Approved: April 27, 2000
Date

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairman Carl D. Holmes at 12:26 p.m. on April 5, 2000 in Room 231-N of the Capitol.

All members were present.

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

Conferees appearing before the committee: Attorney General Carla Stovall
Erick Nordling, Southwest Kansas Royalty Owners Assn.
James Remsberg, Argent Energy, Inc.
Mary Kay Miller, Northern Natural Gas
James Bartling, Greeley Gas Company

Others attending: See Attached Guest List

HB 3050 - Natural gas producer ad valorem tax refund

Mary Torrence, Revisor, presented a brief overview of the bill based on the supplemental note to **SUB SB 571**, which is nearly identical to **HB 3050**. Ms. Torrence responded to questions from Rep. Kuether, Rep. Alldritt and Rep. McClure.

Chairman Holmes welcomed Attorney General Carla Stovall, who appeared as a proponent of **HB 3050** (Attachment 1). General Stovall provided the committee a brief overview of the laws and legal decisions that led to the current situation. General Stovall then explained that there is one way that the state can right this wrong, by legislating in areas where the Federal Energy Regulatory Commission (FERC) has no jurisdiction. General Stovall stated that the passage of **HB 3050** would allow us to capture the opportunity to right a wrong which she believes was perpetrated upon the Kansas government, Kansas businesses and Kansas citizens. General Stovall then responded to questions from Rep. Sloan, Rep. Loyd and Rep. Dahl.

Appearing as a proponent of **HB 3050**, Erick Nordling, Executive Secretary of the Southwest Kansas Royalty Owners Association, testified (Attachment 1) on behalf of the Association and the several thousand royalty owners of Kansas. Mr. Nordling stated that royalty owners in the Hugoton Field have been treated unfairly in a situation created by disastrous federal regulation and the 'flip-flop' in federal decision making. Mr. Nordling included with his testimony a copy of the testimony provided, to the U. S. House of Representatives' Committee on Commerce's Subcommittee on Energy and Power, by John Majeroni of Cornell University (Attachment 2).

James C. Remsberg, President of Argent Energy, Inc., provided testimony in support of **HB 3050** (Attachment 3). Mr. Remsberg explained that his company was being held liable for repayment of the ad valorem taxes and interest for a company that was no longer in business because of Argent's buy-out. He stated that should Argent be forced to make these reimbursements, their ultimate fate, and perhaps that of similar small producers in Kansas, would be bankruptcy.

Mary Kay Miller, Vice President of Regulatory Affairs for Northern Natural Gas, then presented testimony in opposition to **HB 3050** (Attachment 4). Ms. Miller explained that the FERC held that the Kansas ad valorem tax was not a production tax and was, therefore, not eligible to be an add-on to the maximum lawful prices of natural gas. They ordered refunds, plus interest. The Court of Appeals then held that the refunds should go back to 1983. Ms. Miller stated that this bill would invite numerous litigations and could interfere with proposed settlements between interested parties and the FERC. Ms. Miller then responded to questions from Rep. Kuether, Rep. Holmes, and Rep. McClure.

Chairman Holmes asked Leslie Casson, Kansas Development Finance Authority, to respond to questions.

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES in Room 231-N at 12:26 p.m. on April 5, 2000.

James Bartling, Public Affairs Manager appearing on behalf of Greeley Gas Company and Atmos Energy Corporation, testified in opposition to **HB 3050** (Attachment 5). Mr. Bartling stated that, if passed, this bill would cause Greeley Gas to incur this tax as an additional cost of transporting and their only recourse would be to pass this cost on to their customers. Mr. Bartling responded to questions from Rep. Long, Rep. Holmes and Rep. McClure.

The hearing on **HB 3050** was recessed.

The meeting adjourned at 2:00 p.m. Next meeting will be Thursday, April 6 at 12:00 noon in room 231-N.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: April 5, 2000

NAME	REPRESENTING
TOM DAY	KCC
~~Ken Peterson~~	KS Petroleum Council
Ron Gaches	CIG & Williams
DICK CANTER	ENRON/NNG
ERICK NORDLING	SWKROA
DOUG SMITH	Southwest Ks Royalty Owners Assn.
JACK GLAVES	Panhandle Eastern/Kinder/Morgan
Mary Kay Miller	Northern Natural Gas
Dan Doman	"
Tim Kissner	" " "
Rob Wilson	NNG
Carrie L. Rensberg	Cigent Energy Inc.
~~Matt~~ Robert D. Devaney	Mull Drilling Company
Mark Holtmann	Western Res
	Hein & Weir
Cynthia Smith	KCPL
Chuck Debart	Williams
Debbie Beaver	Williams
Sandy Braden	CIG/Williams
NANCY VANDENBERG	Coastal Corp.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: April 5, 2000

NAME	REPRESENTING
Tom Day Miles	KCC
Nancy Ulrich	AG's Office
CHARLES H. FREEMAN	AARP - KS - STATE LEG. COMM
WALKER HENDRIX	CURB
Leslie Cassor	Kansas Development Finance Authority
Paula Lentz	KCC
Whitney Damron	ONEOK, Inc.
Eldridge Luber	ONEOK, Inc.
JIM BARTLING	GREELEY GAS CO / ATMOS ENERGY CORP
ED SCHAUB	WESTERN RESOURCES
Ron Hein	
Chris Wilson	
Carla Stovall	Attorney General
Nancy Lundstrom	AG's office
George Barbee	

State of Kansas
Office of the Attorney General

CARLA J. STOVALL
ATTORNEY GENERAL

HOUSE UTILITIES COMMITTEE
TESTIMONY REGARDING
HOUSE BILL 3050

by
Carla J. Stovall
Attorney General
April 5, 2000

Mr. Chairman, members of the committee, thank you for the opportunity to appear before your committee in support of HB 3050. I would like to give a brief overview of the laws and legal decisions which have brought us to the current situation, followed by a brief statement in support of the bill.

Historic Review

In 1954, the United States Supreme Court held that the Natural Gas Act allowed the Federal Government, under the Commerce Clause, to control the price paid for natural gas at the wellhead if the gas was sold to an interstate pipeline. *Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954).* From that time to 1993, the Federal Government, through the Federal Power Commission (FPC) and its successor agency, the Federal Energy Regulatory Commission (FERC), established substantially all of the rates that could be recovered by natural gas producers across the nation (i.e., regulated prices) and established the highest rate that could be charged by producers (i.e., the maximum lawful price, or MLP).

In 1974, in Opinion No. 699, the FPC authorized producers to recover "production, severance, or other similar taxes." The effect of this was to allow producers to add onto the MLP an amount equal to these taxes. At this time, Kansas did not have a severance tax, but an *ad valorem* tax, and in 1974 after Opinion No. 699

HOUSE UTILITIES
DATE: 4-5-00
ATTACHMENT 1

was issued, the Kansas Corporation Commission filed a request with the FPC to clarify whether Kansas producers were specifically allowed to recover the Kansas *ad valorem* tax. The FPC responded by issuing Opinion No. 699-D which ruled that Opinion No. 699 allowed producers to recover the Kansas *ad valorem* tax in excess of the MLP.

Four years later, in the Natural Gas Policy Act of 1978, Congress codified (in Section 110) the FPC's earlier decisions allowing reimbursement of State "production-related" taxes (e.g., Opinions No. 699 and 699D). While Section 110 did not mention the tax of any specific state, the legislative history made it clear that the Kansas *ad valorem* tax was intended to be included as a tax allowed to be passed through; the NGPA Conference Report noted that this included "an ad valorem tax or a gross receipts tax."

As I am sure you remember, in the early 1980's the Kansas legislature began considering enactment of a severance tax on the production of oil and gas. In the 1981 the Kansas Secretary of Revenue testified before the Kansas Senate Tax Committee that the FPC had ruled that Kansas' current *ad valorem* tax, as well as a severance tax if enacted, could be passed through to allow producers to recover both taxes. In reliance on the FPC ruling, previous Congressional action, and other rationale, the Kansas Legislature in 1983 passed a severance tax. The information legislators had at the time they cast their votes made it clear that no natural gas producer would have to shoulder this additional tax because the law was crystal clear in this regard. Kansas legislators expected producers to lawfully add on both the severance and *ad valorem* taxes in excess of the maximum lawful price.

Now that Kansas had two taxes being passed through, Northern Natural Gas Company filed an application with the FERC to "reopen, reconsider and rescind" Opinion No. 699-D. FERC rejected Northern's request stating that it was **"clear beyond question, that the Kansas *ad valorem* tax is based, in large part, on gas production"** (emphasis added), and reaffirmed its prior opinion, issued twelve years earlier, which allowed the tax to be passed through. Northern asked for a rehearing of its application, which FERC denied, once again confirming the validity of Opinion No. 699-D and assuring Kansas and Kansas producers that *ad valorem* taxes could lawfully be passed through.

Shortly thereafter, the *Northern* decision was appealed to the D.C. Circuit which, on June 28, 1988, held that FERC had not adequately explained the rationale of its order in allowing the Kansas *ad valorem* tax to be passed through as a tax on production. *Colorado Interstate Gas Co. v. FERC, 850 F.2d 769, 773 (D.C. Cir. 1988)*. The case was remanded to FERC where it sat idle on FERC's docket for a period of **five years**, from 1988 to 1993. (This delay is significant because a subsequent FERC decision would cause interest claims amounting to millions of dollars to accrue during this period, through no fault of the producers, royalty owners, or the State of Kansas.)

Finally, in 1993, FERC issued an Order on Remand reversing itself and its Opinion No. 699-D, finding that the Kansas *ad valorem* taxes had been improperly added onto the maximum lawful prices, because the tax was not now considered by FERC to be a tax on production. The FERC ordered natural gas producers to pay refunds of the *ad valorem* amounts **retroactive to June 28, 1988**, the date the Court of Appeals had first remanded the case to FERC. This ruling was also appealed to the D.C. Circuit and in 1996, the Court agreed with FERC's new interpretation, that Kansas' ad valorem tax did not qualify under Section 110, to be passed through. But the Court held that refunds would be **retroactive to October of 1983** when the notice of Northern's petition had been published in the Federal Register -- expanding by five years the period for which refunds were due. It was these five years, from 1983 to 1988, that the case had sat idle on FERC's docket! *Public Service Company of Colorado v. FERC, 91 F.3d 1478 (D.C. Cir. 1996).*

By selecting this date for retroactivity, the D.C. Circuit essentially held that all producers should have known that Northern's 1983 petition would be granted thirteen years later. Not only is it absurd to presume producers should have known the FERC would reverse six separate opinions that it had issued over a 13 year period, but it is incomprehensible that the Court could expect the producers to have known retroactive refunds would be ordered when nothing in the notice of the petition made any mention of potential refunds! **The Court went so far as to say the producers were "foolhardy"** to have relied on the FERC's decisions - despite those opinions were final, non-appealable orders - and notwithstanding the administrative finality provisions of the NGPA.

FERC not only has refused to grant hearings to determine the actual amounts of retroactive tax refund due, but has refused to waive interest on these retroactive refunds, interpreting the Court's decision to require the imposition of interest on the *ad valorem* tax refunds, even though the court's decision was silent on this issue.

The decision of the Court of Appeals effected a retroactive change in the law. That change was a **complete reversal** of the state of the law at the time. Had there been any warning of the impending change in federal policy, this legislature could have amended - or at least had the opportunity to consider amending - the Kansas ad valorem tax statute to assure that the tax would qualify for continued treatment under the NGPA in the same manner as the tax had been treated under the Natural Gas Act and as similar taxes in other producing states are treated, notably that of Colorado. But the FERC's dilatory actions and the revisionist ruling of the Court of Appeals conspired to impose a harsh burden on the State of Kansas, Kansas producers, and Kansas royalty owners.

The Kansas legislature justifiably relied on the FPC's and the FERC's several decisions that the Kansas ad valorem tax was a permissible add-on to the maximum lawful price both under the NGA and under the NGPA. The point is that it is not just the producers who relied on FERC's assurances. The government of the State of Kansas relied on FERC's rulings. Our producers, royalty owners and domestic economy are now disadvantaged by reason of a retroactively effective Court ruling.

It should be noted that this is not an area where consumers have been harmed in any sense. In fact, consumers were the primary beneficiaries of the abundant gas supplies and lower gas prices which resulted from the NGPA. After Congress enacted section 110 of the NGPA in 1978, consumers had no reasonable expectation that the production-related taxes of producing states would not be passed on to consumers. Additionally, consumers have also received the benefit under the NGPA of regulated prices often below the MLP and in many instances well below the market price.

I would also note that neither the producers nor the royalty owners are the J.R. Ewings we remember from the television show, living in mansions and driving expensive automobiles. The royalty owners are retired farmers who have come to rely

on the little "gas check" each quarter to supplement their Social Security. The producers are often small family companies that are now on the brink of bankruptcy as they face this court's mandate to pay refunds.

The FERC does not have an accounting of what the producers should refund so it called for the pipelines to make their own accountings and submit "bills" to the producers. The producers are required to pay 100% of the "bill" into escrow or to post a bond in the amount of the "bill." Before allowing the pipelines to take possession of the money, FERC agreed to determine the liability of the producers if they requested hearings or sought adjustment relief. To date FERC has not granted any hearings, although 20 requests for hearing on the accuracy of the claims have been filed. In my view, requiring payment before any determination of whether the refund is actually owed is simply an other indication of the arrogance of the federal government in this issue and of its absolute jaundiced view of justice and due process as those concepts should apply to the producers and royalty owners. The "bills" being sent by the pipelines to small natural gas producers have caused those producers to teeter on the brink of bankruptcy. The interest - calculated at prime compounded quarterly - that the pipelines claim is due is now more than 160% of the principal! Such adverse financial consequences, in a period of historic low prices, spells doom for the natural gas industry in Kansas -- home of the Hugoton gas field, the largest in the continental U.S. and second largest gas field in the world.

And why are the producers and royalty owners being made to pay these exorbitant "bills"? Not because they were cheating on their taxes. Not because they hid their interest in a gas well from government officials. Not because they thought of a scheme to overcharge the pipelines and ultimately consumers. But because they were following the law as it had been interpreted consistently for nineteen years by a federal agency!

This seems no different to me than if the Internal Revenue Service reinterpreted its policies and procedures and determined that home mortgage interest was no longer deductible - and should never have been considered deductible. Can you imagine the public outcry that would deafen us as homeowners received notice that they owed retroactively all the deductions they had claimed on their income taxes ***plus interest*** thereon! Can you simply fathom it? And, yet, I cannot say, in light of this FERC phenomem that it could not happen. As the state's chief lawyer, I am stymied to

explain how this system of American jurisprudence, said to be the finest in the world, could condone this travesty.

Not only do the owners, employees, and suppliers of the production companies suffer financially -- the State of Kansas suffers as revenue from income, property, severance, *ad valorem*, conservation and anti-pollution taxes declines. The state will also lose income tax revenue from the major out-of-state producers, who also owe these *ad valorem* tax rebates. This is especially problematic in this time of our state's severe budget shortfall.

Judicial, Administrative and Legislative Remedial Action

As you would expect, the *Public Service* decision of the Circuit Court was not accepted without objection. A Petition for *Certerari* was filed with the United States Supreme Court, but was not accepted. As you know, the odds on getting a case accepted by the High Court are very high and, because this issue affects essentially one state only, it was not a surprise the Court did not take the case - although, assuredly, it was a disappointment.

A specific issue on this entire morass was before the D.C. Circuit Court of Appeals in September of 1999 and I argued the state's portion of the case myself because I believed the Court had to know that Kansas is heavily invested in remedial action and finds the latest rulings of the Circuit Court and FERC unjustifiable. I have never appeared before such a hostile court as I did that day and no one was surprised when an unfavorable decision was issued.

There have been several attempts on the administrative level to get FERC to revisit this problem. First, although there have been numerous requests to the FERC for hearings by affected producers, no hearings of any kind have been set. A few "hardship" cases involving bankruptcy and the like have been decided, however, the FERC will not grant any kind of hearings to establish what, if anything, individual owners owe. The FERC admits that some will owe nothing at all but it still does nothing to make such findings!

Congress has also been a forum in which we have sought relief. Petitions for redress of grievances have been presented to Congress and have been pursued vigorously by Senators Roberts and Brownback and Congressman Moran and the rest of the Kansas delegation. The bills did not seek waiver of the entire debt, but just of the obligation to pay interest. It is probably not surprising that our delegation has been unable to get this issue high on leadership's agenda as it affects only producers and royalty owners with interest in Kansas natural gas. It is a essentially viewed as a parochial problem and not one likely to receive Congressional remediation. Thus, it is up to us to help ourselves.

And the Kansas legislature has acted to mitigate the situation in two ways. First, in 1998 you passed Senate Concurrent Resolution 1616 urging Congress to provide "...relief from the order of the Federal Energy Regulatory Commission requiring Kansas natural gas producers to pay penalties and interest on certain refunds..." Secondly, the same year you passed K.S.A. § 55-1624, which absolved both producers and royalty owners from having to pay refunds and interest with respect to the royalty portion of any claim. (A royalty interest can range up to a quarter or thereabouts of the total claims.) Royalty owners are not subject to the FERC's jurisdiction, so the FERC ordered the producers to assume financial responsibility for the royalty owners' liability unless the producers could prove that the amounts were uncollectible from the royalty owners. The Kansas statute made any such claim uncollectible - thereby relieving both the producers and royalty owners of this financial obligation.

The FERC, however, reviewed the good work of the Kansas Legislature and **disregarded it.** The FERC essentially said they were unwilling to recognize your authority to enact such a statute. The arrogance of this federal agency is intolerable, in my judgment and the State of Kansas is challenging that decision. I am determined to vindicate that Act of this legislature. I will not accept the proposition that a mere federal agency can nullify a Kansas statute, something that even a federal judge cannot do.

HB 3050

Remedies have all but been exhausted, however, there is a bright spot of hope. There is one way that the State of Kansas can right this terrible injustice: it can legislate in areas where the FERC, indeed the federal government, has no jurisdiction. This is

the genesis of HB 3050, which mounts an effective and just solution desperately needed to protect Kansas' vital gas interests from the excessive and unreasonable exercise of power by the FERC and the Federal Courts. This Legislature can extinguish all liability for both principal and interest.

When the D.C. Circuit dismissed Kansas' argument in our September argument regarding the disastrous impact the refund obligation would hold for the Kansas economy in general and the gas industry in particular, it held voiced its recognition that we could remedy our own problems. The Court stated, Kansas "...retains numerous avenues for aiding" producers if it so desires. *Anadarko Petroleum Corp. v. FERC, 196 F.3d 1264 (D.C. Circ. 1999).* The passage of HB 3050 would allow us to capture the opportunity to right the unfathomable wrong which has been perpetrated upon Kansas government, Kansas business, and Kansas citizens.

Conclusion

I urge you to support this bill. It redresses an unjust ruling having detrimental effects on a significant sector of the Kansas economy. I also urge you to support this bill to correct the effects of an unjust and unreasonable decision by a federal administrative agency against the sovereign state of Kansas. Since neither the federal courts, FERC nor Congress appear inclined to alleviate this injustice, this legislature can through HB 3050 alleviate the detrimental affect on the Kansas economy.

Although I will continue the fight on all fronts to right this terrible injustice perpetrated by the FERC and the federal courts, you can do more than is within my power. "Fools" though you and I may be in the eyes of the DC Circuit, fools for trusting in the federal government to honor its precedents or, if not, to make only prospective adjustments, you are not powerless to rectify this injustice. Indeed, you are the only institution with the power to eliminate the liability. That power rests soundly in the passage of HB 3050. Let us work together to achieve justice.

SWKROA
SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION

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PHIL DICK, PRESIDENT
ERICK NORDLING, EXECUTIVE SECRETARY
B.E. NORDLING, ASS'T. SECRETARY

Statement of
Erick E. Nordling, Executive Secretary
Southwest Kansas Royalty Owners Association
Hugoton, Kansas

RE: House Bill No. 3050

April 5, 2000

To the Honorable Members of the House Utilities Committee.

Chairman Holmes and Members of the Committee:

REMARKS

My name is Erick E. Nordling of Hugoton, Kansas. I am Executive Secretary of the Southwest Kansas Royalty Owners Association (SWKROA). I would like to submit remarks for your consideration on behalf of members of our Association and on behalf of all Kansas royalty owners in support of House Bill No. 3050, which is comparable to Substitute for Senate Bill No. 571.

Our Association is a non-profit Kansas corporation, organized in 1948, for the primary purpose of protecting the rights of landowners in the Hugoton Gas Field. We have a membership of around 2,500 members. Our membership consists of landowners owning mineral interests in the Kansas portion of the Hugoton Field who are lessors under oil and gas leases as distinguished from oil and gas lessees, producers, operators, or working interest owners.

There are tens of thousands of royalty owners who own minerals in Kansas, including someone in virtually every Kansas community. Although many are not members of the Association,

the Association still represents their interests as well by advancing its goal of protecting the interests of royalty owners in the Hugoton Field. While most royalty owners in the Hugoton Field are people who acquired their interest from their ancestors who worked the lands that overlay the Field in southwest Kansas, there are also charitable organizations and public institutions which own royalty interests as a result of gifts from royalty owners. They include: Kansas Masonic Home, Kansas Chapter American Heart Association, Salvation Army, Dakota Boys Ranch Association, Society of the Precious Blood, Kansas Children Service League, Sloan Kettering Institute, Baughman Foundation, Mennonite General Conference Church, University of Kansas, Kansas State University, Wichita State University, Regents of Colorado University, McPherson College, and Southwestern College, just to name a few. Most of the interests of the royalty owners are quite small, and most probably receive less than a couple of thousand dollars annually from their interest. Unfortunately for them, unlike the recent surge in oil prices, the price of gas has not seen any substantial increase in more than a decade.

Royalty owners in the Hugoton Field have been treated unfairly from a situation created by disastrous federal regulation and the flip-fop in federal decision-making which had its genesis over 25 years ago, but the royalty owners are just feeling those effects today. I am attaching the testimony of Mr. John Majeroni of Cornell University, a member of the Association, who describes this situation to the U. S. Congress Committee on Commerce, Subcommittee of Energy and Power last year. Suffice it to say, Kansas royalty owners are now being demanded to pay tens of millions of dollars by pipeline companies, producers and the Federal Energy Regulatory Commission for claimed overpayments to them due to the flow-through of Kansas ad valorem taxes assessed in the mid-1980s. Indeed, many are presently being sued in putative class action lawsuits by producers,

which are forced to take this action by the pipeline companies and the Federal Energy Regulatory Commission.

The Association deeply appreciates the past support of the Kansas Legislature, including the passage of House Bill No. 2419 in 1998 that addressed this problem. At least to date, however, the Federal Energy Regulatory Commission has rebuffed this Legislature's attempts to deal with this obvious inequity, which was, in part, created by the Commission itself. On behalf of all Kansas royalty owners, the Association asks for your support of House Bill No. 3050, which would relieve those royalty owners of the threats of payment of those unjust and ancient claimed debts associated with the discharge of the assessment of Kansas ad valorem taxes over a decade ago.

Respectfully submitted,

Erick E. Nordling,
Executive Secretary of the Southwest Kansas
Royalty Owners Association

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EXECUTIVE SUMMARY

JOHN MAJERONI,
Cornell University Real Estate Department,
on behalf of the
SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION

RE: KANSAS AD VALOREM TAX REFUND
Committee on Commerce, Subcommittee on Energy and Power
June 8, 1999

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 benefited will not be the same as those who are being punished, and collection will be uneven and unequitable.
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.

Statement of
JOHN MAJERONI,
Cornell University Real Estate Department,
on behalf of the
SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION

RE: KANSAS AD VALOREM TAX REFUND

June 8, 1999

To the Honorable Members of the Committee on Commerce,
Subcommittee on Energy and Power:

Chairman Barton and Members of the Committee:

INTRODUCTION

My name is John Majeroni of Ithaca, New York. I'm a West Point graduate from the Class of 1974. During my six years in the Army I served as a Platoon Leader, on General Staff, and as a Company Commander. Shortly after getting out of the Service I went to work for Cornell University and am now the Director of the University's Real Estate Department. I have been managing Cornell's oil and gas properties for 18 years. I am not an attorney. I think I represent a knowledgeable, but lay-person's, point of view.

I was invited to speak by the Southwest Kansas Royalty Owners Association (SWKROA) -- a non-profit Kansas corporation,

organized in 1948 to protect the rights of landowners in the Hugoton Gas Field. Cornell is a member of this organization which has a membership of around 2,500 members, many of whom are farmers and ranchers. Most of its members are family owners of mineral interests, as distinguished from the companies that act as producers, operators, or working interest owners. SWKROA has been our primary source of information about the ad valorem tax refund problem. In fact, to my knowledge, we've had no communications from our producers or the FERC on this very important issue.

You may be surprised to see a representative from a university here. I'm probably not what you expected to see. When you think of a royalty owner, perhaps you have visions of rich Texans, like 'J. R. Ewing'. But the impact of the ad valorem tax refund issue is much greater than a few rich oil men. It impacts thousands of people and organizations who own mineral and royalty interests, including not-for-profit organizations, such as Cornell University. It impacts local school districts and churches.

The average royalty owner isn't rich. They are farmers and ranchers. In many instances these royalty and mineral interests have descended from generation to generation from people who lived in Southwest Kansas many years ago. Current royalty owners often only own a small fraction of the original interest. Many of the

royalty owners are elderly. These royalty checks are like their Social Security supplements. Further, this is not an issue which affects only Kansas residents. Persons throughout the United States and several foreign countries own these minerals and are affected by this ruling. It is certain that some royalty owners are among your constituents.

And so my remarks are being made on behalf of all affected royalty owners to seek legislative relief from the impact of the Federal Energy Regulatory Commission (FERC) order dated September 10, 1997. In that ruling, FERC ordered first sellers of natural gas to make refunds of reimbursement for Kansas ad valorem taxes paid from 1983 to 1988, plus interest, including reimbursements attributable to royalty interest owners.

I am here because of the unfair and unjust treatment which FERC has inflicted upon the royalty owners. Apparently it is legal, but it is wrong.

It is wrong because people are being punished for flip-flops in decision making at FERC. It is wrong because royalty owners had, and continue to have, absolutely no control over any decisions relating to the issue, and yet we bear not equal, but even more liability, than those who have control. It is wrong because royalty owners are already in a less-than-equitable

position financially in most wells and are only being punished further. It is wrong because the nature of the compound interest calculations on the amount due makes it punitive. It is wrong because it in many cases, those who benefited will not be the same as those who are being punished. And it is wrong because there will be no real winners, but plenty of real losers -- in other words: the action will be an unearned windfall of profits for pipeline companies, but will have a substantial, painful impact on the royalty owners from whom it is being collected. And besides arguments of equity, there are still legal questions relating to FERC's jurisdiction over royalty owners and the statue of limitations. I'd like to go briefly into detail on each of these issues.

FLIP-FLOPS IN DECISIONS AT FERC.

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.

Several years prior to the passage of the Natural Gas Policy Act of 1978, the Federal Power Commission (FPC), (the predecessor of the Federal Energy Regulatory Commission (FERC)), had held that

producers could increase the applicable just and reasonable rate for natural gas to recover "state production, severance or similar taxes", and that any state ad valorem tax "based on production factors" was a "similar tax" which could be added to the national rate. In 1976, the FPC held that the Kansas ad valorem tax qualified because the bulk of the tax was based upon production factors.

In 1978, the Natural Gas Policy Act ("NGPA") set maximum lawful prices for the first sale of various categories of natural gas. Under Section 110(a)(1) of the NGPA, the first sale was allowed to exceed the maximum lawful price to the extent necessary to receive "state severance taxes attributable to the production of such natural gas." The NGPA defined "state severance tax," as "any severance, production, or similar tax, fee or other levy imposed on the production of natural gas."

Oil and gas producers in Kansas, relying on FPC and FERC rules, "passed through" the Kansas ad valorem taxes to consumers of natural gas. The time frame covered by the controversial ad valorem tax refund is for the years 1983 through 1988.

The problem arose when FERC changed its position some fifteen years after its order and retroactively ruled that the producers should not have been allowed to pass the Kansas ad valorem taxes

through the pipeline companies to the consumers.

FERC then ordered producers (first sellers) to reimburse the consumers, through the pipeline companies, for not only the ad valorem tax which had been added to the maximum lawful price, but also for interest. FERC has also attempted to exert control over Kansas royalty owners by urging the producers to collect the refund from royalty owners, taking the position the producer will be liable to also pay the royalty owner's share of the refund with interest.

The projected impact of the FERC's unfair decision is estimated to be approximately $340 million dollars. Of this amount, approximately $200 million dollars represents interest. Congressman Moran has introduced a bill to waive the interest portion of refund obligation. This would be a significant help, but Congress should go further by overruling FERC's September 10, 1997 and subsequent orders.

Kansas State Senator Stephen R. Morris, R-Hugoton, made an analogy that FERC's actions should evoke a similar reaction that taxpayers would make if the Internal Revenue Service (IRS) were to disallow the deduction of home mortgage interest, with no justification, and require taxpayers - who had been relying on regulations which the IRS had been operating under for twenty or

more years - to retroactively pay back the amount of the home mortgage deduction, plus interest. Surely, such action would raise a public outcry of illegal, unfair and unjust treatment by a federal agency. Yet FERC, if left unchecked by Congress, has caused such a travesty.

ROYALTY OWNERS HAD NO CONTROL.

The way that a gas lease is structured, royalty owners have no control over the wells. We don't control when or where the wells are drilled. We don't control the price gas is sold for, or to whom the gas is sold. We certainly don't control expenses of drillers. We didn't direct taxes to be paid on our behalf. In most instances, royalty owners didn't even see the tax bills. Generally, the taxes were billed by the County Treasurer directly to the producer who either paid the taxes, including the royalty share, and then sought reimbursement from the pipeline companies for the taxes. Or, the producer billed the pipeline company for the taxes and the pipeline company paid the taxes.

For certain, we have had absolutely no decision making in this issue. None. In most cases, royalty owners don't even have any knowledge or aren't aware that there is an issue. If there was as mistake, royalty owners shouldn't pay for it. This is

especially true of having to pay interest. Most royalty owners have yet to be billed (or even notified), and yet interest continues to grow and compound!

Despite this lack of control over any decisions relating to the ad valorem issue, we bear not equal, but even more liability, than those who did have control. Because of the way that ad valorem taxes are determined, royalty owners generally pay more than 1/8th of the amount that producers pay because they have no effective deductions to offset against the tax as do the producers, such as depreciation. (One-eighth (1/8) is the normal fraction for royalty paid under old oil and gas leases.) SWKROA has estimated the ad valorem tax bill for royalty owners could be in the range of 20 to 30 percent of the total ad valorem assessment rather than the usual 1/8th. Based on that estimate, Kansas royalty owners could potentially be asked to refund between 68 to 100 million dollars. That, of course, is a huge amount by anyone's standards.

ROYALTY OWNERS WERE ALREADY IN A LESS-THAN-EQUITABLE POSITION FINANCIALLY.

The FERC ruling is also wrong because it is seeking to "adjust" a position that was inequitable to begin with. Prices

for Hugoton gas in the 1983-1988 time frame were capped at unrealistic levels of $.50 per MCF or less. Pipeline companies were already profiting at royalty owners' expense. The FERC ruling essentially directs us to pay over even more profit for the pipeline companies. The leases from which the affected mineral owners are receiving royalties, are for a long term, most of them being fifty to sixty years old. Most of these leases provide for 1/8th royalty. This is already unfair to landowners since new leases are at 20-25% royalty. Why punish the royalty owners further?

THE INTEREST CALCULATIONS ON THE AMOUNT DUE MAKE IT PUNITIVE.

Interest is fair and proper if knowledgeable financial transactions are entered into. Decisions are made about whether or not "the interest" is worth the advanced funds. This is the decision one makes when deciding to buy an expensive TV on credit or save for it. In this instance, royalty owners had no opportunity to make any decision on the payment of interest.

The interest assessed by FERC isn't part of a financial transaction. It's a form of punishment -- a punishment for an act taken by somebody else, not the royalty owner's. FERC arbitrarily assigned interest to accrue. To my knowledge, there has been no

judicial determination that interest should be charged.

The FERC interest rates also appear to be very high, especially by today's standards. We didn't ask to borrow the money. We haven't been asked yet to repay it. The interest continues to accrue and we don't even have information on what we supposedly owe. This is patently unfair.

Further, the typical royalty owner certainly did not earn the level of interest being charged. They spent it. They live on it.

Interest is bad enough, but compound interest is particularly punitive. Someone once said "interest never sleeps." It is certainly true in this case. Look at the facts here: $140 million owed, $200 million in interest.

THOSE WHO BENEFITTED WILL NOT BE THE SAME AS THOSE WHO ARE BEING PUNISHED.

The funds in question are 10 to 15 years old. In some cases properties have been sold. In other cases, parents have passed away. How are these funds to be collected?

Royalty owners who inherited minerals subsequent to 1988 are not subject to the refund claim under the Wylee case. Different producers are approaching the problem in different ways. Imagine, in your district, going back and trying to collect an adjustment in taxes that was levied on homeowners 15 years ago. Imagine the confusion as you try to sort out who was living where when and who should pay.

Collection is bound to be uneven and unequitable. The producers even recognize this and, as you will see by their statements in subsequent pages, object to being put in the position of collecting these funds.

SWKROA Director John Crump, in 1998, testified before the Kansas Legislature in support of Kansas Senate Bill No. 685 (which later became HB2419) and gave several reasons for supporting SB685. Among his arguments was that collecting this debt would be difficult, expensive and time-consuming for the producers to

locate and correspond with those royalty owners who owned the royalty interests from 1983 to 1988. Crump then pointed out examples of the inconsistencies in the pattern of billing by some of the producers on the claimed refunds.

THERE ARE NO REAL WINNERS, BUT PLENTY OF REAL LOSERS.

There are really no injured parties in the FERC ruling, but enforcing the ruling will certainly injure plenty of people. Who is the money going to? While the ultimate destination of the funds to be collected is not clear, you must also ask why are the pipeline companies fighting this issue so hard. Is it to benefit the consumers who should receive the recoupment? Or is it more likely that the pipeline companies will keep it?

The action will be an unearned windfall of profits for pipeline companies who, remember, are already reaping more than their fair share of profits.

If efforts are made to somehow distribute the funds to all natural gas users in America, it will provide no meaningful benefit to their lives. It may end up getting distributed to them in the form of grocery coupons or it might end up as a one-time deduction of a few cents off their gas bill. However, there is a real, substantial, painful impact on the royalty owners from whom

it is being collected. Imagine the typical family in your district getting a bill in the mail for $5,000, or $25,000, or $100,000. They simply don't have the savings to pay it. Some of the producers are signaling that if payments aren't made, they will just stop making royalty payments and collect it that way. But if royalties stop, it will still be have huge impact on royalty owners, many of whom are elderly. They've adjusted their lives to live off of it. In some cases, for generations.

Let me give you an example of the impact. I recently spoke on the phone with Kimberly Nicholson. She lives in Vancouver, Washington. Her family owns minerals in Kansas. They are a moderate family with three children and an average income. She was also caring for her mother, who lived nearby in a small two room house. Her mom was dying from Lou Gehrig's disease.

In March, she got a letter from a producer, Helmerich and Payne, saying they owed $25,000, which was due in ten days. $9,000 of this amount was for the ad valorem tax, and $16,000 for interest.

There is absolutely no way the Nicholson family has this much money available on 10 days notice. They had no advance notice whatsoever and had no prior knowledge of the entire situation. They just got a bill in the mail for $25,000, due in 10 days.

They couldn't understand how a mistake by the oil company in 1984-1985 could still apply. They contacted their attorney about the statute of limitations which would govern this situation. Even their local attorney didn't really know what to tell them. She commented to me that they certainly had not earned $16,000 interest on the money. They had spent it. They count on their royalty checks as part of their income. In particular, it is what they used to take care of her mother.

This is the way that most of the thousands of royalty owners will be affected by FERC's actions.

By the way, Kimberly's mother passed away last month.

FERC'S LACK OF JURISDICTION OVER ROYALTY OWNERS

Producers have agreed that FERC lacks jurisdiction over a royalty owner. In a motion before FERC, the producers stated that:

> "The Commission (FERC) purports to design around this obvious bar (Kansas House Bill No. 2419, which became K.S.A. 1998 Supp. 55-1624) by saying that the working interest owner must underwrite royalty owners' share, even though the royalty owners, not being first sellers, could not have violated the NGPA (Natural Gas Policy Act). **That is trying to do indirectly what the law denies directly: regulate the royalty owners.**
>
> "Working interest owners cannot be the pawns in an issue of the reach of the commerce clause and the related

> statutes. The federal government cannot make the working interest owners take money away from non-jurisdictional royalty owners without notice and an opportunity to be heard, when to do so would violate a state statute. **It is unjust, unreasonable, and unlawful to force producers to knowingly violate of a putatively valid State law or else pay a penalty at the command of the federal government."** (Emphasis ours)

The FERC has no jurisdiction of Kansas royalty owners and yet it has placed on Kansas producers the burden of attempting to collect the tax. The order affects thousands of Kansas royalty owners.

STATUTE OF LIMITATIONS ARGUMENTS

Royalty owners have also asserted that the Kansas statute of limitations bars recovery of the ad valorem tax recoupment from royalty owners. Kansas lawmakers in 1998 specifically addressed the issue and declared that the ad valorem tax refund is uncollectible due to the expiration of the statute of limitations governing such recovery and bars recovery against royalty owners. (Kansas 1998 House Bill No. 2419, which became K.S.A. 1998 Supp. 55-1624)

On May 19, 1998, in order to determine whether FERC would honor the Kansas legislation by finding that such legislation would render 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 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, R-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 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."

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."

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.

It is obvious that Congressional help is needed to abate

FERC's rulings.

AFTERMATH OF FERC DECISIONS

So where do things stand now? Producers are handling their royalty owners differently. A number of royalty owners have received letters from their producers or pipeline companies (or in some instances directly from FERC) demanding or requesting that they reimburse them for the Kansas ad valorem tax and interest. **However, perhaps only 5% of Kansas royalty owners have received such notices.**

SWKROA General Counsel, Gregory J. Stucky, summarized the impact of the FERC decision, as follows:

> "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 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. Even that date may not be considered firm by the FERC, if the producer can show some justifiable excuse for missing that date."

Taken to a more individual level, any potential refund obligation could possibly represent several years of current royalty payments, or with the compounding of interest and because of declining production could last the life of the well. 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 SWKROA has membership of around 2,500, there are literally tens of thousands of royalty owners throughout the United States who are completely unaware of this potential financial bomb.

On behalf of the royalty owners I respectfully request your Sub-committee and Congress grant relief to royalty owners from the burden of this decision by FERC. What are your alternatives?

1. Seek no adjustment at all, from either producers or royalty owners, recognizing that:

- the change in FERC's decisions are unfair;
- that collection benefits only pipeline companies who at the time already had a financial edge;

- that collection efforts for a 15 year old debt will be uneven and inequitable;
- that there will be no winners, but plenty of real losers from this ruling; and
- that the statue of limitations may have expired on this issue.

2. Release producers from the burden of collecting from royalty owners, recognizing that royalty owners:
   - had no control over the actions which took place;
   - were already in a less-than-equitable position financially and are only being punished further; and
   - FERC's ruling illegally expands their jurisdiction to regulate royalty owners.
3. At the very least, prohibit interest from being charged on royalty owners share, because it is punitive.

I started my remarks by saying that Cornell was not the typical royalty owner. Because of our resources and our involvement with SWKROA we are probably more knowledgeable and in some ways better prepared than the average royalty owner to deal with this issue. As you proceed in learning more about this issue and hopefully in becoming involved, I urge that you keep them in

mind -- hard working farmers and ranchers who are being punished for something they had no hand in.

Respectfully submitted,

John Majeroni

2-26

Testimony of James C. Remsberg,
President of Argent Energy, Inc.

on

House Bill 3050

Before the House Utilities Committee

April 5, 2000

HOUSE UTILITIES
DATE: 4-5-00
ATTACHMENT 3

Argent Energy, Inc. is a small independent Kansas oil and gas producer/operator. I formed Argent Energy November 1, 1989, three years after the 1986 oil price collapse. At its inception, the company had no producing properties, only some cash the stockholders had contributed to get it started. Argent has survived and grown both by successful exploratory drilling and by acquiring producing properties. Additionally, it operates producing properties owned by others, and receives compensation for these services. It has three employees.

Early in 1993, Argent purchased working interests in 27 wells from Kiwanda Energy, Inc. for $195,000. Ten of these wells were oil wells, two were saltwater disposal wells, and fifteen were gas wells. Prior to purchase, Argent had had no connection whatsoever with any of these wells. The sale was an arms length, contractual business deal wherein Kiwanda agreed to indemnify and hold Argent harmless from all claims, liabilities, penalties, and losses arising out of any obligations incurred by Kiwanda concerning these properties (except as specifically assumed by Argent). Further, Kiwanda warranted that these properties were unencumbered and were free and clear of adverse claims.

A few weeks after the purchase of these properties, Argent terminated the gas sales contract Kiwanda had in place with Northern Natural Gas Company. Under that termination agreement, Northern discharged Argent (and its officer, directors, agents, and employees) from "any and all liabilities, claims and causes of action, whether known and asserted or hereafter discovered, arising out of or relating to said contracts ----". Argent then entered into its own sales contract with Northern.

By letters dated October 5, 1998, and October 12, 1998, Northern Natural Gas Company directed Kiwanda and its predecessor, Energy Exploration and Production, Inc. to make payments for stated amounts due for reimbursement of Kansas *ad valorem* taxes paid them during the period 1983 to 1988. Since both Kiwanda and

its predecessor are now out of business, the letters were readdressed by Northern and sent to those two entities at Argent's mailing address. By letter dated November 2, 1998, Argent replied that it was not affiliated with, and was not a mail drop for either Kiwanda or its predecessor. Further, at the time interval specified in the demand letter, Argent did not own an interest in these properties, and indeed was not even in existence during the time of the alleged reimbursements, thus could not have received any such reimbursements.

In spite of this reply, Argent received a letter from the Federal Energy Commission dated March 26, 1999, in which the Commission appears to have determined that Argent is indeed liable for these reimbursements as a successor to Kiwanda and its predecessor. The total of these alleged reimbursements plus interest was stated to be $855,147.60. I say alleged, because in all the files we were given when we purchased these properties, there is nothing to indicate such reimbursements were paid to Argent's predecessors. Perhaps they were, but I certainly have no proof of that. In any event, Argent has been forced to retain legal counsel to defend itself from being held responsible for an amount more than six times what it paid for these properties in 1993. At times, I wish we had just thrown the first letters from Northern Natural in the trash unopened, but I suppose that would have only delayed this debacle.

I still don't understand how a 1974 FPC ruling which allowed pass-through of Kansas *ad valorem* taxes (a ruling which was consistently upheld), could be reversed retroactively for fourteen years, be assessed on natural gas producers who had complied with the law in effect at the time, then have fourteen years of interest, (at FERC prescribed rates, compounded quarterly) added as a penalty. It is difficult to comprehend such an action occurring in this country -- and I still cannot believe that any regulatory body constituted in this country could hold Argent Energy, Inc. liable for repayment of reimbursements which it did not receive, on properties it did not

own, during a time period before it existed, with no possibility of recoupment from the now non-existent seller.

April 26, 1999, Argent filed with the FERC a request for Waiver of Refunds or for a Re-Hearing. The Request for Re-hearing was denied May 26, 1999. Argent's filing was supplemented July 12, 1999. The FERC indicated, by letter to Argent, dated August 27, 1999, that it had not completed its review, and extended its determination period 150 days. By letter dated January 13, 2000, the FERC informed Argent that "We have not yet completed our review", and extended the determination period another 150 days. If the FERC cannot make a determination in less than 15 minutes, given the facts established in Argent's situation, I submit something is terribly wrong.

Yet, the threat still hangs over us.

As I stated at the beginning, Argent is a small independent producer. Our cash flow is simply insufficient to pay this amount of money, even if payment over the time allowed for hardship cases is granted. If the FERC determines Argent must pay the stipulated reimbursements, we have two options: One, we can take bankruptcy and let the FERC derive what funds it can out of the gas producing properties, or, Two, we can hire legal counsel and try to reverse the FERC's determination all by ourselves. Given the expense of hiring Washington, DC attorneys, this option probably would force us into bankruptcy, as well. While Argent's position is unique, I fear that the ultimate fate of bankruptcy faces more than a few similar Kansas small producers if they cannot receive relief.

Mr. Chairman, and members of the Committee, I urge your support of Amended Senate Bill 571. Thank you.

Statement of Mary Kay Miller
Vice President, Regulatory Affairs
Northern Natural Gas

Hearing on HB 3050
House Utilities Committee
Kansas Legislature
April 2000

Chairman Holmes, members of the Utilities committee.

Good morning,

My name is Mary Kay Miller, I am Vice President of Regulatory Affairs, Northern Natural Gas (NNG). The NNG pipeline system consists of approximately 16,500 miles of pipe and 59 BCF of total storage capacity. In Kansas, NNG operates in 23 counties, serving residential, commercial, and industrial customers in 27 communities. In 1998, NNG paid nearly $9 MM in property taxes to the State of Kansas.

I commend Chairman Holmes and this committee for holding this hearing on HB 3050. The Kansas Ad Valorem tax reimbursement issue is clearly an important and complicated issue before the FERC and the state of Kansas.

Let me first give a brief overview of the history of the Kansas Ad Valorem tax refund issue. I believe this brief overview will not only put HB 3050 into an important historical context, but will also help explain our concerns with the proposed legislation. In 1983, following the passage of the Natural Gas Policy Act (NGPA), the Federal Energy Regulatory Commission was asked to change its prior ruling that natural gas producers may pass through to the consumer the cost of the Kansas Ad Valorem property tax as an "add-on" to the maximum

lawful price (MLP) of gas. FERC denied the request, but was required on remand from the Court of Appeals to further explain its order. On remand, FERC held that the tax was not a production tax and thus was not eligible as an add-on to NGPA maximum lawful prices and in December 1993, ordered refunds, plus interest for the period of 1988 to 1993. On appeal, the Court of Appeals held that the refunds, plus interest, should commence starting in 1983 when the recoverability of the tax was first questioned. FERC ordered interstate gas pipeline companies to act as the collection and distribution agents for those funds. In 1997, FERC established procedures for the payment of Kansas Ad Valorem Tax refunds. The order further required interstate pipelines to return 100 percent of FERC jurisdictional refunds collected from producers to the affected interstate pipelines' customers.

Since these initial orders and appeals, all of the interested parties, including the producers, pipelines, and consumers, have participated in numerous dockets before FERC on various issues, and these dockets are awaiting final orders. In addition, legislation to resolve the Kansas Ad Valorem tax obligation issue is in discussion at the federal level before Congress. In the meantime, certain producers have refunded millions of dollars to the pipelines who in turn have passed the refunds on to their customers, a number of producers have escrowed their money due, and others have not done anything.

At this point in the process, NNG like others in the pipeline industry, remain skeptical that legislative remedies, such as HB 3050, contribute to the resolution of this issue. The large tax increase proposed to be levied upon the pipeline industry and ultimately Kansans, constitutional questions, and the marketability

of revenue bonds issued for the purpose of generating refunds to Kansas gas producers, certainly provide justification for such skepticism.

HB 3050 imposes an estimated annual tax increase that could be as high as $10-12 MM on NNG service. Since tax payments are included in the pipeline cost of service and therefore pipeline rates, Kansas consumers ultimately will bear the burden of the increase. The tax increase proposed in HB 3050 sets in motion a regressive tax with trend lines all too clear; Kansas residential customers will end up paying more. The tax increase contained in HB 3050 is an unfair and flawed attempt to resolve the Kansas Ad Valorem refund issue. New taxes and increased energy costs for all Kansans is not the solution to alleviating refund obligations for one group: the producers.

HB 3050 also invites a litigious relationship to develop between Kansas and other parties to the Ad Valorem refund process. As indicated above, the Kansas Ad Valorem tax refund issue remains actively litigated at the FERC level. Adoption of HB 3050 could interfere with settlements that have been proposed by interested parties at the FERC level, frustrate KCC settlement initiatives and be inconsistent with the intent of federal legislation that is currently under consideration. NNG believes HB 3050 invites prolonged and very controversial litigation regarding the constitutionality of this bill under the Commerce and Supremacy Clauses of the United States Constitution, which is more likely to complicate the refund process rather than assist it.

In addition, NNG suggests these uncertainties create a cloud of litigation around this funding scheme, to tax all Kansans and relieve producers of any Kansas Ad

Valorem refund obligations, which ultimately jeopardizes the marketability of the revenue bonds.

Worse case, when HB 3050 is ruled legally impermissible, the State of Kansas could find itself in the risky position of seeking repayment of the pipeline tax from the natural gas producers, thus placing the state in a similar situation as the FERC. If the State cannot recoup all such payments from the natural gas producers, then the State would have to enact a new tax or develop some new revenue generation method to repay the pipelines. Consequently, HB 3050 presents a bleak future for Kansas energy consumers, creating more acrimony, more litigation, more delays, more interest accumulation, higher energy prices, and no refunds.

NNG respectfully requests the committee defer to other methods or existing processes to address this issue. The KCC, with the support of the Honorable Steve Morris and Attorney General Carla Stovall, have convened conferences for the purpose of initiating settlement discussions. The conferences have been widely attended by interstate pipelines, local distribution companies, producers, royalty owners and by a senior member of FERC's staff. NNG has found these discussions to be beneficial in creating a dialogue between our customers and the producers. NNG supports this effort and has actively participated in both meetings to date. As a result of this process, NNG has committed to hosting a meeting of interested parties, specific to NNG's system, during the month of May in Kansas City, MO. The KCC settlement conference process affords the best

best opportunity for fair resolution of the issues and to bring to closure years of protracted and expensive litigation.

NNG respectfully requests the Committee not advance HB 3050 which further polarizes consumer and producer interests, and will frustrate the ongoing settlement discussions related to the Kansas Ad Valorem Tax issue.

Kansas
Ad Valorem Tax Reimbursement
Fact Sheet

Background

On August 2, 1996, following 13 years of litigation, the United States Court of Appeals for the D.C. Circuit ruled in Public Service Company of Colorado v. Federal Energy Commission that Kansas natural gas producers violated the Natural Gas Policy Act (NGPA) of 1978 when they passed onto consumers Kansas' ad valorem taxes in addition to the maximum lawful price.

The D.C. Court of Appeals ruled the Kansas tax was not a tax on production and was improperly passed along. As a result of this ruling, Kansas, along with 22 other states, are owed a refund of the principal and accrued interest of the tax passed along during this time. With principal and accrued interest included, the total estimated amount is over $360MM, of which an estimated $60MM is due to Kansas natural gas consumers.

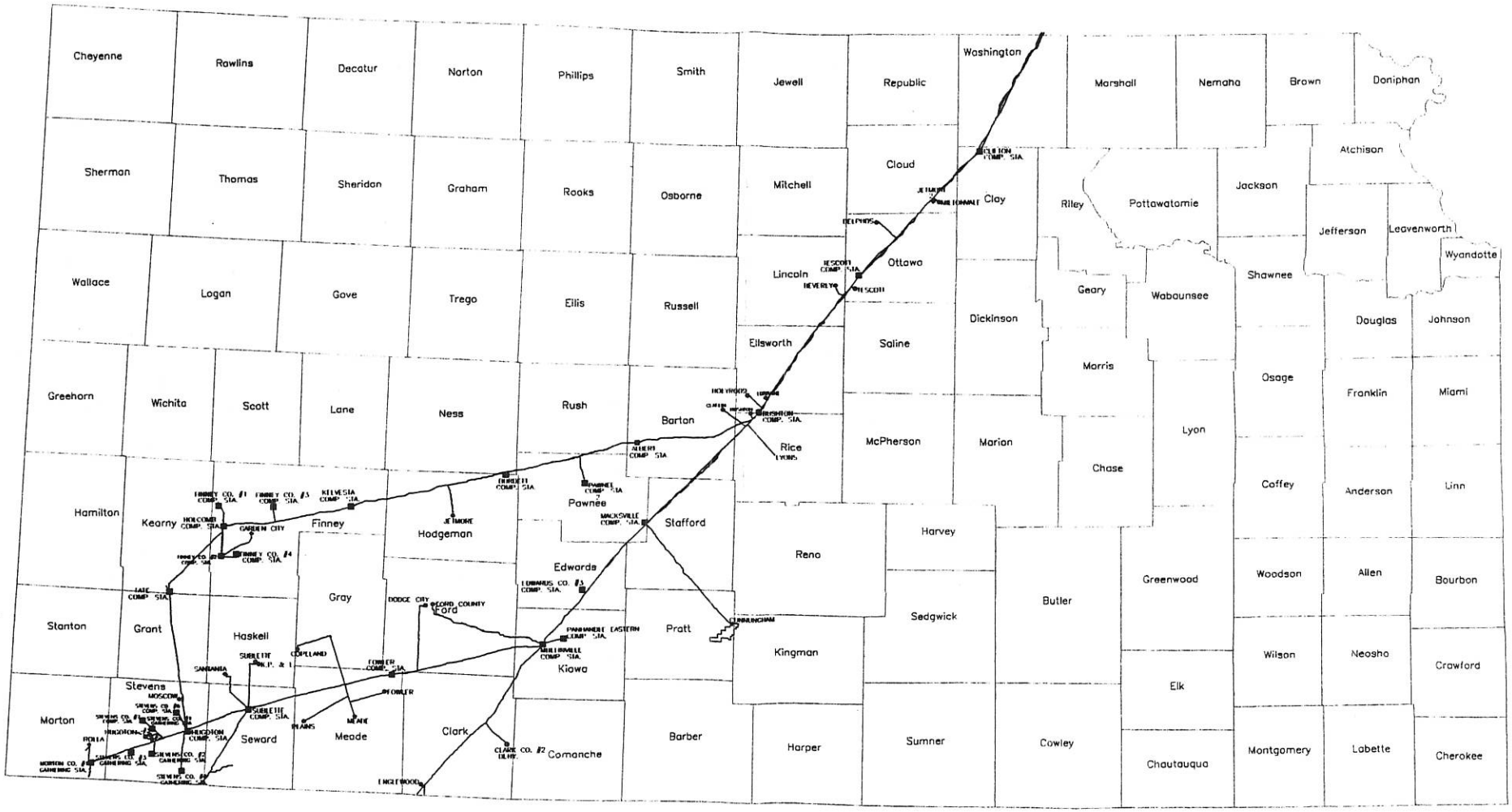
Who Pays	Producers
Who Collects/Disperses Payment	Pipelines
Who Receives Payment	Local Distribution Companies Ultimate Consumer
Estimated Payment Amount	$ 360MM $ 60MM Kansas Consumers
Federal Activity Congressional	HR 1117 (Moran); SB 626 (Roberts); Prohibit the collection and refunding of interest accrued and/or exempting small producers from tax refund obligations.
FERC	Missouri PUC filed a settlement proposal providing a $50,000 credit to first sellers towards their tax refund liability KCC filed comments regarding the Missouri settlement proposal requesting the FERC appoint a settlement judge and convene a settlement conference to address a possible resolution to this issue. The FERC has established a procedure to assist producers who would be faced with financial difficulty.

Kansas Legislature

NNG respectfully requests the committee defer to other methods or existing processes to address this issue utilizing the FERC process for ultimate resolution.

KANSAS

Enron Transportation & Storage Facilities



BEFORE THE
KANSAS HOUSE COMMITTEE ON
UTILITIES

PREPARED TESTIMONY OF JAMES W. BARTLING MANAGER PUBLIC AFFAIRS

ON BEHALF OF
GREELEY GAS COMPANY
AND
ATMOS ENERGY CORPORATION

TESTIMONY IN OPPOSITION TO HOUSE BILL NO. 3050

APRIL 4, 2000

HOUSE UTILITIES
DATE: 4-5-00
ATTACHMENT 5

TESTIMONY ON BEHALF OF ATMOS ENERGY CORPORATION
AND
GREELEY GAS COMPANY IN OPPOSITION TO
HOUSE BILL NO. 3050

I wish to thank the House Committee on Utilities in allowing me to appear on behalf of Greeley Gas Company and Atmos Energy Corporation. My name is James W. (Jim) Bartling and I am the Manager of Public Affairs for the Kansas Region of Greeley Gas Company, a Business Unit of Atmos Energy Corporation. For those of you unfamiliar with us, Atmos Energy Corporation has its headquarters in Dallas, Texas, and is structured with six business units: Greeley Gas Company, with headquarters in Denver, Colorado, United Cities Gas Company, with headquarters in Cool Springs, Tennessee, Western Kentucky Gas, with headquarters in Owensboro, Kentucky, Trans Louisiana Gas, with headquarters in Lafayette, Louisiana, Energas Company, with headquarters in Lubbock, Texas, and Atmos Propane, with headquarters in Franklin, Tennessee. On December 1, 1999, the Kansas Corporation Commission approved the consolidation of the Kansas operations of United Cities Gas Company into Greeley Gas Company to improve efficiency and eliminate some of the confusion caused by having two of Atmos' Business Units operating within one state.

Greeley Gas Company is a local distribution company (LDC) that serves approximately 113,000 customers in the state of Kansas with

approximately 70,000 of these customers in the northeast counties of Douglas, Leavenworth, Johnson, and Wyandotte where we serve parts of the cities of Olathe, Lenexa, Overland Park, Bonner Springs, Lawrence, and Kansas City. We serve a little less than 5,000 customers in the southwest counties of Grant, Hamilton, Kearny, Morton, and Stanton where we serve the cities of Johnson City, Syracuse, and Ulysses. In the southeast section of Kansas we serve over 13,000 customers in Montgomery County, including the cities of Independence and Coffeyville.

But we also serve the "little" towns of Kansas including Fall River, Jarbalo, Linwood, Stark, Tyro, Havana, Hickock, Manter, Ness City, Lincolnville, Wilsey, and many others. When I say "little" I don't mean little in importance because Greeley Gas Company and the other five Business Units of Atmos Energy Corporation serve hundreds of towns with several hundred or less customers. It is these customers in these "little" towns, as well as us "fat cats" living in Johnson County, that will ultimately be paying this tax as proposed in House Bill No. 3050.

As I meet with the various city councils of these "little" towns or speak to senior citizens groups one of their main concerns is the high cost of gas. They continue to tell me that they expect us to keep the price as low as possible. I give them our assurance that we are doing everything possible to

keep our expenses down, to buy our gas at the most favorable price, and to do everything that we can to keep the price of gas from going up. That's why I am appearing before you today.

Most of the gas that Greeley Gas Company sells to our customers is transported to our cities' respective city gate delivery points by the various pipelines serving Kansas, both interstate and intrastate, and would be subject to this tax. We, as a utility, would ultimately have to pass this tax on to our 113,000 Kansas customers who would no doubt tell you, if they were able to appear before you today, that they feel that their gas cost is already too high.

Once approval has been obtained from the Kansas Corporation Commission to pass along these increased costs, whether through the purchased gas adjustment (PGA) mechanism or as the result of increased costs identified within a rate case, these increased costs will be passed on to our customers as an increase to each hundred cubic foot (Ccf) that they use. While it appears that the stated intent of this bill is that it "shall not apply to the local distribution of natural gas," the fact that LDC's must transport most of their gas will result in them incurring this tax as an additional cost of the transported gas. Their only recourse is to pass this cost along as an added cost to their customers.

By virtue of this added cost, and others like it, we can expect that some businesses may desire to switch to an alternate fuel because the price of natural gas has become less competitive. We strongly believe that competition is good for the economy but cannot support this added cost to our customers. Any cost that can be either eliminated or not incurred in the first place benefits all of our customers as well as the LDC's themselves.

On behalf of Greeley Gas Company and Atmos Energy Corporation I thank you for your time and will now answer any questions that you may have.