly than simply elimination of the entire refund. Furthermore, it will need to be addressed at the federal level.

CIG is currently actively engaged in efforts to resolve the concerns of Kansas royalty owners and small interest owners at the FERC.

Regardless of the policy reasons that HB 2823 should not be passed, the Committee should be aware that it cannot succeed in those objectives. There are two problems with the bill that, in our view, cannot be remedied.

First, the bill is legally infirm under holdings of both the United States Supreme Court and the Supreme Court of Kansas. Those holdings prohibit the legislature from trying to upset a judgment once it has vested. In other words, once the Federal Court ruled and the FERC (which had regulatory authority over the gas producers during the period at issue) ordered refunds, no state legislature can undo the underlying statutes in such a way that the order can be frustrated. The relevant cases, *McCullough v. Commonwealth of Virginia* in the U.S. Supreme Court and *Kansas City Life Ins. Co. v. Anthony et al.* in the Supreme Court of Kansas, are still very firmly the law.

The second reason HB 2823 cannot work is centered in the history of the overcharge issue. For CIG, the controversy began when the FERC allowed the passthrough of the Kansas tax, but disallowed pass through of an identical tax in Texas. CIG simply asked which ruling of FERC was right. After years of legal and regulatory delay and appeals, the law was that neither tax was the kind meant by Congress to be added to NGPA prices.

FERC's ultimate decision was not made based on what the tax called itself. The decision was made based on the actual mechanics of the tax, as compared with similar taxes in other states. Thus, an attempt in Kansas to simply rename the tax, without changing the fundamental way it was levied from 1983 to 1988, will have absolutely no effect on the Federal finding that the tax was not reimbursable under the Federal statutory scheme of the NGPA. The NPGA prices were based on the market for energy, not on the producers' costs, and basically the FERC found it inappropriate to add the Kansas tax to those market-based prices.

The Kansas Legislature has a choice. It can work with the pipeline industry and other interested stakeholders, including the regulatory commissions and local distribution companies in other states, to try to find a negotiated resolution of the refund issues specific to Kansas. Or, it can attempt through state legislative efforts to frustrate the lawful orders of the Federal Court and FERC.

The second course of action will send us all back to court, with consumers ultimately winning as they have previously in the U.S. Court of Appeals. However, the time that will pass will just mean the refunds are that much bigger because of accumulated interest, and consumers–including those in Kansas–will have waited that much longer for the return of their money.

We urge the members of the House Taxation Committee, and all the interested members of the Kansas Legislature, to engage instead in supporting industry efforts to resolve the Kansas royalty/small producer issues, without providing a windfall to huge multinational gas companies.

PRINCIPLES OF SETTLEMENT
OF
KANSAS *AD VALOREM* TAX REFUND PROCEEDINGS
AS PROPOSED BY
COLORADO INTERSTATE GAS COMPANY
PUBLIC SERVICE COMPANY OF COLORADO
AND
CHEYENNE LIGHT, FUEL AND POWER COMPANY

1. The Settlement Refund Obligation of each Working Interest Owner shall be the Gross Refund Liability for that Working Interest Owner less a credit equal to 12.5% of such amount plus $10,000. If application of the $10,000 credit results in a Settlement Refund Obligation equal to zero or less, then the Settlement Refund Obligation shall be zero. The purpose of the 12.5% credit is to provide each Working Interest Owner relief from refund liability to the extent of the 12.5% royalty to Royalty Owners and to enable the Working Interest Owners to forgo most, if not all, claims for refunds against the Royalty Owners.

2. The Gross Refund Liability shall be calculated as follows for each Working Interest Owner:

   - The Gross Refund Liability shall consist of all Kansas *ad valorem* tax reimbursements received from Colorado Interstate Pipeline Company by the Working Interest Owner on and after October 4, 1983, which have not heretofore been refunded, plus interest computed thereon in accordance with FERC regulations governing interest on refunds as set forth on an Appendix to be attached to the Settlement;

   - The Gross Refund Liability shall be based on the Working Interest Owner's gross working interest percentage, including all royalty and overriding royalty interests (8/8ths); and

   - The Gross Refund Liability shall be based upon the assumption that the Working Interest Owner received the maximum lawful price for all first sales (*i.e.*, no "headroom"), unless there is a written agreement to the contrary between the Working Interest Owner and Colorado Interstate Gas Company, in which case the Gross Refund Liability shall be as set forth in such agreement.

3. Each Working Interest Owner participating in the Settlement shall remit payment of the Settlement Refund Obligation to Colorado Interstate Gas Company within thirty (30) days of the date of an order of the FERC approving the Settlement without condition or modification. Failure to remit timely payment shall constitute a material breach of the settlement and result in exclusion of such Working Interest Owner from this settlement.

4. Each Working Interest Owner participating in the Settlement that has previously remitted refunds to Colorado Interstate Pipeline Company in excess of those required under the Settlement shall be reimbursed by an amount equal to the difference between the amount refunded and the Settlement Refund Obligation. Funds for this reimbursement shall be generated from the payment of refunds made to Colorado Interstate Pipeline Company by other Working Interest Owners participating in the Settlement.

5. All parties agree that the economic effect of the Settlement will be maintained without change as it relates to Colorado Interstate Gas Company and its Refund Recipients, whether or not any federal or state legislation or any subsequent judicial decision would alter the outcome or the economic position of the parties intended by the Settlement The Settlement will also provide a mechanism to restore the parties to the economic position intended by the Settlement should any party fail to honor this provision.

6-5

Charles Dehart

Williams

Comments on HB 2823 2/22/00

1. We support the position taken by CIG on this bill.

2. We believe the best approach to take is the settlement process through FERC.

3. To make retro-active changes to the tax code is not good policy for the state and in this case will add serious legal questions to an already complex issue.

House Taxation
Date 2/22/00
Attachment # 7

Kansas Legislative Policy Group
P.O. Box 2716 • Topeka, Kansas 66601 • 785-232-9265 • FAX 785-232-5036
ANN PAPAY, Executive Director

TO: House Taxation Committee
Representative Susan Wagle, Chairperson

FROM: Alan E. Steppat

DATE: February 22, 2000

RE: HB 2823

Chairperson Wagle and members of the Taxation Committee. I appear today on behalf of the Kansas Legislative Policy Group (KLPG) which is an organization of County Commissioners from 38 oil and gas producing counties in Western Kansas.

Although we support the intent of the bill, we continue to have concerns with the amendatory language in Section 1, Sub-section (d) in regards to the unknown fiscal impact to counties.

Thank you for your time and consideration.

House Taxation
Date 2/22/00
Attachment # 8