Approved: April 27, 2000 Carl Dean Holmes
Date

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairman Carl D. Holmes at 12:00 noon on April 6, 2000 in Room 231-N of the Capitol.

All members were present except: Rep. Billie Vining

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

Conferees appearing before the committee: Robert Krehbiel, Kansas Independent Oil & Gas Assn.
Ron Hein, Hein & Weir, Chartered
Debbie Beaver, Williams Companies
Ron Gaches, McGill, Gaches & Associates
Walker Hendrix, Citizens' Utility Ratepayer Board
Charles Freeman, AARP
Jack Glaves, Panhandle Eastern Pipe Line & Kinder/Morgan

Others attending: See Attached Guest List

HB 3050 - Natural gas producer ad valorem tax refund

Robert Krehbiel, Executive Vice President of the Kansas Independent Oil & Gas Association (KIOGA), appeared in support of **HB 3050**. Mr. Krehbiel distributed written testimony of Mr. R. Gordon Gooch, special counsel to KIOGA (Attachment 1). Mr. Krehbiel then explained KIOGA's support of the bill (Attachment 2). He stated that the series of events that led to the retroactive reversal of FERC Opinion 699-D has been appropriately described as the worst tax atrocity ever perpetrated by a federal agency. He stated that the impact on small producers and royalty owners is incredible and the injustices numerous. He explained that the purpose of this bill is to restore the tax policy intended with the passage of the severance tax in 1983. Mr. Krehbiel also included with his testimony a copy of Congressman Jerry Moran's statements to the Subcommittee on Energy and Power on June 8, 1999 and numerous documents supporting KIOGA's position. Mr. Krehbiel also distributed copies of a Western Resources memorandum regarding coal taxes for the Jeffrey Energy Center (Attachment 3).

Ron Hein, appearing on behalf of Pioneer Natural Resources USA, Inc., testified in support of **HB 3050** (Attachment 4). Mr. Hein stated that this bill is an effort to correct a manifest injustice that resulted from a retroactive decision made by the Federal Energy Regulatory Commission (FERC). He explained that, although **HB 3050** may need some revision, it is one method for the State of Kansas to correct that injustice.

Ms. Debbie Beaver, appearing on behalf of Williams Gas Pipelines Central, Inc., provided copies of the testimony of Gary W Boyle, Williams Companies Senior Counsel (Attachment 5), in opposition to **HB 3050**.

Appearing on behalf of Colorado Interstate Gas Company and ANR Pipeline Company, Mr. Ron Gaches testified in opposition to **HB 3050** (Attachment 6). Mr. Gaches stated that the bill deals with a set of issues that has confronted the Kansas gas industry for many years. He stated that the refunds ordered by the FERC are for overcharges in producers' gas prices when those producers were federally regulated. Mr. Gaches explained that this bill would take the refund and turn it into a fourth year problem whereby the same consumers who are supposed to get their money back would be paying the cost of new tax to pay back the money. Mr. Gaches stated that there could be years of legal challenges and that the constitutionality of this bill would be questioned. Mr. Gaches also distributed documentation of a state by state estimated allocation of the Kansas ad valorem tax refunds, including interest (Attachment 7).

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.

Walker Hendrix, Consumer Counsel for the Citizens' Utility Ratepayer Board (CURB), testified as an opponent to **HB 3050** (Attachment 8). Mr. Hendrix stated that this bill establishes an elaborate financing arrangement that places considerable future burdens on consumers. He stated that CURB opposes this bill because it forces Kansas consumers to fund anticipated refunds for overcharges made under the Natural Gas Policy Act of 1978. Mr. Hendrix urged the committee to reject the bill and protect the interest of consumers as it has no public purpose and is in conflict with federal law.

Mr. Charles "Sonny" Freeman, appearing on behalf of AARP's Kansas State Legislative Committee, provided testimony in opposition to **HB 3050** (Attachment 9). Mr. Freeman stated that now was the time for consumers to get the refunds they deserve and not pay twice for the same tax.

Mr. Jack Glaves, appearing on behalf of Panhandle Eastern Pipe Line Company and Kinder/Morgan, Inc., testified in opposition to **HB 3050** (Attachment 10). Mr. Glaves stated that the bill is defective in concept, impaired constitutionally, would constitute an impediment to an alternative resolution of the very real problem which it is seeking to resolve and can only result in endless litigation.

Chairman Holmes distributed an amortization schedule provided by the Kansas Development Finance Authority (Attachment 11).

The conferees then responded to questions from Rep. Klein, Rep. Holmes, Rep. Loyd and Rep. Dahl.

Chairman Holmes closed the hearing on **HB 3050** by addressing the industry. He stated, "I'm talking to everybody involved. If we don't do anything in this legislature, if we don't do anything in this committee, you will be before this committee next year in January, if you don't settle. I'm talking to all parties. It will be before the 2001 legislature in Kansas, if you don't settle."

Meeting adjourned at 2:00 p.m.

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.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: April 6, 2000

NAME	REPRESENTING
Whitney Damron	ONEOK, Inc.
Jim Bartling	Greeley Gas Co / Atmos Energy
Jack Glaves	Panhandle Eastern / Kinder Morgan
Bob Krehbiel	Ks Ind Oil & Gas Assoc
Nancy Vandenberg	Coastal Corp.
Debbie Beaver	Williams
Chuck Dehart	Williams
Doug Smith	SWKS Royalty Owners Assn.
Eldridge Luber	ONEOK
Ed Schaub	Western Resources
Don Miles	KEC
Ken Peterson	KS Petroleum Council
Sandy Braden	Williams / CIG
George Barbee	Northern Natl. Gas
Dick Carter	Northern Natl Gas
Tim Kissner	" " "
Bill Light	Leg.
Walker Hendrix	CURB
Paula Lentz	KCC
Cynthia Smith	KCPL

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: April 6, 2000

NAME	REPRESENTING
Leslie Casson	Kansas Development Finance Authority
Todd Fraizer	Kansas Development Finance Authority

BEFORE THE
HOUSE UTILITIES COMMITTEE

House Bill 3050
(Hearing April 5, 2000)

TESTIMONY OF R. GORDON GOOCH

Chairman Holmes and Members of this Distinguished Committee. My name is Gordon Gooch and I am a special counsel to KIOGA. I would like very much to appear before you in person and to answer your questions, but budgetary restraints are only a problem on the proponent's side of this legislation. Since the consumers of energy subsidize the legal expenses of public utilities through the legal costs being included in rates, the utilities always have an unfair advantage. I cannot hope to offset this advantage, especially by being absent for this most important hearing, but I can hope to share some views from one who knows something about FERC regulation, being a former General Counsel of its predecessor, the FPC, and one who sincerely believes that there is a terrible miscarriage of justice here that only the legislature of the State of Kansas can correct.

Rather than repeat it here, I hope that you will accept my testimony before the Senate Energy and Natural Resources Committee on March 13, 2000. While technical provisions of the then bill have been modified and improved, the policy and legal issues remain the same. Therefore, I will here concentrate on responding to the critics and opponents of this legislation.

Those interstate pipelines and their allies who, naturally, oppose this legislation appear to me to make the following basic arguments. I could not know this in advance of the hearing before the Senate Committee and include a rebuttal then. I can now.

Objection number 1: the federal government imposed what amounts to a retroactive fine against Kansas producers and royalty owners, and the State of Kansas has no business interfering.

I suggest that the State of Kansas will be honoring the time tested principle of "checks and balances" so important to the rule of law under our Constitution. If the Congress passes a law, is it interference if the Supreme Court sets it aside? You bet. If the Supreme Court makes a decision regarding legislation that the Congress does not like, is it interference if the Congress passes a new law to overturn the Supreme Court decision? Indeed it is.

If the State of Kansas, operating within the powers reserved under the Tenth amendment, offsets a decision of the Federal Energy Regulatory Commission that affects only Kansas producers and royalty owners, is that interference? I would certainly hope

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ATTACHMENT 1

so, but the proper words to use are: the State of Kansas "checked and balanced" the excesses of the federal government.

Objection number 2: Kansas law prohibits legislation that does not serve a public purpose; legislation that only benefits individuals is proscribed.

Not even claiming to be an expert on Kansas law, I take the proposition at face value. I would then deduce that the State of Kansas never issues any sort of "development" bonds, since such bonds tend to benefit certain individuals. If Kansas does issue any sort of "development" bonds, then I guess the principle does not apply as the pipelines suggest.

However, can it be said that the bonds have no public purpose? I do not think so. Draining some $360,000,000 in cash from Kansas producers and royalty owners would further damage an essential industry in Kansas, one that is and has been exploited over the years by public utilities selling gas to customers in other States. The overwhelming majority of those who stand accused of being outlaws are Kansans. The pipelines try to mask this obvious fact by saying that the majority of the volumes are attributable to major international oil companies. Is it in the public interest in Kansas to encourage investment by multinational oil companies? Does Kansas have to be classified as high political risk, such as some third world country, where retroactive action impairs revenues? Showing that Kansas protects those who invest here is a public purpose.

Objection number 3: a tax on interstate pipelines violates the Commerce clause as interference with interstate commerce.

As stated, the proposition is undoubtedly true. Fortunately, the proposition is falsely stated. This tax falls on the transportation of natural gas within the jurisdiction of the State of Kansas, whether the pipeline is classified as "interstate" or "intrastate." One of the interstate pipelines has estimated that 80% or so of the potential burden of the tax falls outside the State of Kansas. That demonstrates clearly that the tax falls on both interstate and intrastate commerce and therefore is not a tax only on interstate commerce. (See Smead of Colorado Interstate, p2; Glaves of Panhandle and KM, p 3, 6)

Tellingly, the principal case relied upon by all of the opponents involves an attempt by the State of Louisiana to impose a tax on gas produced in the federal domain offshore. Maryland v. Louisiana, 451 U.S. 725 (1981). I quite agree that a severance or similar tax imposed on gas produced and sold from wellheads in Texas or Colorado or some other State would fall under this case. This tax does not even purport to affect the sales price of natural gas anywhere; it deals with the transportation of natural gas through Kansas.

Strangely, a case closer in point is neglected by all but a few of the opponents. I would have expected the main case to be cited to be Michigan-Wisconsin P.L. Co. v. Calvert, 347 U.S. 157 (1954). There the State of Texas tried to tax the transfer of gas from products extraction plants but with an exclusion for local consumption. While the

tax purported to fall on both interstate and intrastate pipelines alike, the Supreme Court held that a tax on the privilege of taking, or buying, gas from a plant for transmission in interstate commerce would not pass muster. The Texas tax on a transfer transaction after the production and gathering function had been completed and added to the price of gas itself could not stand. (In effect, this was a sales tax on the sale of gas at the tailgate of gas processing plants).

If I were on the other side, I would argue that case. The answer, of course, is that no "privilege" or "sale" is being taxed here. The State provides value and services for the pipelines traversing the state; that is the basis of a tax. No permission of the State of Kansas is required in order to transport gas and no "sales" tax is imposed on the commodity of gas.

You may think it weird that I would make a better argument against the tax then the opponents. What this illustrates -- and why I do it -- is first to expose the double standard being applied to the producers and royalty owners of Kansas gas. States can tax interstate pipelines, as demonstrated below. The pipelines do not deny this; it is only a matter of how. They argue that the right label has to be placed on the tax before it can be levied. Contrast this concern over the label to be applied to the tax to the question that the FERC decided time and time again: the Kansas ad valorem tax is in fact a production or severance tax. Finally the FERC changed its mind, and here we are today. I ask your indulgence: call upon the pipeline advocates to say what kind of taxes are lawful, and see if they have a suggestion superior to the nondiscriminatory tax on the transportation of gas. They may well have a better idea, and it is not too late to adopt it.

There is another reason why I can safely endorse the Michigan-Wisconsin case. It has been superceded and distinguished virtually out of existence. See, e.g., Complete Auto Transit v. Brady, 430 U.S. 274 (1977), Goldberg v. Sweet, 488 U.S. 252 (1989), United Airlines v. Mahin, 410 U.S. 623 (1973); Evansville Vanderburgh Airport Auth Dist v. Delta Airlines, 405 U.S. 707 (1972), and Mobil Oil Corp v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980).

Without inquiry from you, you are supposed to believe that any tax on interstate pipelines imposed by the State of Kansas would be unconstitutional under the Commerce Clause. Well, as one of the interstate pipelines here points out, the State of Kansas does impose taxes on interstate pipelines. (See Boyle of Williams, p2) There is no objection of any kind; indeed the FERC recognizes the legitimacy of the State taxation. This is further verified by the pipeline threats to "pass on" the tax to consumers. (See Mary Kay Miller of Northern, p.3; Glaves, p 3; Boyle p 7).

Objection number 4: a tax on the transportation of gas would contradict the jurisdiction of the FERC to set the price of gas in interstate commerce, thus violating the Supremacy Clause.

Now, I fully recognize the efficacy of the Supremacy Clause: where a state law and a federal law conflict in an area where the federal government has jurisdiction to act,

the state law must yield. I had the personal privilege, as a Law Clerk to the Chief Justice of the United States, of watching the Supreme Court of the United States reiterate that basic principle in Free v. Bland, 369 U.S. 663 (1962), perhaps the best example of that principle. However, that principle does not apply at all.

First, the FERC no longer has any jurisdiction to set the price of gas in a first sale; the Wellhead Decontrol Act took away all of the FERC's jurisdiction. Thus, there is no jurisdiction of the FERC to contradict.

Second, this tax does not fall on the sale of natural gas anywhere. Thus there could be no conflict with the FERC's jurisdiction to set the price of gas, if any jurisdiction did exist -- which it does not.

Objection number 5: Kansas gas production is on the decline, so the tax cannot be sustained over time.

Of all the spurious objections, this is my favorite.

First, the tax is not tied to Kansas production at all. The tax falls on the transportation of gas through or within Kansas, wherever the gas originally surfaced at a wellhead.

Second, a corollary of the first, is that Kansas is not only a producer of natural gas, it is a conduit for gas produced elsewhere. For the objection to have any validity, it would have to propose that gas supply in the southwest, the rockies, and in the mid-continent is spiraling downward.

It is most strange to hear interstate pipelines make any such argument -- and indeed they do not, nor can they. The federal government, including the FERC, is anticipating a gas demand in the next few years that will call for almost a 50% increase in current supply. The interstate pipelines, including some here involved, are clamoring at the FERC to authorize sufficient additional capacity to accommodate this mammoth increase.

The pipelines would have you ignore the administration's Comprehensive National Energy Strategy, counting on increased production to meet a 40% increase in demand for natural gas. You are also expected to ignore the findings of the National Petroleum Council, an federal advisory council duly constituted to assess supply potential, which find that the substantial increase in demand can be met by 2015, there being trillions of cubic feet of gas still in the ground. You are, in addition, expected to ignore the findings of the Energy Information Administration of the U.S. Department of Energy.

I asked Paul Premo, one of the outstanding experts who appears regularly before the Federal Energy Regulatory Commission, and a person who has had personal as well as professional experience in the natural gas and oil industry, to calculate the potential tax

revenues in the future based upon the DOE/EIA estimates using a standard pro rata allocation assumption and with sensitivity runs. His report is attached. Based on the government projections and the stated assumptions, each 1 cent of a Kansas tax would raise between $18,000,000 and $21,000,000 in the year 2020. (See Premo attachment)

The interstate pipelines and their allies should not be allowed to talk out of both sides of their mouths.

There is another implication in this objection that should be considered. Why is the production in Kansas in a decline, if it is? Could it be that the monopolistic and oligopolistic behavior of the interstate gas pipelines and their so called "independent" "field services" and "marketing" affiliates are holding down the "net back" prices at the wellheads in Kansas, thus discouraging investment in exploration and production? There is no doubt in my mind that this is so. This is particularly true with the smaller producers, the ones who make up the overwhelming majority of Kansas producers. What bargaining power do they have with these multibillion dollar companies who control access to markets -- These public utilities who profit so handsomely from the licenses granted by the federal government?

The whole history of production in Kansas has been one of exploitation since the Supreme Court decided in 1954 that sales for resale in interstate commerce -- that is, a sale to an interstate pipeline or to an out of state local distribution company -- made the producer into a public utility. Until 1978, at least the Kansas producer could rely on contracts in dealing with the intrastate market, but with the passage of the NGPA all first sales were federalized. "Nationalized" might even be a more accurate word. Billions of dollars in wellhead value and in taxes to the State of Kansas were thus captured for the benefit of those in consuming states who do not worry much about Kansas. This continues today, as the power to set prices at the wellhead has passed from the FERC to the interstate pipelines and their affiliates and those utilities who control the capacity on interstate pipelines.

To illustrate from the latest government numbers I find in the EIA reports, in 1998 the average wellhead price in the State of Kansas was $1.70. The average wellhead price nationwide was $1.94. What is it that makes Kansas gas worth less than even the national average? Why is the national average $.24, or 14% higher than the Kansas average? That translates into $78,746,117 loss to the Kansas producers and royalty owners-- and an extra $78,746,117 into the pockets of the middlemen, unless, of course, the middlemen do not mark up the cheaper price of Kansas gas at least to the average. (See Table 63 of Natural Gas Annual and January 2000 issue of Natural Gas Monthly, both EIA publications)

Now they want another $360,000,000 to boot.

Objection number 6: a tax on transportation of natural gas is anticonsumer.

This objection stings me personally, since I have devoted most of my professional life to the effort to control the unjust and unreasonable rates and the discriminatory service of public utilities who control the essential facilities for producers of gas, oil, and electricity to reach consumers. The more the monopolistic middlemen are able to exact for the access to markets, the less the producer can receive and the more the consumer has to pay.

I believe it to be important that the producer of oil and gas receive a full and fair market price for these vital commodities, or else the supply function will be artificially depressed. A producer of oil or gas has to risk his or her own funds, as do the royalty owners have to risk their assets, with a return only based on success.

I believe that it is important that the consumer of oil or gas pay the lowest reasonable transportation costs, so that the impact on personal income is lower and the impact on industry, in providing jobs, is optimal.

Hopefully we learned this lesson in the 1970s, when the policies of the FERC (then FPC) in the sixties led to such low gas prices -- set by the government -- that supply was discouraged. Not only did that result in consumers being denied the commodity of gas, it caused the price of transportation of gas to increase. As this committee well knows, a public utility does not lower its prices when throughput declines, the public utility raises its prices.

Let us consider the consumer in Kansas. Whether the transportation rates are "just and reasonable" or "unjust and unreasonable", distance is a factor in the delivered price. The more Kansans can consume Kansas gas, the less the transportation cost.

Take hundreds of millions of dollars out of the potential investment of Kansas producers, and what effect would you anticipate? A decline in supply in Kansas, over and above that inflicted by the monopsonies of the interstate pipelines and their affiliates and allies? For the consumer in Kansas, this means higher pipeline costs.

In contrast, what would it cost the average Kansas householder, for each 1 cent of tax -- assuming that the tax were passed on (an assumption I am not willing to make). The cost would be $.83 per year. A two cent tax would mean $1.63 per year, a little over $.13 a month. Thirteen cents. I asked Mr. Premo to make this calculation also, and it is attached.

The reason that I will not accept the assumption that the tax will be passed through is this: in order to pass through a tax, the permission of the FERC (in the case of interstate pipelines) and of the KCC (intrastate) would have to be sought and obtained.

This would open the rates of the pipelines to scrutiny. I firmly believe that the vast majority of interstate pipelines are earning an unreasonably high profit margin. A filing for a rate increase of say, 2 cents, would risk rollback in rates of a far greater amount of dollars.

This proposition was presented in my testimony to the Senate, and do you know what the answer was? In essence, the answer was that it would not be necessary to file a rate case; the FERC would be induced to allow an automatic rate increase to cover the tax, called a "tracker." Two comments are in order.

The first is to note the arrogance of those who feel that their influence and control over the FERC is such that the FERC would waive the basic consumer protection of a case to justify all rates. The unfortunate inference, if true, goes far to explain how Kansas producers and royalty owners are being pressed to turn over $360,000,000, some $50,000,000 or so sticking to the fingers of the pipelines and no telling how much more will evaporate at their affiliate level.

The second comment is this: if the pipelines are so confident that their clout with the FERC would result in an automatic tracker, why are they opposing this legislation? Is it perhaps because there is a very real risk -- I would say a virtual certainty -- that with the assistance of stalwart consumer advocates like Walker Hendrix and the Attorney General and the KCC and the AARP, the FERC would not grant a tracker but would examine the pipeline rates?

The problem does lie at the FERC, not at the KCC. Indeed, the KCC has done and continues to do a magnificent job of representing the State of Kansas before the FERC, just as the Attorney General has before the Courts and the Congress, but it is unreasonable to expect that the KCC alone can fight this fight at the FERC, particularly with the limited budget.

Let's look at the facts in 1998. The average "city gate" price in the U.S. was $3.07. The "city gate", as you know, is the point of delivery from a pipeline to a distributor of gas, so it measures the costs charged at this delivery point, here principally the interstate pipelines. A U.S. average rolls in Boston with Atlanta and Houston and Seattle and Chicago and everywhere else in between and around. With few exceptions, pipeline rates are set based on distance, so you would expect the city gate prices in the producing states to be substantially less than in the distant consuming states.

Can someone please explain to me why the average city gate price in Kansas was $2.96 while the average price in other producing states, Texas was $2.63, in Colorado $2.40, and in Oklahoma $2.55?

I respectfully submit that the primary issue is not whether the average city gate price rises from $2.96 to $2.98 -- a 00.7% increase as a result of a Kansas tax. The primary issue is whether the citygate price can be lowered at least 33 cents in order to match Texas. That is $85,814,520 a year in potential savings to the consumers of Kansas. This is where the consumer advocates should invest their time and efforts, and I am prepared to assist in this worthwhile endeavor.

In sum, I do not find persuasive the arguments advanced against the State of Kansas exercising its right to tax and its right to refund taxes previously collected. I continue to believe that the State should "check and balance" the excesses of the federal government. I do find ironic and not amusing at all that the pipelines deny the basic right under the Constitution for producers and related royalties: that no property be taken without due process of law. All calls for hearings to determine whether there has been any violation of the law and any refunds due have been resisted by the pipelines and their allies. Yet, when the question of taxes comes up, who is the first to assert Constitutional rights?

You might choose to ask the pipeline representatives whether their utilities will agree to a hearing for those producers who wish a full and fair adjudication of whether they owe any money at all. If the answer is "No", then you will have still another gauge for their Constitutional arguments.

Not one single producer has been found guilty of an illegal overcharge. Not one out of an estimated 7,500 working interest owners (using Colorado Interstate estimates of 10 working interest owners per claim) and at least as many royalty owners. Demands for hearings to exonerate the producers and royalty owners are met with hoots of derision and reams of opposition filings, the most recent being Colorado Interstate opposing the request for a hearing of the Strohl family of Pretty Prairie. You see, interest claims are running at the floating prime rate, compounded quarterly. Interest claims alone are already over 160% of claimed refunds. The longer the delay, the more pressure is on the producers and royalty owners just to capitulate. The pipelines do not care how long this takes; they think they have a win-win case for themselves, including a little gravy skimmed off the top for themselves.

Hopefully, this callous disregard for the most basic Constitutional right to due process for Kansans will not be tolerated by the legislature. Pass this bill, and the risk of interest shifts to the pipelines, in the form of taxes to amortize bonds at whatever interest rate is necessary to make the bonds attractive to investors.

The pipelines promise to sue to overturn the legislature; let them do so, and delay as long as they wish. The interest on the bonds effectively can be accrued by adjustment of the interest rate. If it is fair for the producers and royalty owners to pay interest on refunds from nearly two decades ago at the prime rate, floating at times into double digits, and compounded quarterly, is it not fair to place the same interest rate on the bonds? An eye for an eye, a tooth for a tooth ought still to be good law in Kansas.

The message to the interstate pipelines should be clear: oppress the Kansas producers and royalty owners at your peril!

A. Impact of 1 and 2 cents per MCF (approx. per MMBtu) on Kansas Consumers.

Basis---Calendar year 1998 Kansas Info from Various DOE EIA Data Sources.

1. Total Kansas Consumption of Natural Gas: 313.88 Million MCF.
   Of this:

Lease, Plant and Pipeline Fuel	53.84
Residential	70.22
Commercial	41.79
Industrial	111.14
Electric Utilities	38.90

2. Therefore, state-wide Residential burden at 1 cent per MCF is $702,200 per year.

3. Average Kansas residential consumption for 1998 was 83 MCF (841,843 consumers)

4. Average cost per residential consumer is $0.83 per year.

5. Double the above results for a 2 Cents per MCF flow-through---Average cost per residential consumer then becomes $1.66 per year.

B. Projection of Gas Volumes Transported Through Kansas

1. Per DOE's Year 2000 Annual Energy Outlook Report Projections to the Year 2020, Total Lower 48 onshore conventional natural gas production is shown to increase from about 6-6.5 TCF in 2000, to about 11 TCF by 2020.

2. It is reasonable to assume that this ~70% increase in production will result in a similar 70% increase in natural gas transported through Kansas, enroute to consumer markets in the Mid-west and other markets served by the pipelines that transit Kansas (delivering gas produced in Oklahoma, Texas and Wyoming/Colorado).

3. Therefore, assume that the gas transported through Kansas rises by 70% over the next 20 years (approximately 3.5% per year average increase). Sensitivity cases could assume lesser rates of increase---perhaps down to 50% (approximately 2.5% per year average increase). In all cases, assume the annual build-up is fairly even, year-to-year, because the DOE projections similarly show fairly steady annual gas production growth over that time period.

4. Thus, for the 3.5% per year average increase, start with 1998 total gas transported through Kansas (1.151812 Trillion Cubic Feet), increase by 7% to an estimated 1.23 TCF for 2000, and grow it annually to a total of 2.1 TCF for the year 2020.

5. Similarly, for the 2.5% per year average increase, compute a starting point for 2000 of 5% over 1998---therefore 1.21 TCF. Then grow it by about 2.5% per year to a total of 1.8 TCF for the year 2020.

6. One cent per MCF on those quantities would be $18 - $21 Million in the year 2020.

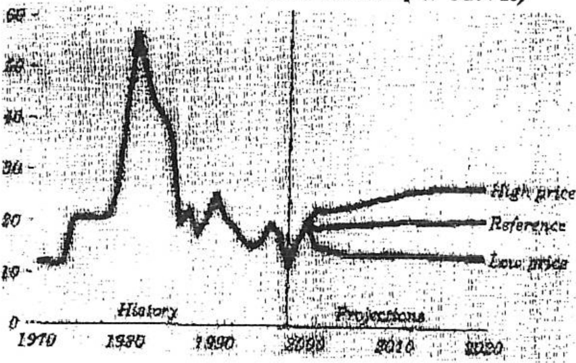
Paul Premo
3-30-00

Appendix F. AEO 2000 3/16/00

MAR 16 '00 PMP

Oil Prices Are Expected To Remain Above Low 1998 Levels

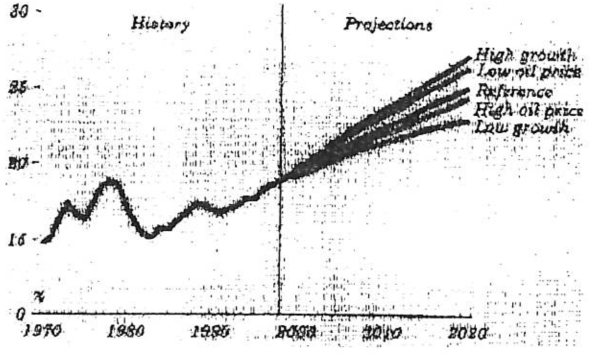
Figure 84. Lower 48 crude oil wellhead prices in three cases, 1970-2020 (1998 dollars per barrel)



Because domestic prices for crude oil are determined largely by the international market, the recovery from the 1998 decline in world oil prices causes a steep increase in wellhead prices for crude oil in the lower 48 States from 1998 through 2000 in all cases. After 2000, prices initially decline in the reference and low world oil price cases, then prices in all cases generally increase through the rest of the forecast. Prices remain above 1998 levels throughout the forecast in all cases, with wellhead prices projected to increase by 0.9, 2.8, and 4.0 percent a year from 1998 to 2020 in the low world oil price, reference, and high world oil price cases, respectively (Figure 84).

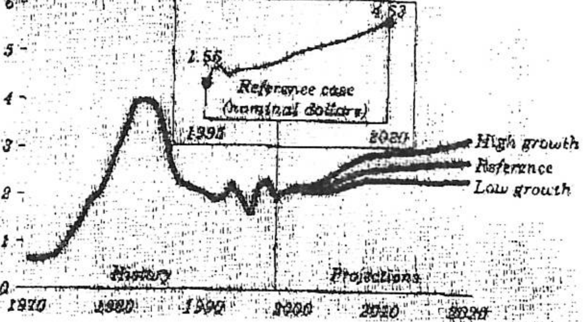
U.S. petroleum consumption continues to rise in all the *AEO2000* cases (Figure 85). Total petroleum product supplied ranges from 23.0 million barrels per day in the low economic growth case to 27.3 million in the high growth case, as compared with 18.9 million barrels per day in 1998.

Figure 85. U.S. petroleum consumption in five cases, 1970-2020 (million barrels per day)



Rising Demand Increases Natural Gas Prices in All Economic Growth Cases

Figure 86. Lower 48 natural gas wellhead prices in three cases, 1970-2020 (1998 dollars per thousand cubic feet)



Wellhead prices for natural gas in the lower 48 States increase on average by 0.9, 1.7, and 2.4 percent a year in the low economic growth, reference, and high economic growth cases, respectively (Figure 86). The reference case price increases from $1.96 per thousand cubic feet in 1998 to $2.81 in 2020. The increases reflect rising demand for natural gas and its impact on the natural progression of the discovery process from larger and more profitable fields to smaller, less economical ones. Price increases also reflect more production from higher cost sources, such as unconventional gas recovery. Growth in lower 48 unconventional gas production ranges from 1.3 to 2.7 percent a year across cases, compared with a 2.1- to 2.2-percent range in annual growth for conventional sources across the cases. Despite the changes in sources of production, technically recoverable resources (Table 10) remain more than adequate overall to meet the production increases.

Although consumption, and thus production and price levels, for natural gas rise in all three cases, the price increases attributable to the rising demand are tempered by the beneficial impacts of technological progress on both the discovery process and production operations.

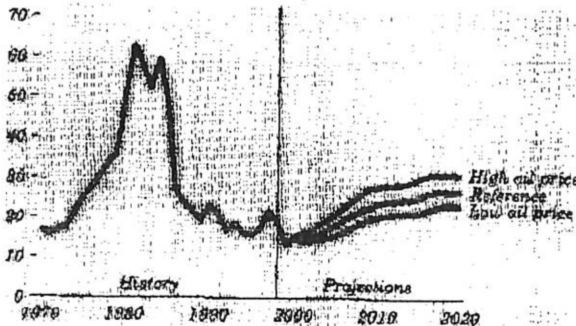
Table 10. Technically recoverable U.S. oil and gas resources as of January 1, 1998

Total U.S. resources	Crude oil (billion barrels)	Natural gas (trillion cubic feet)
Proved	24	167
Unproved	116	1,092
Total	140	1,259

1-10

Rising Gas Prices and Lower Drilling Costs Increase Well Completions

Figure 87. Successful new lower 48 natural gas and oil wells in three cases, 1970-2020 (thousand successful wells)



Both exploratory drilling and developmental drilling increase in the forecast. With rising prices and declining drilling costs, crude oil and natural gas well completions increase on average by 1.4 and 2.7 percent a year in the low and high oil price cases, respectively, compared with 2.1 percent in the reference case (Figure 87). Projected oil drilling varies more than gas drilling in the world oil price cases (Table 11), reflecting the relative sizes of the changes in prices for the two fuels.

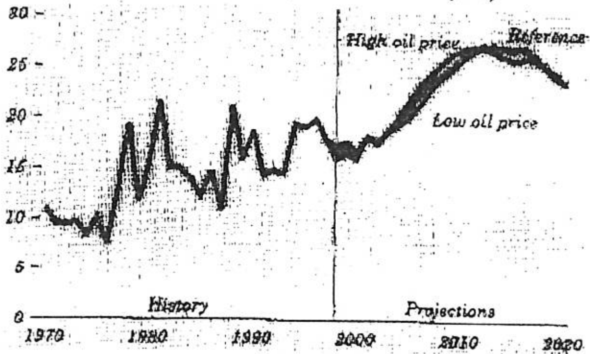
The productivity of natural gas drilling does not decline as much as that of oil drilling, in part because total recoverable gas resources are more abundant than oil resources. At the projected production levels, however, undiscovered recoverable resources of conventional natural gas decline rapidly in some areas, particularly in the onshore Gulf Coast and offshore Gulf of Mexico regions. In the final analysis, the future overall productivity of both oil and gas drilling is necessarily uncertain, given the uncertainty associated with such factors as the extent of the Nation's oil and gas resources [66].

Table 11. Natural gas and crude oil drilling in three cases, 1998-2020 (thousand successful wells)

	1998	2000	2010	2020
Natural gas				
Low oil price case		10.7	14.5	16.5
Reference case	12.1	11.0	15.9	16.9
High oil price case		11.0	17.3	16.7
Crude oil				
Low oil price case		4.3	5.8	7.2
Reference case	7.0	4.4	7.9	10.2
High oil price case		4.4	10.7	14.4

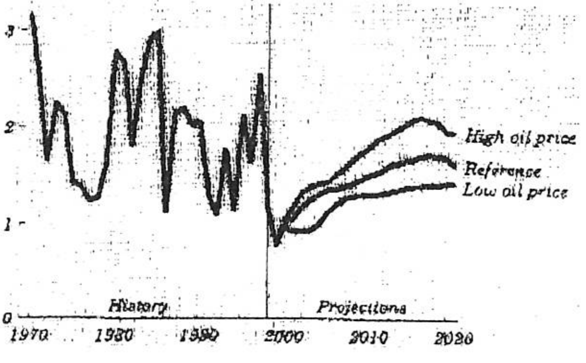
High Levels of Gas Reserve Additions Are Projected Through 2020

Figure 88. Lower 48 natural gas reserve additions in three cases, 1970-2020 (trillion cubic feet)



Although for most of the past two decades lower 48 production of both oil and natural gas has exceeded reserve additions, the pattern for natural gas reversed from 1994 through 1997. In 1998, falling prices caused production to exceed reserve additions again. After 2003, rising prices in the forecast cause natural gas reserve additions generally to exceed production until close to the end of the projection period (Figure 88), even with expected increases in demand. Relatively high levels of annual gas reserve additions through 2020 reflect increased exploratory and developmental drilling as a result of higher prices, as well as productivity gains from technology improvements comparable to those of recent years. In contrast, despite varying patterns of lower 48 oil reserve additions (Figure 89), total lower 48 crude oil production exceeds total reserve additions over the forecast period in all cases.

Figure 89. Lower 48 crude oil reserve additions in three cases, 1970-2020 (billion barrels)



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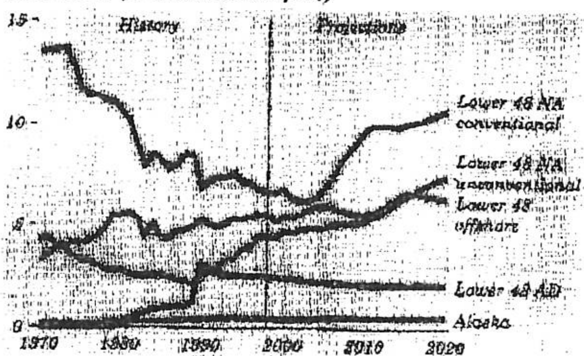
Significant New Finds Are Likely To Continue Increases in Gas Production

Figure 90. Natural gas production by source, 1970-2020 (trillion cubic feet)



The continuing increase in domestic natural gas production in the forecast comes primarily from lower 48 onshore nonassociated (NA) sources (Figure 90). Conventional onshore production, which accounted for 35.4 percent of total U.S. domestic production in 1998, increases in share to 40.7 percent of the total in 2020. Unconventional sources also increase in share, and gas from offshore wells in the Gulf of Mexico contributes significantly to production. The innovative use of cost-saving technology and the expected mid-term continuation of recent huge finds, particularly in the deep waters of the Gulf of Mexico, support this projection.

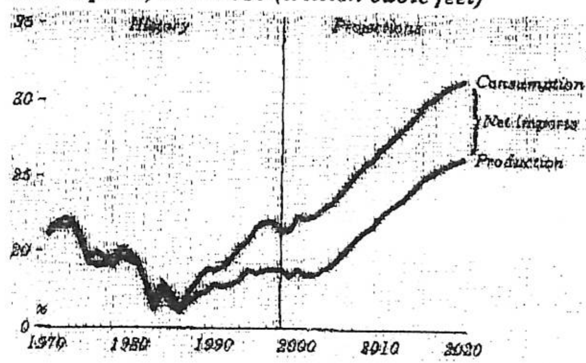
Production from conventional sources is projected to grow rapidly through 2010 in response to increasing demand. After 2010, slower growth of consumption and higher production from increasingly economical offshore and unconventional sources cause production from conventional sources to level off.

Natural gas production from Alaska grows by 0.9 percent a year in the forecast. Alaskan gas is not expected to be transported to the lower 48 States, however, because the projected lower 48 prices are not high enough in the forecast period to support the required transport system [67].

Production of associated-dissolved (AD) natural gas from lower 48 crude oil reservoirs generally declines in the projections, following the expected pattern of domestic crude oil production. AD gas accounts for 8.4 percent of total lower 48 production in 2020, compared with 14.1 percent in 1998.

Net Imports of Natural Gas Grow in the Projections

Figure 91. Natural gas production, consumption, and imports, 1970-2020 (trillion cubic feet)



Net natural gas imports are expected to grow in the forecast (Figure 91) from 14.6 percent of total gas consumption in 1998 to 16.3 percent in 2020. Most of the increase is attributable to imports from Canada, which are projected to grow substantially. Although most of the additional imports come from western Canada, new pipeline capacity is also expected to provide access to eastern supplies. Natural gas from Sable Island, in the offshore Atlantic, is expected to begin flowing in late 1999.

Mexico has a considerable natural gas resource base, but its indigenous production is unlikely to increase sufficiently to satisfy rising demand. Since 1984, U.S. natural gas trade with Mexico has consisted primarily of exports. That trend is expected to continue throughout the forecast, especially in light of the recent elimination of the 4-percent import tariff and an increase in cross-border pipeline capacity. U.S. exports to Mexico are projected to grow from 50 billion cubic feet in 1998 to 240 billion cubic feet in 2020.

Imports of liquefied natural gas (LNG) are projected to grow at a rate of 7.2 percent a year, resulting in part from a 50-percent expansion of capacity at the Everett, Massachusetts, terminal and the projected reactivation of the Elba Island terminal in 2002. In spite of this activity, given the projected low natural gas prices in the lower 48 markets, LNG is not expected to grow beyond a regionally significant source of U.S. supply. LNG imports are projected to reach a level of 0.39 trillion cubic feet in 2020, compared with 0.07 trillion cubic feet in 1998 [68].

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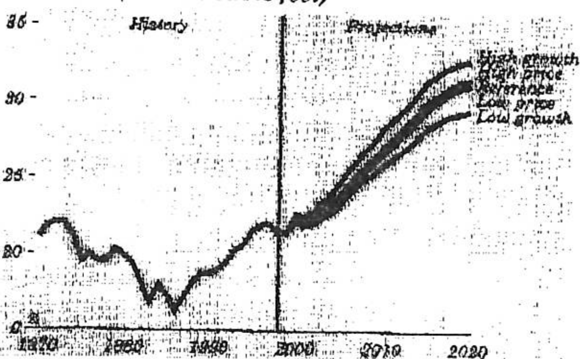
Natural Gas Consumption

Significant Increases in Natural Gas Use Are Seen in All Cases

Figure 92. Natural gas consumption in five cases, 1970-2020 (trillion cubic feet)

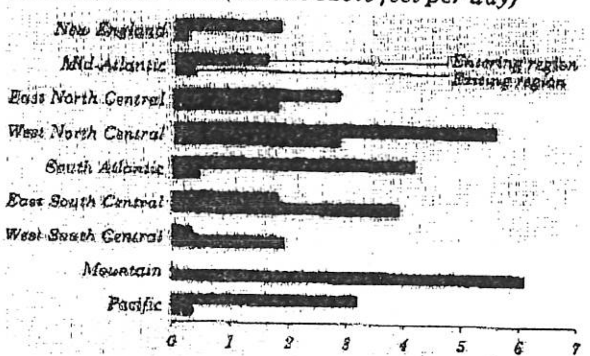


Natural gas consumption increases from 1998 to 2020 in all the *AEO2000* cases (Figure 92). Domestic consumption ranges from 29.5 trillion cubic feet per year in the low economic growth case to 32.7 trillion cubic feet in the high growth case in 2020, as compared with 21.4 trillion cubic feet in 1998. Growth is seen in all end-use sectors, and more than half the increase results from rising demand for electricity generation. Natural gas consumption in the electricity generation sector grows steadily throughout the forecast, as demand for electricity increases and retiring nuclear and older oil and gas steam plants are replaced by turbines and combined-cycle facilities.

In the reference case, natural gas consumption for electricity generation more than doubles, from 3.7 trillion cubic feet in 1998 to 9.3 trillion cubic feet in 2020. Although projected coal prices to the electricity generation sector fall throughout the forecast, the natural gas share of new capacity far outpaces the coal share. Lower capital costs, shorter construction lead times, higher efficiencies, and lower emissions give gas an advantage over coal for new generation in most regions of the United States. Natural-gas-fired facilities are less capital-intensive than coal, nuclear, or renewable electricity generation plants. Growth in natural gas use for electricity generation is also expected to be spurred by the environmental advantages of natural gas.

Gas Pipeline Capacity Expansion Is Needed To Serve New Markets

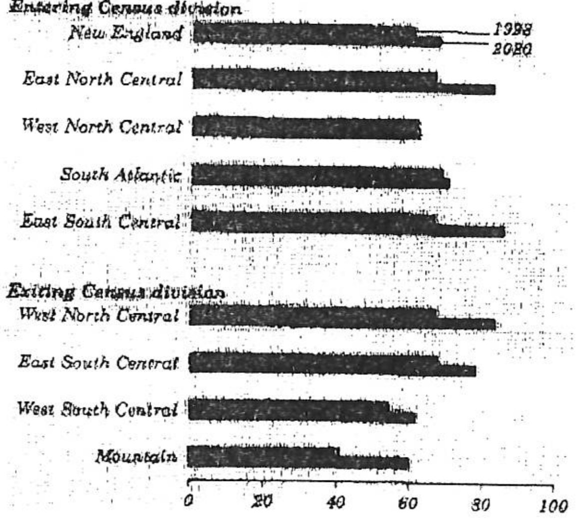
Figure 93. Pipeline capacity expansion by Census division, 1998-2020 (billion cubic feet per day)



Projected growth in natural gas consumption will require additional pipeline capacity. Expansion of interstate capacity (Figure 93) will be needed to provide access to new supplies and to serve expanding markets. Expansion is projected to proceed at an average rate of 0.8 percent a year in the forecast.

The greatest increases in capacity are expected along the corridors that provide access to Canadian, Gulf Coast, and Mountain region supplies and deliver them to the South Atlantic, Pacific, and Northeast regions. In all regions, growth in new pipeline construction is tempered by higher utilization of existing pipeline capacity (Figure 94).

Figure 94. Pipeline capacity utilization by Census division, 1998 and 2020 (percent)



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

TESTIMONY OF ROBERT E. KREHBIEL
EXECUTIVE VICE PRESIDENT, KANSAS INDEPENDENT OIL & GAS ASSOCIATION
IN SUPPORT OF H.B. 3050
BEFORE THE HOUSE COMMITTEE ON UTILITIES
APRIL 5, 2000

Chairman Holmes and members of the Committee:

Thank you very much for the opportunity to appear in support of House Bill 3050. My name is Robert E. Krehbiel and I am appearing on behalf of the Kansas Independent Oil & Gas Association.

The chronology of events which led to the introduction of House Bill 3050 reflects the long and tortuous history of the conflict between producing and consuming states and the federal regulation of natural gas prices. The series of events, which resulted in the retroactive reversal of Opinion 699-D, has been accurately and appropriately described as "the worst tax atrocity ever perpetrated by a federal agency".

Today, because the Federal Energy Regulatory Commission reversed Opinion 699-D 19 years after it issued that opinion, Kansas tax policy, established by the Kansas Legislature in 1983 in reliance on Opinion 699-D, has been emaciated.

This is the most significant issue facing the members of the Kansas Independent Oil & Gas Association. Over 400 operators and uncounted thousands of working interest owners are facing refunds of Kansas Ad Valorem Taxes recovered in accordance with federal law during the period 1983 through 1988, with interest accrued. The total amount is estimated to be in excess of $339 million, of which $127 million is

HOUSE UTILITIES

DATE: 4-6-00

ATTACHMENT 2

principal, and $212 million is interest. The refund amounts by operator range in size from $20 to $62 million.

Typical examples of refunds of Kansas ad valorem taxes facing the small independent producers are:

Kansas Natural Gas at Hays, Kansas $4 million,

Beren Corporation in Wichita, $1.95 million,

Molz Oil of Kiowa, Kansas, $388,000.00,

F.G. Holl of Wichita, $1.25 million,

Pickrell Drilling of Wichita, $325,000,

Hasada Industries of Overland Park, $122,000.00,

Petroleum Production of Lawrence, Kansas, $116,000.00,

R.J. Patrick of Liberal, $436,000.00,

Lester Smith of Syracuse, Kansas, $56,000.00,

Edgar White of Elkhart, Kansas, $138,000,

Lee Banks, Wichita, Kansas $397,000,

Suerte Oil Company of Howard, Kansas, $68,000, and

Aurora, Inc. of Wichita, Kansas, $19,000.

The impact on small producers is incredible and the injustices are many. Edgar White of Elkhart, Kansas, wrote: "I have been terribly concerned about this matter as it would nearly bankrupt me. I filed a hardship application about two years ago and that hearing has been continued now until August 8, 2000. This matter is the most outrageous matter to come out of Washington and FERC that I am aware of." Consider the case of one petroleum engineer from Wichita, Kansas, who formed a new corporation, raised money with a group of friends and drilled one gas well in Edwards County, Kansas. Northern Natural Gas Company agreed to purchase the gas and pay the new company the maximum lawful price provided by the Natural Gas Policy Act of

1978 and to re-imburse them for ad valorem taxes paid to Edwards County. Northern complied with this contract until 1985 at which time the contract was amended to provide for much lower prices. The net effect of this amendment was that for the period from 1983 through 1988 the group was actually paid $125,000 less than the maximum lawful price for natural gas pursuant to the Natural Gas Policy Act of 1978. In spite of this gross underpayment Northern Natural Gas Company is trying to force the refund of $19,000, the amount of ad valorem taxes refunded for 1983, 1984 and 1985 with interest. The owner is deceased and the corporation was dissolved so Northern Natural is trying to recover the money from his widow. The contract was terminated years ago with the Company held harmless from any further claims.

Joel T. Strohl and his two sons, Scott and Sid Strohl, friends of mine from Pretty Prairie, Kansas, were working interest owners in this well and they have asked the FERC for a hearing. Their request for a hearing is vigorously opposed by Northern Natural Gas Company and a hearing has not been granted.

For some producers this refund will result in bankruptcy. Others will have their operations significantly curtailed and future drilling canceled. On a state wide basis the issue has the potential to consume the entire drilling budget for the State of Kansas for the next three to five years. It will seriously impair producers' ability to supply the growing consumer demand for natural gas. It will significantly impact the entire state, including state and local tax revenues. The ripple effect of lost dollars will permeate the Kansas economy.

The impact of the ad valorem refund issue has been extended to royalty owners as well. Royalty owners include farmers and ranchers, their children, heirs and devisees, churches and charitable organizations, and Kansas' universities and colleges. The Federal Energy Regulatory Commission has attempted to exert control over these Kansas landowners by forcing producers to collect the royalty owner's share of the ad

valorem tax refund with interest. Because of this action by the FERC 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 to $90 million.

The pipeline map attached to my testimony 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. A series of attachments will review prior legislative activity and other information which I hope you find helpful. (See Attachment List beginning withAP Articles by Lew Ferguson and the Hutch News)

In 1998, the Kansas Legislature 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. Congress did not act.

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. The Federal Energy Regulatory Commission chose to ignore the statute.

In 1999, the Interstate Oil and Gas Compact Commission, a thirty member organization of oil and gas producing states also recognized the injustice of the FERC actions and passed a resolution urging Congress to provide relief. A copy of IOGCC Resolution 99.121 is attached. Congress did not respond.

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 with complete support from Senator Brownback,

Representative Todd Tiahrt, Representative Dennis Moore and Representative Jim Ryun.

And, we are particularly indebted to Attorney General Stovall who personally faced the power of the legal forces of the giant interstate pipelines in the unfriendly Courts of the eastern establishment.

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

But after spending considerable time in Washington, D.C. and testifying before the Energy and Power Committee, and after witnessing the inability of Kansas producers to even get a hearing before the FERC, I have come to realize that the power politics that play in that arena will 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 everyone involved they have succeeded in defeating corrective federal legislation to date. This issue will have to be resolved in Kansas for Kansas.

A background paper included with the attachments will discuss the private ownership of Land and minerals and the historical conflicts between producing and consuming states.

PURPOSE OF H.B. 3050

The purpose of H.B. 3050 is to restore the tax policy which the Kansas Legislature intended with the passage of the severance tax in 1983, a tax which was passed" in addition to" the existing ad valorem tax on the advice that both the severance

and the ad valorem tax could be recovered by Kansas producers and royalty owners as a cost of production, as any other public utility could, and as the General Counsel of the Kansas Corporation Commission was informed by the Federal Power Commission in Opinion 699-D. This was a tax policy which was passed by the Kansas Legislature in clear reliance on FPC Opinion 699-D.

H.B. 3050 will refund all of the Kansas ad valorem taxes to the interstate pipelines and, what the pipelines do not keep for themselves and their subsidiaries, will be returned to reduce current utility rates for the benefit of todays consumers.

The bill is quite simple. First, raise refund money through the sale of bonds to cover the pipeline's claims for principal and interest. Second, pay the bonds off through a tax on transportation of natural gas by all pipelines operating within the protection of the State of Kansas, whether interstate or intrastate. The tax policy of the State of Kansas is realized.

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 <u>production</u> or <u>gathering</u> 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 <u>"production, severance, or other similar taxes."</u>
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, <u>**relying upon Opinion 699-D**</u>, 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.

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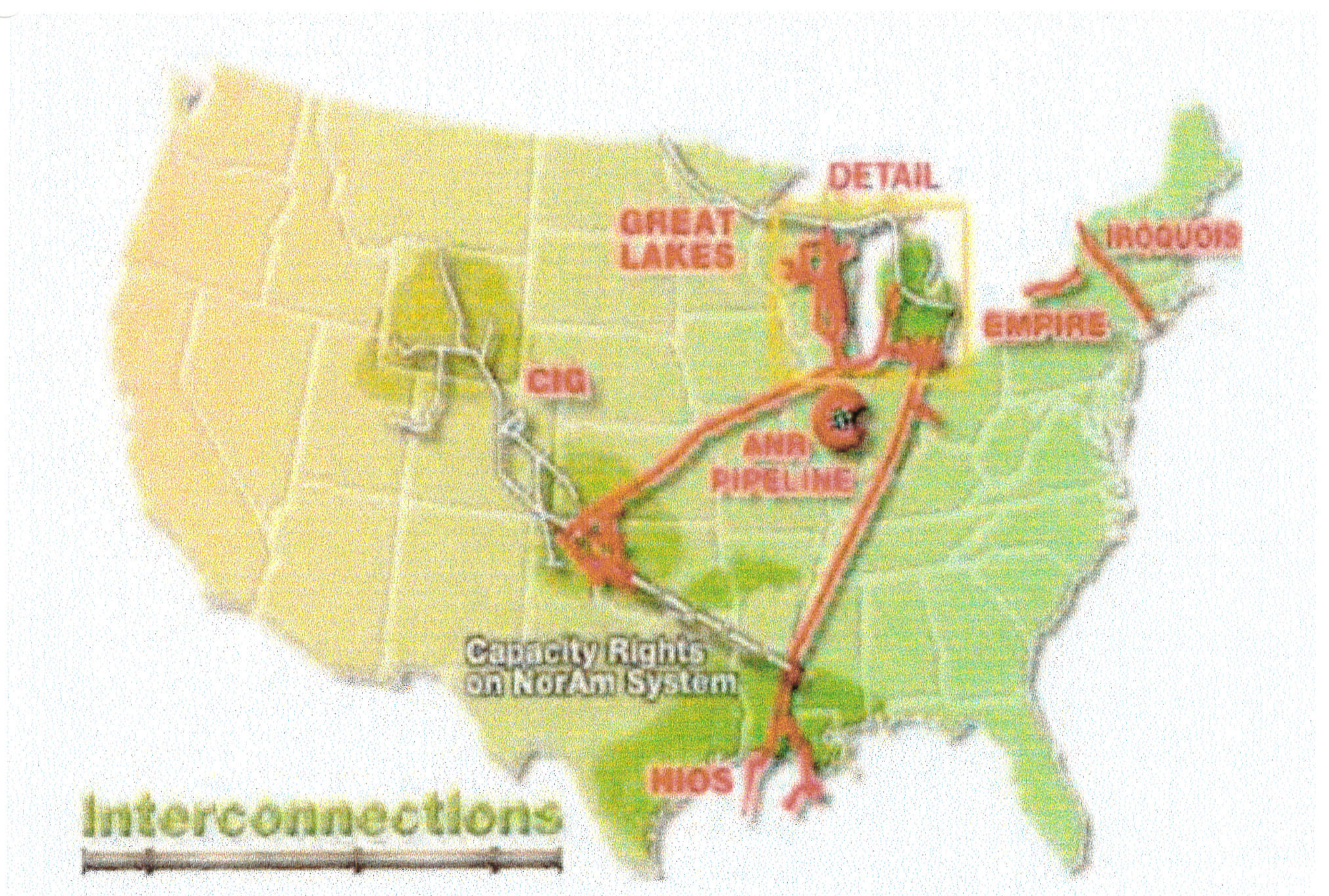

Statement of Congressman Jerry Moran
Subcommittee on Energy and Power
Kansas Ad Valorem Tax
June 8, 1999

Imagine receiving a notice from the IRS saying that, while you had paid your taxes in full fifteen years ago, the IRS has changed its mind about how you figured your taxes and could you please pay an additional $5000 and another $10,000 in penalty and interest. We would not tolerate this type of retroactive taxpayer abuse by the IRS. However, this is essentially what another government agency has done to Kansas natural gas producers and royalty owners.

I appreciate having the opportunity to be here to discuss an injustice that is being perpetrated on many of my constituents. At issue here is whether Kansas natural gas producers could pass through to their customers the Kansas ad valorem tax. In the regulated energy marketplace in the 1980's these decisions and the resulting prices charged for natural gas, were made by the Federal Power Commission (FPC), the predecessor to the Federal Energy Regulatory Commission (FERC).

In several rulings on this issue, FPC and later FERC, consistently ruled that the Kansas ad valorem tax could be included in the price of gas paid to these companies by their pipeline customers. It wasn't until 1993 that FERC reversed its previous rulings. FERC's reversal and subsequent court case provide that charges for ad valorem taxes should not have been passed through from 1983 to 1988 and must now be refunded. In addition, interest penalties were assessed and now more that double the actual amount of tax in question.

I would like to make several points as we review the issue today:

First, my constituents, and all royalty owners and producers, followed all applicable laws, rules and regulations. The federal agency responsible for regulating these matters explicitly gave its blessing to the pass through of taxes. Many gas contracts were written with specific reference to FERC's rulings on the matter. This was not a gray area, was not subject to interpretation and none of these individuals could, should or would have been expected to have handled it any differently.

There are those who would claim that producers and royalty owners somehow should have known that FERC would change its ruling. That is simply not the case. FERC ruled on the issue three separate times in 1983, 1986, and 1987. Each time, FERC ruled that the taxes where correctly applied. I don't know how many times we need to hear from a Federal agency to believe it, but I suspect that after three rulings since the issue was questioned and the two rulings prior to 1983 that producers rightly believed they were following the law. After five separate successful rulings on my taxes from 15 years ago, I might even throw away my returns and sleep well at night.

Second, a fifteen year reach-back is outrageous. We have all heard of cases of unfair, arbitrary, abusive, irrational or convoluted actions by federal government agencies, but this one takes the cake. To reverse a decision and then go back over 15 years and force the payment of refunds, with interest, isn't just unfair, it's unconscionable. Why is there no statute of limitations? What about ex post facto? This country was born out of protest against this type of improper governmental conduct. We should not stand for it in this case.

Third, the tax is devastating for producers and offers little for customers. For royalty owners and small businesses this tax could not have come at a more difficult time. We read of the consolidation of the major oil and gas companies due to the difficult times, but we do not so easily see the hundreds of small businesses that have gone bankrupt, gone through layoffs, or otherwise been forced to close their doors. In Kansas alone, the oil and gas industry lost some 5,000 jobs in the last year.

The burden on small businesses as a result of this situation is enormous. For example, Mid Continent Energy, a small Kansas company with two employees owes $244,000. Several elderly constituents describe bills well over the value of their annual payments they now receive from Social Security. A typical example is Mrs. Betty Shingler, of Wichita, Kansas. She, along with her husband, were the owners of a company called Aurora, Inc. In the early 1980's, Mr. and Mrs. Shingler, with outside investors, had 6 gas wells. Today, Mrs. Shingler who lost her husband three years ago, now faces a $19,000 bill.

FERC's decision not only effects the companies that explore for and produce natural gas, their far reaching decision has a terrible impact on royalty owners. Royalty owners are those who own the land under which the natural gas is located - often the farmers and ranchers of Southwest Kansas. Today you will hear examples from property owners who have been unknowingly attacked by this situation.

You will also hear about consumers and how they are owed this refund. This issue deserves your review. Of the eight pipeline companies involved in obtaining the refund and interest, two have already filed to keep the refund and not pass it on to consumers. My counterparts in the Senate, Senators Roberts and Brownback, have called for a General Accounting Office investigation on the distribution of the refunds and I fully support that request. One would like to think that each dollar collected would be returned to the original customer; however, after fifteen years, many people have moved, retired or passed away. What happens to the money when the customer can't be located? Could this be why the pipelines are fighting so aggressively?

Although the damage is huge, the benefits are small. For the average household consumer, this refund is minimal and will likely be prorated. For example, in Kansas a typical house receiving gas from the Greeley Gas Company using 100 mcf per year will get an estimated $6 refund. Among the estimates I have seen, a typical household will receive around $15, or just over a dollar a month for one year.

Keep in mind, that Kansans, as well as producing the gas, are also the largest recipients of the refunds. Representing the largest positions on both sides in this issue, I introduced the compromise legislation that has been referred to this subcommittee, H.R. 1117.

This legislation attempts to strike at the basic requirement of fairness. Under the bill, the amount of disputed tax would be collected, but an interest penalty would not be assessed and the refunds required only to the extent they will be received by the ultimate consumer.

While I contend that the pass through of the tax, after being approved by FERC five times, should be allowed to stand and no refund ordered, I introduced this bill as a compromise to try and protect the hundreds of individuals who had always acted in accordance with the law.

Again, I thank the committee for their time and attention and would be happy to answer any questions.

Attached is just one example for the committee's review. In this situation, the accused company was not even involved in the gas business during the time in question.

STATEMENT
OF
THE HONORABLE JOHN D. DINGELL
REGARDING
SUBCOMMITTEE ON ENERGY AND POWER
HEARING ON "THE KANSAS AD VALOREM GAS TAX"

June 8, 1999

Mr. Chairman, today's hearing explores issues relating to the treatment of the Kansas ad valorem tax on natural gas and its disposition under federal law: specifically the Natural Gas Act and the Natural Gas Policy Act.

There is a long and complex history behind this issue, which I am sure we will have recounted today by our esteemed witnesses. I will only point out that Federal Energy Regulatory Commission (FERC) has ordered that the costs of the Kansas tax be refunded to gas consumers and that in 1997, the D.C. Circuit held that since refund claims had been pending from 1983 forward, that FERC should order refunds with interest from1983 forward.

Now, on March 18th of this year, Senator Roberts of Kansas succeeded in attaching language to the Supplemental Appropriations bill to exempt producers from having to pay interest on the refunds of the Kansas ad valorem tax. This is a very nice deal if you can get it, and it's certainly one that the IRS would never give you or me if we failed to pay our taxes for five years or more. However, Senator Roberts convinced his colleagues that this was a good idea and it passed the Senate along with the rest of the Supplemental bill. Noting that the House-passed bill contained no such provision, Chairman Bliley and I both conveyed our opposition to the Roberts language to the Appropriations Committee on the grounds that the provision was amending the Natural Gas Policy Act, a statute primarily within the jurisdiction of this Committee. Fortunately, the House position carried the day and the Roberts language was dropped in conference.

But jurisdiction was not the only reason I objected to the Roberts amendment. I also opposed this language because it clearly represented a transfer of wealth from my state to gas producers in the State of Kansas. I know my esteemed colleague from Kansas is concerned about whether the refunded money would ultimately find its way into the pockets of ratepayers, and let me assure him I share his concern. I also share his concern for the small producers of natural gas, who may indeed require some assistance.

Nonetheless, both issues are irrelevant to this debate. It is for state public utility commissions to decide how much money goes to companies and how much to ratepayers. And with regard to assisting natural gas producers, I would point out that there are other ways to help Kansas producers than by taking it directly from the pockets of my constituents or those residing in Missouri, Illinois, Iowa, Ohio, California or any of the other states owed refunds.

I would also posit that my good friend from Kansas may be pursuing an avenue that may ultimately prove unconstitutional since his legislation appears to have the effect of altering a

final judgement by the courts and, if enacted, could be considered a taking.

Frankly, I find it difficult to understand why we are having this hearing today. The final disposition of refunds of the Kansas ad valorem tax is an issue that is still pending before the courts. Why should Congress legislate at this time? The producers are spending lots of their hard earned money to appeal the 1997 court ruling and I think it would be wrong for this Committee to deny them their day in court. Furthermore, if the issue is small, hardship cases, then I fail to understand these attempts to circumvent the FERC hardship process, because so far the Commission has granted exemptions in 6 out of the 11 cases it has reviewed to date. It certainly makes me wonder whether this process is truly driven by small producers, rather than large producers who already know they have the ability to pay the refunds with interest.

It's also unclear to me what action, if any, this Committee intends to take on the Kansas ad valorem issue. I note that this is being billed as an oversight hearing, yet the invitation letter to at least one of our witnesses asks them to comment on Mr. Moran's bill.

What is also unclear to me is the position and the procedures of the Federal Energy Regulatory Commission. I have a memorandum from FERC, with Mr. Smith's name on it, that went to our friends on the Appropriations Committee stating that Chairman Hoecker would not oppose the language that was included in the Supplemental Appropriations bill. Now the Roberts language amended the Natural Gas Policy Act which is within our jurisdiction, yet no one from FERC saw fit to consult with Chairman Bliley or me about our views on legislation affecting a law within this Committee's jurisdiction. I am curious how this position was arrived at and how FERC came to the decision to involve itself in this matter. Was an open public meeting held to consider this issue? Did the Commission vote on this matter, or was this memorandum only the position of one commissioner? If it was only Chairman Hoecker's position, what were the positions of the other Commissioners and are they aware that he intervened in this matter both here and at the White House? I would also like to understand why FERC took a position on an issue that is still pending in the courts and why Mr. Smith's testimony states that FERC has no position, when it's clear that the Chairman has taken a position in favor of one side's view in this matter. These questions must be answered because they raise serious concerns for me at a time when we are being asked to grant them more power in the area of electricity transmission.

Mr. Chairman, while I am certainly interested in hearing from our witnesses, it seems clear to me that this is a topic that, at the very least, is not yet ripe for legislative action. What may be ripe, however, is an oversight hearing on FERC and its procedures and I hope the Chairman will consider holding such a hearing before we take any action that would have the effect of increasing FERC's power.

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. Resolution of the Interstate Oil and Gas Compact Commission

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

7. 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.

8. 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.

9. 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.

10. 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.

11. 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.

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

13. Energy Information Administration/Annual Energy Outlook 2000 and Paul Premo, Energy Economics Consultant, 310 Hazel Ave. Mill Valley, Ca., on natural gas production projections through 2020 and funds available to pay off bonds.

14. Federal Energy Regulatory Commission Letter to Joel T. Strohl and Sons and response.

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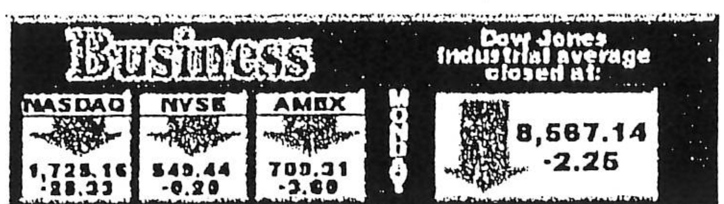

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Thursday, September 11, 1997

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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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.

2-20

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.

RESOLUTION 99.121

Urging Congress To Provide Relief From FERC Ordered Interest Penalties

I N T E R S T A T E O I L A N D G A S C O M P A C T C O M M I S S I O N

Whereas, in 1974, the Federal Energy Regulatory Commission (FERC) and its predecessor, the Federal Power Commission (FPC), allowed natural gas producers operating in the State of Kansas to include the cost of state property taxes on production in their rates; and

Whereas, in 1978, the enactment of the Natural Gas Policy Act (NGPA) codified FERC's treatment of Kansas property taxes and continued to allow producers to recover this cost in their rates; and

Whereas, in 1979 and again in 1982, FERC reaffirmed the treatment of Kansas property taxes prior to the enactment of the NGPA to allow producers to recover this cost in their rates; and

Whereas, in 1986 and 1987 in response to petitions filed at FERC challenging the inclusion of the costs of property taxes in rates, FERC in each instance reaffirmed its prior rulings under the NGPA to allow the recovery of those costs in the producers' rates; and

Whereas, in 1993, five years after the United States Court of Appeals, Washington DC Circuit, ordered FERC to explain its prior rulings, FERC unexpectedly reversed its 19 year precedent of allowing the recovery of tax costs and ordered refunds retroactive to 1988; and

Whereas, the natural gas producers operating in Kansas paid the ordered refunds, including interest, but then in 1996 the United States Court of Appeals, Washington DC Circuit, added five years of retroactivity to the FERC order by ruling that refunds should begin to run from 1983, rather than 1988; and

Whereas, as a result of this order, the producers were ordered to refund an additional $125 million representing the principal amount of property taxes collected from 1983 through 1988 plus an interest penalty for this extended period which is estimated to be $210 million through 1997; and

Whereas, the imposition of the $210 million interest penalty for the extended period, particularly in light of administrative delays exceeding 10 years, further exacerbates the serious financial harm done not only to the gas producers operating in Kansas, but also to the state and local economies and governmental budgets that rely on the industry's economic base;

Now, Therefore, be it Resolved; that the IOGCC urges the Congress to enact legislation to provide relief from the FERC ordered interest penalty that the natural gas producers operating in Kansas are to pay on refunds for property tax costs included in natural gas rates from 1983 through 1988.

S:\RES\99.121.doc

STATE OF KANSAS

BILL GRAVES, *Governor*
State Capitol, 2nd Floor
Topeka, Kansas 66612-1590

(785) 296-3232
1-800-748-4408
FAX: (785) 296-7973

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.

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 Pardue -
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.

8
2-29

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.

(SEAL)

Kenneth F. Plumb,
Secretary.

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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.

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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.

State of Kansas

Senate Chamber

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

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UTILITIES
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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.

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What could the Kansas Legislature have d[illegible]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 pr[illegible] 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[illegible] and Power Subcommitte[illegible] the name of consumer protection. How much of the refund will ultimat[illegible]ach the consumer is unde[illegible]ned at this time, but I am advised that any residential consumer likely wi[illegible]ive 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.

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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:

Amount	Item
$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

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

Amount	Item
$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

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

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

Amount	Item
$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 Legislative 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.

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

State	Severance Taxes (not including regulatory taxes)				1980 Property Tax as Estimated Percentage of Value of Production
	Oil Severance Tax Rate	Severance Tax In Lieu of Property Tax	Exemptions or Lower Rates	Other Minerals Taxed	
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.

TABLE 1 FOOTNOTES

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.

SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION
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(316) 544-4333

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

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

> 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

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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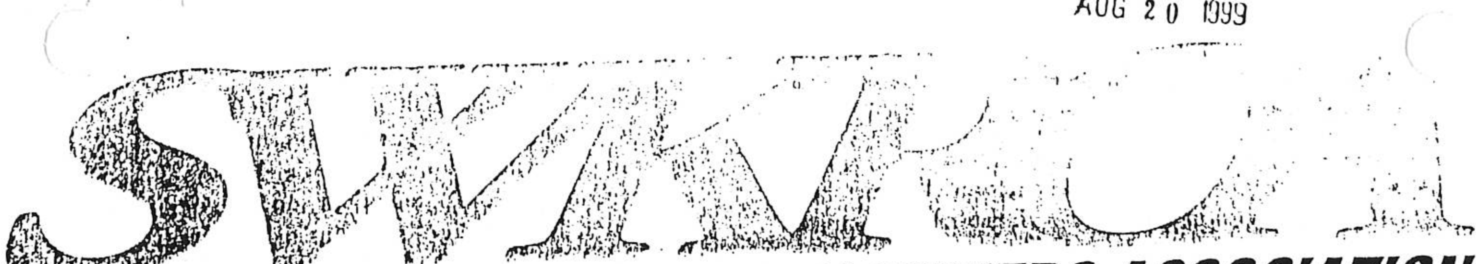

SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION

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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) payments 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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Oklahoma; 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 in the 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.

<u>Stucky advised members to challenge letters from some small producers requiring them to pay the contested refund amount.</u> 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.

<u>ELECTION OF DIRECTORS</u>

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.

<u>Eulogy for Ted Julian</u>

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 North America and the second 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

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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 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".

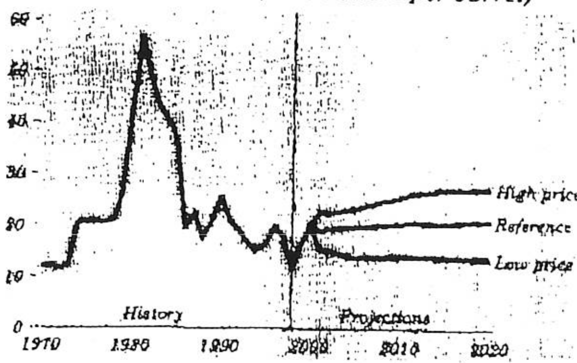
The State of Kansas was not present in the D.C. Court on that day to tell Judge Doug Ginsburg that the entire Kansas Legislature had relied on Opinion 699-D when they passed the severance tax in Kansas in 1983 and that it was the understanding and intention of the State of Kansas that the new severance 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 effectively subverted by the retroactive reversal of Opinion 699-D.

Appendix F. AEO 2000 3/16/00

MAR 16 '00 PMP

Oil Prices Are Expected To Remain Above Low 1998 Levels

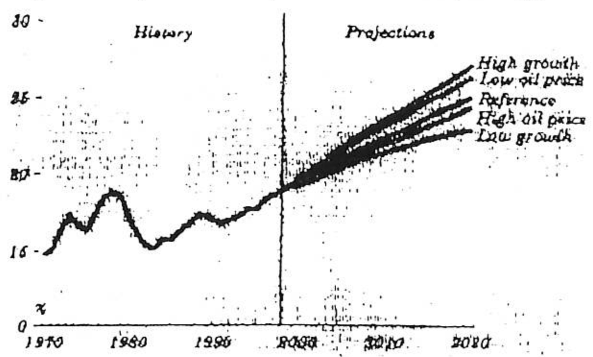
Figure 84. Lower 48 crude oil wellhead prices in three cases, 1970-2020 (1998 dollars per barrel)



Because domestic prices for crude oil are determined largely by the international market, the recovery from the 1998 decline in world oil prices causes a steep increase in wellhead prices for crude oil in the lower 48 States from 1998 through 2000 in all cases. After 2000, prices initially decline in the reference and low world oil price cases, then prices in all cases generally increase through the rest of the forecast. Prices remain above 1998 levels throughout the forecast in all cases, with wellhead prices projected to increase by 0.9, 2.8, and 4.0 percent a year from 1998 to 2020 in the low world oil price, reference, and high world oil price cases, respectively (Figure 84).

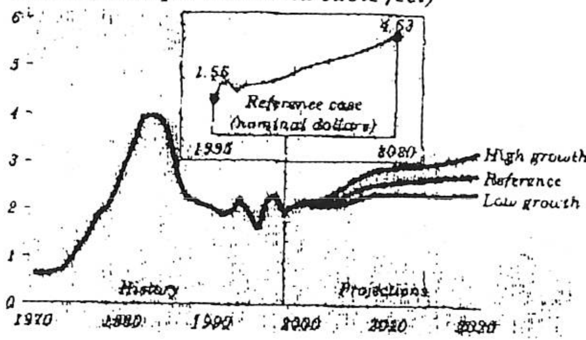
U.S. petroleum consumption continues to rise in all the *AEO2000* cases (Figure 85). Total petroleum product supplied ranges from 23.0 million barrels per day in the low economic growth case to 27.3 million in the high growth case, as compared with 18.9 million barrels per day in 1998.

Figure 85. U.S. petroleum consumption in five cases, 1970-2020 (million barrels per day)



Rising Demand Increases Natural Gas Prices in All Economic Growth Cases

Figure 86. Lower 48 natural gas wellhead prices in three cases, 1970-2020 (1998 dollars per thousand cubic feet)



Wellhead prices for natural gas in the lower 48 States increase on average by 0.9, 1.7, and 2.4 percent a year in the low economic growth, reference, and high economic growth cases, respectively (Figure 86). The reference case price increases from $1.96 per thousand cubic feet in 1998 to $2.81 in 2020. The increases reflect rising demand for natural gas and its impact on the natural progression of the discovery process from larger and more profitable fields to smaller, less economical ones. Price increases also reflect more production from higher cost sources, such as unconventional gas recovery. Growth in lower 48 unconventional gas production ranges from 1.3 to 2.7 percent a year across cases, compared with a 2.1- to 2.2-percent range in annual growth for conventional sources across the cases. Despite the changes in sources of production, technically recoverable resources (Table 10) remain more than adequate overall to meet the production increases.

Although consumption, and thus production and price levels, for natural gas rise in all three cases, the price increases attributable to the rising demand are tempered by the beneficial impacts of technological progress on both the discovery process and production operations.

Table 10. Technically recoverable U.S. oil and gas resources as of January 1, 1998

Total U.S. resources	Crude oil (billion barrels)	Natural gas (trillion cubic feet)
Proved	24	167
Unproved	116	1,092
Total	140	1,259

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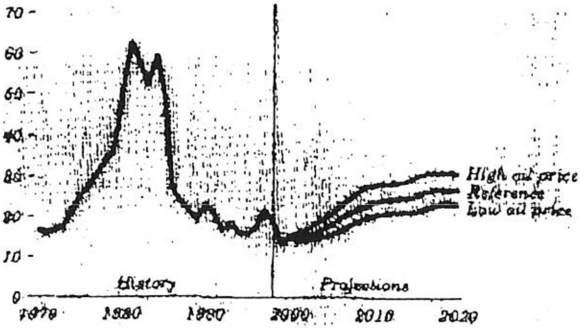
Rising Gas Prices and Lower Drilling Costs Increase Well Completions

Figure 87. Successful new lower 48 natural gas and oil wells in three cases, 1970-2020 (thousand successful wells)



Both exploratory drilling and developmental drilling increase in the forecast. With rising prices and declining drilling costs, crude oil and natural gas well completions increase on average by 1.4 and 2.7 percent a year in the low and high oil price cases, respectively, compared with 2.1 percent in the reference case (Figure 87). Projected oil drilling varies more than gas drilling in the world oil price cases (Table 11), reflecting the relative sizes of the changes in prices for the two fuels.

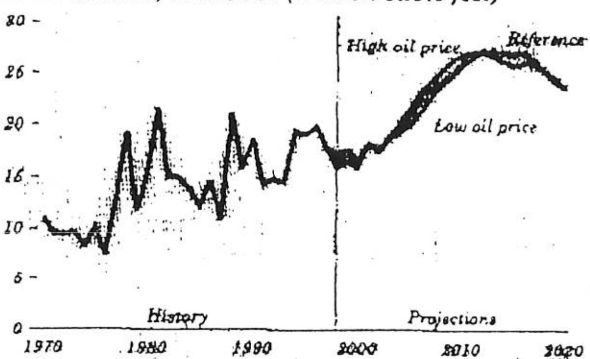
The productivity of natural gas drilling does not decline as much as that of oil drilling, in part because total recoverable gas resources are more abundant than oil resources. At the projected production levels, however, undiscovered recoverable resources of conventional natural gas decline rapidly in some areas, particularly in the onshore Gulf Coast and offshore Gulf of Mexico regions. In the final analysis, the future overall productivity of both oil and gas drilling is necessarily uncertain, given the uncertainty associated with such factors as the extent of the Nation's oil and gas resources [66].

Table 11. Natural gas and crude oil drilling in three cases, 1998-2020 (thousand successful wells)

	1998	2000	2010	2020
Natural gas				
Low oil price case		10.7	14.5	16.5
Reference case	12.1	11.0	15.9	16.9
High oil price case		11.0	17.3	16.7
Crude oil				
Low oil price case		4.3	5.8	7.2
Reference case	7.0	4.4	7.9	10.2
High oil price case		4.4	10.7	14.4

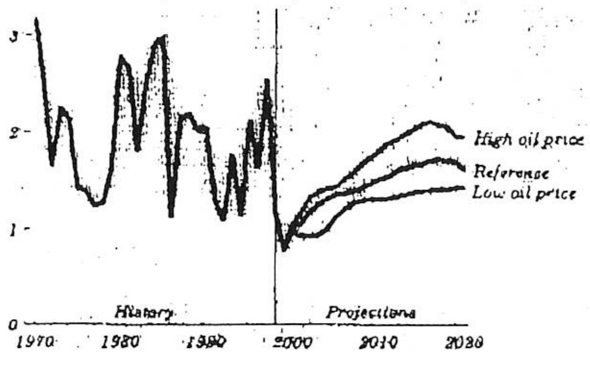
High Levels of Gas Reserve Additions Are Projected Through 2020

Figure 88. Lower 48 natural gas reserve additions in three cases, 1970-2020 (trillion cubic feet)



Although for most of the past two decades lower 48 production of both oil and natural gas has exceeded reserve additions, the pattern for natural gas reversed from 1994 through 1997. In 1998, falling prices caused production to exceed reserve additions again. After 2003, rising prices in the forecast cause natural gas reserve additions generally to exceed production until close to the end of the projection period (Figure 88), even with expected increases in demand. Relatively high levels of annual gas reserve additions through 2020 reflect increased exploratory and developmental drilling as a result of higher prices, as well as productivity gains from technology improvements comparable to those of recent years. In contrast, despite varying patterns of lower 48 oil reserve additions (Figure 89), total lower 48 crude oil production exceeds total reserve additions over the forecast period in all cases.

Figure 89. Lower 48 crude oil reserve additions in three cases, 1970-2020 (billion barrels)



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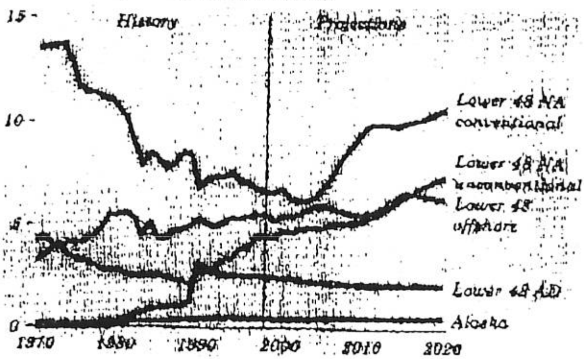
Significant New Finds Are Likely To Continue Increases in Gas Production

Figure 90. Natural gas production by source, 1970-2020 (trillion cubic feet)



The continuing increase in domestic natural gas production in the forecast comes primarily from lower 48 onshore nonassociated (NA) sources (Figure 90). Conventional onshore production, which accounted for 35.4 percent of total U.S. domestic production in 1998, increases in share to 40.7 percent of the total in 2020. Unconventional sources also increase in share, and gas from offshore wells in the Gulf of Mexico contributes significantly to production. The innovative use of cost-saving technology and the expected mid-term continuation of recent huge finds, particularly in the deep waters of the Gulf of Mexico, support this projection.

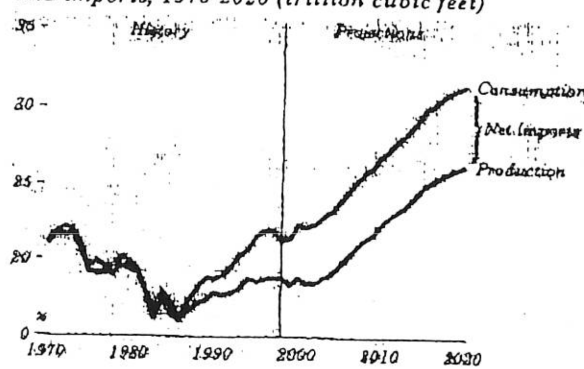
Production from conventional sources is projected to grow rapidly through 2010 in response to increasing demand. After 2010, slower growth of consumption and higher production from increasingly economical offshore and unconventional sources cause production from conventional sources to level off.

Natural gas production from Alaska grows by 0.9 percent a year in the forecast. Alaskan gas is not expected to be transported to the lower 48 States, however, because the projected lower 48 prices are not high enough in the forecast period to support the required transport system [67].

Production of associated-dissolved (AD) natural gas from lower 48 crude oil reservoirs generally declines in the projections, following the expected pattern of domestic crude oil production. AD gas accounts for 8.4 percent of total lower 48 production in 2020, compared with 14.1 percent in 1998.

Net Imports of Natural Gas Grow in the Projections

Figure 91. Natural gas production, consumption, and imports, 1970-2020 (trillion cubic feet)



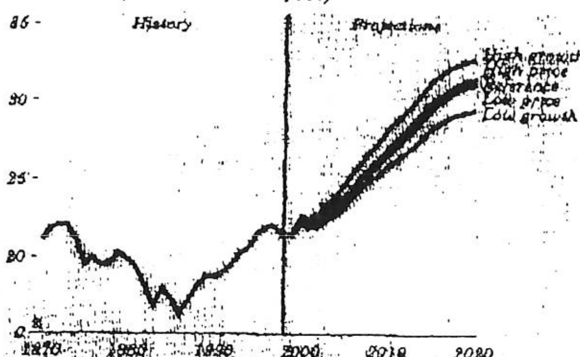
Net natural gas imports are expected to grow in the forecast (Figure 91) from 14.6 percent of total gas consumption in 1998 to 16.3 percent in 2020. Most of the increase is attributable to imports from Canada, which are projected to grow substantially. Although most of the additional imports come from western Canada, new pipeline capacity is also expected to provide access to eastern supplies. Natural gas from Sable Island, in the offshore Atlantic, is expected to begin flowing in late 1999.

Mexico has a considerable natural gas resource base, but its indigenous production is unlikely to increase sufficiently to satisfy rising demand. Since 1984, U.S. natural gas trade with Mexico has consisted primarily of exports. That trend is expected to continue throughout the forecast, especially in light of the recent elimination of the 4-percent import tariff and an increase in cross-border pipeline capacity. U.S. exports to Mexico are projected to grow from 50 billion cubic feet in 1998 to 240 billion cubic feet in 2020.

Imports of liquefied natural gas (LNG) are projected to grow at a rate of 7.2 percent a year, resulting in part from a 60-percent expansion of capacity at the Everett, Massachusetts, terminal and the projected reactivation of the Elba Island terminal in 2002. In spite of this activity, given the projected low natural gas prices in the lower 48 markets, LNG is not expected to grow beyond a regionally significant source of U.S. supply. LNG imports are projected to reach a level of 0.39 trillion cubic feet in 2020, compared with 0.07 trillion cubic feet in 1998 [68].

Significant Increases in Natural Gas Use Are Seen in All Cases

Figure 92. Natural gas consumption in five cases, 1970-2020 (trillion cubic feet)

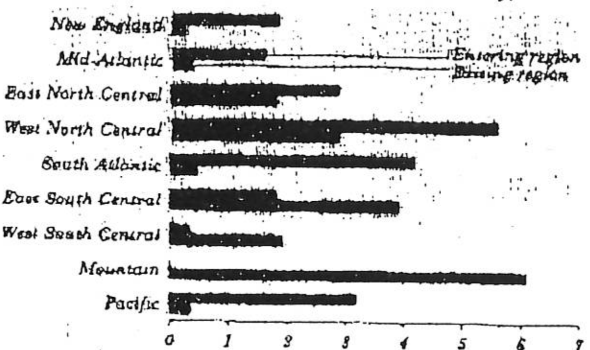


Natural gas consumption increases from 1998 to 2020 in all the *AEO2000* cases (Figure 92). Domestic consumption ranges from 29.5 trillion cubic feet per year in the low economic growth case to 32.7 trillion cubic feet in the high growth case in 2020, as compared with 21.4 trillion cubic feet in 1998. Growth is seen in all end-use sectors, and more than half the increase results from rising demand for electricity generation. Natural gas consumption in the electricity generation sector grows steadily throughout the forecast, as demand for electricity increases and retiring nuclear and older oil and gas steam plants are replaced by turbines and combined-cycle facilities.

In the reference case, natural gas consumption for electricity generation more than doubles, from 3.7 trillion cubic feet in 1998 to 9.3 trillion cubic feet in 2020. Although projected coal prices to the electricity generation sector fall throughout the forecast, the natural gas share of new capacity far outpaces the coal share. Lower capital costs, shorter construction lead times, higher efficiencies, and lower emissions give gas an advantage over coal for new generation in most regions of the United States. Natural-gas-fired facilities are less capital-intensive than coal, nuclear, or renewable electricity generation plants. Growth in natural gas use for electricity generation is also expected to be spurred by the environmental advantages of natural gas.

Gas Pipeline Capacity Expansion Is Needed To Serve New Markets

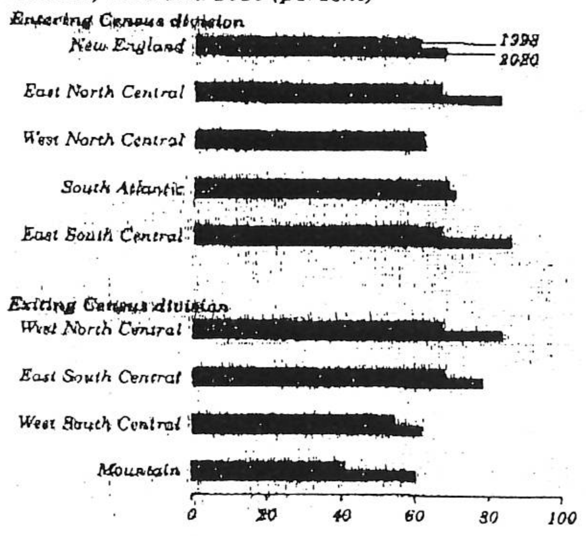
Figure 93. Pipeline capacity expansion by Census division, 1998-2020 (billion cubic feet per day)



Projected growth in natural gas consumption will require additional pipeline capacity. Expansion of interstate capacity (Figure 93) will be needed to provide access to new supplies and to serve expanding markets. Expansion is projected to proceed at an average rate of 0.8 percent a year in the forecast.

The greatest increases in capacity are expected along the corridors that provide access to Canadian, Gulf Coast, and Mountain region supplies and deliver them to the South Atlantic, Pacific, and Northeast regions. In all regions, growth in new pipeline construction is tempered by higher utilization of existing pipeline capacity (Figure 94).

Figure 94. Pipeline capacity utilization by Census division, 1998 and 2020 (percent)



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Kansas — Natural Gas 1998

	Million Cu. Feet	Percent of National Total		Million Cu. Feet	Percent of National Total
Net Interstate Movements:	**-80,882**		Industrial:	**111,143**	**1.28**
Marketed Production:	**603,586**	**3.07**	Vehicle Fuel:	**0**	**0.00**
Deliveries to Consumers:					
Residential:	**70,217**	**1.55**	Electric Utilities:	**36,896**	**1.13**
Commercial:	**41,788**	**1.39**	Total:	**260,044**	**1.34**

Table 63. Summary Statistics for Natural Gas — Kansas, 1994-1998

	1994	1995	1996	1997	1998
Reserves (billion cubic feet)					
Estimated Proved Reserves (dry) as of December 31	9,156	8,571	7,694	6,989	NA
Number of Gas and Gas Condensate Wells					
Producing at End of Year	19,365	22,020	21,388	21,500	21,000
Production (million cubic feet)					
Gross Withdrawals					
From Gas Wells	628,900	636,582	629,755	618,016	532,594
From Oil Wells	85,759	86,807	85,876	71,037	72,626
Total	**714,659**	**723,389**	**715,631**	**689,053**	**605,220**
Repressuring	1,215	1,230	2,120	1,157	1,029
Nonhydrocarbon Gases Removed	NA	NA	NA	NA	NA
Wet After Lease Separation	713,444	722,159	713,511	687,896	604,191
Vented and Flared	715	723	716	680	605
Marketed Production	712,730	721,436	712,796	687,215	603,586
Extraction Loss	46,936	47,442	47,996	38,224	45,801
Total Dry Production	**665,794**	**673,994**	**664,800**	**648,991**	**557,785**
Supply (million cubic feet)					
Dry Production	665,794	673,994	664,800	648,991	557,785
Receipts at State Borders					
Imports	0	0	0	0	0
Intransit Receipts	0	0	0	0	0
Interstate Receipts	1,127,799	1,140,230	1,219,027	1,201,629	1,070,930
Withdrawals from Storage					
Underground Storage	99,851	110,567	116,989	103,475	98,402
LNG Storage	0	0	0	0	0
Supplemental Gas Supplies	0	0	0	0	0
Balancing Item	20,703	8,173	-3,039	R-50,157	-144,189
Total Supply *	**1,914,147**	**1,932,964**	**1,997,776**	**R1,903,939**	**1,582,927**
	x .02	x .02	x .02	x .02	x .02
Revenue Stream to pay off bonds based on 94 thru 98 → $	38,282,940	38,659,280	39,955,520	38,078,780	31,658,540

See footnotes at end of table.

* Add '000' to get thousand cubic feet or MCF.

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Table 63. Summary Statistics for Natural Gas — Kansas, 1994-1998 (Continued)

	1994	1995	1996	1997	1998
Disposition (million cubic feet)					
Consumption	418,027	368,342	362,965	R339,197	313,880
Deliveries at State Borders					
Exports	0	0	0	0	0
Intransit Deliveries	0	0	0	0	0
Interstate Deliveries	1,390,051	1,458,930	1,529,940	1,449,894	1,151,812
Additions to Storage					
Underground Storage	106,069	105,693	104,871	114,848	117,235
LNG Storage	0	0	0	0	0
Total Disposition	1,914,147	1,932,964	1,997,776	R1,903,939	1,582,927
Consumption (million cubic feet)					
Lease Fuel	15,623	18,772	18,752	20,641	13
Pipeline Fuel	31,739	34,631	38,262	39,109	32,902
Plant Fuel	28,988	28,510	30,444	26,205	20,921
Delivered to Consumers					
Residential	74,156	75,846	85,376	69,415	70,217
Commercial	52,253	53,122	57,229	R41,482	41,788
Industrial	187,979	129,515	110,294	R116,522	111,143
Vehicle Fuel	10	2	2	1	0
Electric Utilities	27,279	27,945	22,607	25,822	36,896
Total Delivered to Consumers	341,677	286,430	275,508	R253,242	260,044
Total Consumption	418,027	368,342	362,965	R339,197	313,880
Delivered for the Account of Others (million cubic feet)					
Residential	0	0	0	0	0
Commercial	11,295	14,029	16,200	R12,331	12,757
Industrial	175,691	112,942	101,877	R105,838	100,205
Electric Utilities	14,617	16,872	12,545	16,887	27,329
Firm Deliveries (million cubic feet)					
Residential	74,156	75,846	85,376	69,415	70,217
Commercial	43,171	43,843	46,897	R31,529	30,606
Industrial	97,904	59,985	66,922	R54,081	60,550
Electric Utilities	11,213	11,311	8,128	10,001	14,303
Vehicle Fuel	10	1	1	1	0
Interruptible Deliveries (million cubic feet)					
Residential	0	0	0	0	0
Commercial	9,082	9,279	10,333	9,953	11,182
Industrial	90,075	69,530	43,372	62,441	50,593
Electric Utilities	9,243	10,906	5,422	7,074	14,128
Vehicle Fuel	0	1	1	1	0
Number of Consumers					
Residential	773,357	797,524	804,213	811,975	841,843
Commercial	86,457	88,163	89,168	R85,018	89,654
Industrial	3,560	3,079	2,988	R7,015	10,707
Average Annual Consumption per Consumer (thousand cubic feet)					
Residential	96	95	106	85	83
Commercial	604	603	642	R488	466
Industrial	52,803	42,064	36,912	R16,610	10,380
Average Prices for Natural Gas (dollars per thousand cubic feet)					
Wellhead (Marketed Production)	1.60	1.36	1.92	2.05	1.70
Imports	—	—	—	—	—
Exports	—	—	—	—	—
Pipeline Fuel	1.20	1.15	1.83	1.81	1.39
City Gate	2.86	2.36	3.05	3.47	2.96
Delivered to Consumers					
Residential	5.11	4.91	5.59	6.42	6.00
Commercial	4.12	3.93	4.61	5.38	4.98
Industrial	2.75	2.23	3.09	3.32	3.17
Vehicle Fuel	3.18	2.76	3.06	3.70	5.59
Electric Utilities	1.89	1.58	2.25	2.53	2.14

R = Revised data.
NA = Not available.
— = Not applicable.

Notes: Deliveries to electric utilities (consumption) are reported on the Form EIA-176, "Annual Report of Natural and Supplemental Gas Supply and Disposition." See the discussion on electric utility data and Table A1 in Appendix A for a comparison of reporting to these two forms. Totals may not add due to independent rounding. Beginning in 1996, consumption of natural gas for agricultural use was classified as industrial use. In 1995 and earlier years, agricultural use was classified as commercial use.

Sources: Energy Information Administration (EIA), Form EIA-176, "Annual Report of Natural and Supplemental Gas Supply and Disposition"; Form EIA-627, "Annual Quantity and Value of Natural Gas Report" (1994 and 1995); Form EIA-895, "Monthly Quantity and Value of Natural Gas Report" (1996 through 1998); Form EIA-857, "Monthly Report of Natural Gas Purchases and Deliveries to Consumers"; Form EIA-816, "Monthly Natural Gas Liquids Report"; Form EIA-64A, "Annual Report of the Origin of Natural Gas Liquids Production"; Form EIA-759, "Monthly Power Plant Report"; Form FERC-423, "Monthly Report of Cost and Quality of Fuels for Electric Plants"; Form EIA-191, "Underground Gas Storage Report"; Form FPC-14, "Annual Report for Importers and Exporters of Natural Gas" (1994); Office of Fossil Energy, U.S. Department of Energy, Natural Gas Imports and Exports (1995 through 1998); *U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves, Annual Reports*, DOE/EIA-0216; and the U.S. Minerals Management Service.

A. **Impact of 1 and 2 cents per MCF (approx. per MMBtu) on Kansas Consumers.**

Basis---Calendar year 1998 Kansas Info from Various DOE EIA Data Sources.

1. Total Kansas Consumption of Natural Gas: 313.88 Million MCF.
   Of this:

Lease, Plant and Pipeline Fuel	53.84
Residential	70.22
Commercial	41.79
Industrial	111.14
Electric Utilities	38.90

2. Therefore, state-wide Residential burden at 1 cent per MCF is $702,200 per year.

3. Average Kansas residential consumption for 1998 was 83 MCF (841,843 consumers)

4. Average cost per residential consumer is $0.83 per year.

5. Double the above results for a 2 Cents per MCF flow-through---Average cost per residential consumer then becomes $1.66 per year.

B. **Projection of Gas Volumes Transported Through Kansas**

1. Per DOE's Year 2000 Annual Energy Outlook Report Projections to the Year 2020, Total Lower 48 onshore conventional natural gas production is shown to increase from about 6-6.5 TCF in 2000, to about 11 TCF by 2020.

2. It is reasonable to assume that this ~70% increase in production will result in a similar 70% increase in natural gas transported through Kansas, enroute to consumer markets in the Mid-west and other markets served by the pipelines that transit Kansas (delivering gas produced in Oklahoma, Texas and Wyoming/Colorado).

3. Therefore, assume that the gas transported through Kansas rises by 70% over the next 20 years (approximately 3.5% per year average increase). Sensitivity cases could assume lesser rates of increase---perhaps down to 50% (approximately 2.5% per year average increase). In all cases, assume the annual build-up is fairly even, year-to-year, because the DOE projections similarly show fairly steady annual gas production growth over that time period.

4. Thus, for the 3.5% per year average increase, start with 1998 total gas transported through Kansas (1.151812 Trillion Cubic Feet), increase by 7% to an estimated 1.23 TCF for 2000, and grow it annually to a total of 2.1 TCF for the year 2020.

5. Similarly, for the 2.5% per year average increase, compute a starting point for 2000 of 5% over 1998---therefore 1.21 TCF. Then grow it by about 2.5% per year to a total of 1.8 TCF for the year 2020.

6. One cent per MCF on those quantities would be $18 - $21 Million in the year 2020.

Paul Premo
3-30-00

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D C 20426

OFFICE OF PIPELINE REGULATION

In Reply Refer To:
PR14

Joel T. Strohl & Sons
Box 323
Pretty Prairie, KS 67570-0323

DEC 2 1998

Ladies and Gentlemen:

Among other things, the Commission's September 10, 1997 order in Public Service Company of Colorado in Docket No. RP97-369-000, et al., required Kansas producers who collected a price in excess of the maximum lawful price between October 4, 1983 and June 28, 1988, due to the reimbursement of ad valorem taxes, to make refunds by March 9, 1998.

Triplett, Woolf & Garrison, LLC, 2959 North Rock Road, Suite 300, Wichita, KS 67226, the law firm representing Aurora, Inc., former operator of the Shannon Estate No. 1 well, has reported that you held a 6.25 percent working interest in that well during the above-referenced period, which indicates that you have a $1,395.60 refund obligation to Northern Natural Gas Company for sales from this well. Therefore, within 30 days from the date of this letter, you should make refunds to the pipeline, with additional interest to date of payment, and send a copy of your check to the Commission.

In the alternative, you may file: (1) a letter with the Commission explaining why you do not owe refunds or (2) a petition pursuant to Section 502(c) of the Natural Gas Policy Act of 1978, for relief from this refund obligation. The petition should include documentation showing that payment of the refund attributable to your working interest will cause a special hardship, inequity or an unfair distribution of burdens.

Thank you for your prompt attention to this matter.

Sincerely,

Marilyn L. Rand
for Kevin P. Madden, Director
Office of Pipeline Regulation

cc: Mary Kay Miller, Vice President
Rates and Certificates
Northern Natural Gas Company
P.O. Box 3330
Omaha, NE 68103-0330

Post-it® Fax Note 7671	Date 3-20-00	# of pages ▶
To ROBERT KREHBIEL	From JOEL STROHL	
Co./Dept.	Co.	
Phone #	Phone # 316 459-6242	
Fax # 785 232-0917	Fax # 459-6665	

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Pretty Prairie Kansas
Dec 26, 1998

Federal Energy Regulatory Comm.
Washington D.C.

R.E. PR 14
Shannon Estate Well # 1

Office of Pipeline Regulation:

Ladies + Gentlemen:

In reply to your letter of Dec 2, 1998, please be advised I believe this is a ridiculous claim by Northern Natural Gas Co.

The so called ceiling prices for the gas Northern purchased is doubted, Northern cut the price for the natural gas purchased, so how could it be over the ceiling price?

Northern Natural Gas has never provided any information to show support for their claim.

Aurora Inc. the operator for Shannon Well #1 always provided full information about operating expenses and income to interest holders. To date we have received from Aurora this vague claim by Northern Natural gas about the Oct 4, 1983 to June 28, 1988 claim for refund.

It appears to me nine (9) years is about out dated to be making a claim by Northern Natural Gas. This could be a real money maker for them, let the claim ride, let the interest accru

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and then spring this goody claim.

Strahl & Sons as a partnership was dissolved in 1997. Our working interest in Shannon Estate Well #1 was or had been sold and the whole sum of $306.68 was divided (3) three ways.

Let me repeat, this is a ridiculous and frivolous claim.

Respectfully,

Jace T. Strahl
Partner

Jace T Strahl & Sons
Pretty Prairie KS
67570 0323

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TO:	Ed Schaub
FROM:	Jack Reid
DATE:	March 21, 2000
SUBJECT:	Coal Taxes - for Jeffrey Energy Center
CC:	Les Morgan, Dave Phelps, Ron Teeter

Western Resources®

INTERNAL CORRESPONDENCE

Coal Supply Taxes

In the Jeffrey Coal Supply Agreement we indirectly pay taxes and relates fees to the various governmental agencies through the price of our coal. The following taxes are subject to the Royalties and Tax Related Component (RTRC).

1) Federal Black Lung Excise Tax
2) Federal Statutory Depletion
3) Federal Royalties
4) Wyoming Severance Tax
5) Campbell County ad valorem tax
6) Federal Corporate Income Tax Rate

Contract Base Tonnage (Western 84% & Utilicorp 20%)	7,000,000 tons
RTRC for Base effective January 1, 2000	$ 2.25 /ton
Base Taxes	$15,750,000
Incremental Tonnage (100% estimated for 2000)	1,400,000 tons
RTRC for Incremental - January 1, 2000	$ 0.90 /ton
Incremental Taxes	$ 1,260,000
Total Taxes in the Coal Supply Agreement	**$ 17,100,000**

Railcar ad valorem Taxes

We pay railcar ad valorem taxes to any state that our railcars travel during a calendar year. The taxes are based on the number of miles traveled in each state, at a prescribed statutory tax rates. The following figures were paid by Western during 1999.

Wyoming and Nebraska	$ 46,354
Kansas	$ 83,046
Total Railcar ad valorem Taxes	**$ 129,400**

Coal Inventory ad valorem Tax

For Jeffrey, the cost of coal in inventory is included in the overall asset value of the facility for computation of the ad valorem taxes.

1999 inventory ad valorem Taxes - Western Resources only **$ 228,200**

HOUSE UTILITIES

DATE: 4-6-00

ATTACHMENT 3

that cutoff mark excessively rigid and more restrictive than that employed by many other circuits. If it is saying this is an area where individualized facts are paramount, I fail to see why the trial court's discretion should not prevail—at least in a case of three children under the age of 5 and a first-time, low-level drug offender ("mule") parent. If it is saying that the district court must run through any potential source of alternative care imaginable before concluding that incarceration would jeopardize the welfare of a defendant's children, I find that rule overly intrusive. If it is saying something else definitive, I cannot find it. In any event, I believe we are obliged to explain in more detail *what* criteria the district courts should henceforth rely upon in assessing requests for family responsibility departures, and in this particular case, we certainly should evaluate appellant's request on the basis of an accurate reading of the record below. Accordingly, I would hear the case *in banc*.

PUBLIC SERVICE COMPANY OF COLORADO, et al., Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, Respondent,

OXY USA Inc., et al., Intervenors.

Nos. 94–1418, 94–1481, 94–1489 and 95–1138.

United States Court of Appeals, District of Columbia Circuit.

Argued Jan. 12, 1996.

Decided Aug. 2, 1996.

Interstate natural gas pipelines sought review of order of Federal Energy Regulatory Commission (FERC) classifying Kansas ad valorem tax as severance tax under Natural Gas Policy Act (NGPA). The Court of Appeals, Stephen F. Williams, Circuit Judge, 850 F.2d 769, remanded. After the Commission held that ad valorem taxes levied by Wyoming and Colorado were, but ad valorem tax levied by Kansas was not, severance tax, producers, purchaser, and Missouri Public Service Commission (PSC) sought review. The Court of Appeals, Ginsburg, Circuit Judge, held that: (1) Kansas tax was not recoverable severance tax within meaning of NGPA; (2) Wyoming and Colorado taxes were recoverable under NGPA; (3) producers must refund all Kansas taxes collected since date when all interested parties were first put on notice that taxes might not be recoverable; and (4) pipeline was not required to guarantee refunds of improperly collected ad valorem taxes.

So ordered.

Sentelle, Circuit Judge, concurred with separate opinion.

1. Statutes ⚷219(6.1)

On review of Federal Energy Regulatory Commission's (FERC) interpretation of NGPA, Court of Appeals must give effect to unambiguously expressed intent of Congress if Congress has directly spoken to precise question at issue; otherwise, Court will defer to administering agency's interpretation if it is reasonable in light of structure and purpose of statute. Natural Gas Policy Act of 1978, § 2 et seq., 15 U.S.C.A. § 3301 et seq.

2. Mines and Minerals ⚷87

To qualify as "severance tax" under NGPA, physical unit must be taxed only once, at time of production. Natural Gas Policy Act of 1978, § 110, 15 U.S.C.A. § 3320.

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

3. Mines and Minerals ⚷87

As reasonably determined by Federal Energy Regulatory Commission (FERC), Kansas ad valorem tax which was levied primarily upon value of recoverable natural gas reserves and secondarily upon value of gas well equipment and materials was not "severance tax" within the meaning of NGPA even

though tax was partly depe duction. Natural Gas Polic § 110, 15 U.S.C.A. § 3320.

4. Mines and Minerals ⚷8

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6. Administrative Law ⚷419

When there is substit ministrative rule for old r sonably clear, new rule r given prospectively only ef tled expectations of those preexisting rule; however, is appropriate for new ap ing law, clarifications, and

7. Mines and Minerals ⚷

Natural gas producers refund Kansas ad valorem improperly collected from as severance tax price adju when all interested parties in Federal Register that t recoverable under NGPA, dence that producers had reasonably relied upon co agency interpretation of N

though tax was partly dependent upon production. Natural Gas Policy Act of 1978, § 110, 15 U.S.C.A. § 3320.

4. Mines and Minerals ⚿87

Wyoming ad valorem tax, which was assessed upon volume of natural gas removed from well and payable one time only as result of production, was based upon production and thus recoverable as "severance tax" under NGPA even though Wyoming had separate severance tax also recoverable under NGPA; severance tax was excise tax upon current and continuing privileges of extracting minerals while ad valorem tax was property tax which taxed value of minerals produced. Natural Gas Policy Act of 1978, § 110, 15 U.S.C.A. § 3320.

5. Mines and Minerals ⚿87

Colorado ad valorem tax, which was computed as set percentage of market value of natural gas removed from well during tax year, was based upon production and thus recoverable as "severance tax" under NGPA even though Colorado had separate severance tax also recoverable under NGPA; ad valorem tax varied directly with production of gas and was assessed only against gas that was severed from ground. Natural Gas Policy Act of 1978, § 110, 15 U.S.C.A. § 3320.

6. Administrative Law and Procedure ⚿419

When there is substitution of new administrative rule for old rule that was reasonably clear, new rule may justifiably be given prospectively only effect to protect settled expectations of those who had relied on preexisting rule; however, retroactive effect is appropriate for new applications of existing law, clarifications, and additions.

7. Mines and Minerals ⚿87

Natural gas producers were required to refund Kansas ad valorem taxes which were improperly collected from pipeline customers as severance tax price adjustments since date when all interested parties were given notice in Federal Register that taxes might not be recoverable under NGPA, in absence of evidence that producers had detrimentally or reasonably relied upon continuing validity of agency interpretation of NGA. Natural Gas Policy Act of 1978, § 110, 15 U.S.C.A. § 3320; Natural Gas Act, § 1 et seq., 15 U.S.C.A. § 717 et seq.

8. Mines and Minerals ⚿87

Missouri Public Service Commission's (PSC) petition challenging Federal Energy Regulatory Commission's (FERC) decision which required interstate natural gas pipeline to channel producer refunds of improperly collected ad valorem taxes to customers, but which precluded pipeline liability as guarantor in event that producer did not meet its refund obligation was moot insofar as it sought prospective relief; wellhead prices had been totally deregulated since 1993, there was no longer any maximum lawful prices for producer sales, and whether producer recovered severance taxes was matter of negotiation between buyer and seller. Natural Gas Policy Act of 1978, § 110, 15 U.S.C.A. § 3320.

9. Mines and Minerals ⚿87

Interstate natural gas pipeline was not required to guarantee refunds of improperly collected ad valorem taxes due from its producers to its customers; pipeline was mere conduit which had no financial interest in NGPA dispute, and pipeline was not obliged either by contract or by regulation to take any precaution against possibility that producer would fail to refund monies due to consumers. Natural Gas Policy Act of 1978, § 110, 15 U.S.C.A. § 3320.

On Petitions for Review of an Order of the Federal Energy Regulatory Commission.

Mark L. Evans argued the cause for petitioner Anadarko Petroleum Corporation, et al. (Producer Petitioners), with whom John S. Martin was on the briefs. Thomas R. Schwarz, Jr., Jefferson City, MO, argued the cause for petitioner Missouri Public Service Commission, with whom David W. D'Alessandro and Kelly A. Daly, Washington, DC, were on the briefs. Karol L. Newman, Washington, DC, argued the cause for petitioners Public Service Company of Colorado and Cheyenne Light, Fuel and Power Company, with whom James D. Albright, Denver, CO, was on the briefs.

Where was Kansas?

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Eric L. Christensen, Attorney, Federal Energy Regulatory Commission, argued the cause for respondent, with whom Jerome M. Feit, Solicitor, was on the brief.

Thomas R. Schwarz, Jr., Jefferson City, MO, and David W. D'Alessandro, Washington, DC, were on the brief for intervenor Missouri Public Service Commission. Penny G. Baker, Jefferson City, MO, entered an appearance. Emery J. Biro, III, Houston, TX, Jay G. Martin, Douglas F. John, Washington, DC, Kevin M. Sweeney, Kerry R. Brittain and Norma J. Rosner were on the brief for intervenors in support of respondent. Mark L. Evans, Jay G. Martin, Washington, DC, Marge O'Connor, J. Stephen Martin, Houston, TX, and Kerry R. Brittain were on the brief for the Producer Intervenors. Gary W. Boyle, Tulsa, OK, was on the brief for intervenor Williams Natural Gas Company. Martin J. Bregman, Topeka, KS, entered an appearance for intervenor Western Resources, Inc. Donald C. Shepler, Jr., Washington, DC, and James Howard entered appearances for intervenor Colorado Interstate Gas Company. Bruce A. Connell, Houston, TX, entered an appearance for intervenor Conoco, Inc. Michael L. Pate entered an appearance for intervenor OXY USA, Inc. Frank X. Kelly, George J. Meiburger, Mark C. Schroeder and Steve Stojic, Washington, DC, entered appearances for intervenor Northern Natural Gas Company. Kathy L. Cox, Fort Worth, TX, entered an appearance for intervenor Union Pacific Resources Company. Andra B. Greene, Newport Beach, CA, and Buddy J. Becker, Lakewood, CO, entered appearances for intervenor K N Energy, Inc. Thomas R. O'Donnell, Denver, CO, entered an appearance for intervenor Public Service Company of Colorado and Cheyenne Light, Fuel and Power Company. Andrew N. Greene, Washington, DC, and Elisabeth Y. Pendley, Arglington, VA, entered appearances for intervenor K N Interstate Gas Transmission Co. James F. Moriarty, Washington, DC, entered an appearance for intervenor Missouri Gas Energy.

Before: WILLIAMS, GINSBURG and SENTELLE, Circuit Judges.

Opinion for the Court filed by Circuit Judge GINSBURG.

Concurring Opinion filed by Circuit Judge SENTELLE.

GINSBURG, Circuit Judge:

Until 1993 the Natural Gas Policy Act (NGPA) established the maximum lawful price that a producer could charge its pipeline customers for natural gas; under § 110 of the Act, the producer could adjust that price upward in order to recover its payment of a state severance tax. The Federal Energy Regulatory Commission, on remand from our decision in *Colorado Interstate Gas Co. v. FERC,* 850 F.2d 769 (1988), held that *ad valorem* taxes levied by Wyoming and Colorado are, but the *ad valorem* tax levied by Kansas is not, a severance tax within the meaning of § 110. The Commission then ordered producers to refund payments received from pipelines in recovery of the Kansas tax with respect to production occurring after the *Colorado Interstate* decision. The Commission directed the pipelines in turn to channel those refunds to their customers, but decided not to make the pipelines liable for any amounts not received from producers.

Petitioner Public Service Company of Colorado and a subsidiary (jointly PSCC), supported by the Missouri Public Service Commission (MPSC) as an intervenor, challenge the Commission's authority to limit the retroactivity of the producers' liability for refunds of the Kansas tax. As a petitioner the MPSC also objects to the Commission's order relieving Williams Natural Gas Company of any obligation to guarantee the refund of the Kansas taxes that Williams collected from its customers, as to which Williams intervenes in support of the FERC, and to the Commission's decision that the Wyoming and Colorado taxes are severance taxes.

Four producers petition for review of the Commission's decision that the Kansas tax is not a severance tax. These Producer Petitioners also maintain that the FERC's decision worked a change in the law that should be applied prospectively only. As Producer Intervenors the same group argues in the alternative that the Commission properly limited their liability for the refunds of the

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Kansas tax to the date of the *Colorado Interstate* decision. Joined by another producer, the five so-called Indicated Producers intervene in support of the Commission regarding the Wyoming and Colorado taxes.

We conclude that the Commission could properly determine that the Kansas *ad valorem* tax was not, and that the Colorado and Wyoming *ad valorem* taxes were, sufficiently similar to a severance or production tax to qualify for recovery under § 110 of the NGPA. Contrary to the Commission, however, we hold that the producers must refund all the Kansas taxes they collected since October 1983 when all interested parties were first put on notice that the taxes might not be recoverable under § 110. On the question whether Williams should be required to guarantee the refunds due from its producers to its customers, we find no ground upon which to require that the FERC hold the pipeline liable.

I. Background

From 1978 until 1993 producer prices for natural gas were subject to maximum lawful levels specified in the NGPA. 15 U.S.C. §§ 3311–19. Section 110 of the NGPA permitted a producer to charge an amount in excess of those ceilings to the extent necessary to recover its payment of "State severance taxes attributable to the production of such natural gas," 15 U.S.C. § 3320(a)(1). For this purpose, a severance tax was defined as "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas" by a state or Indian tribe, 15 U.S.C. § 3320(c).

In *Sun Exploration and Production Co.*, 36 FERC ¶ 61,093 (1986), the Commission determined that the Kansas *ad valorem* tax qualified as a severance tax under § 110 because it was based upon production factors. In *Colorado Interstate* we concluded that the Commission's analysis in *Sun Exploration* "fell short of reasoned decision-making," and we remanded the matter for a more "cogent theory of what makes a tax 'similar' to a production or severance tax under § 110." 850 F.2d at 770, 773. Reflecting our indulgent standard of review for a question so bound up in administrative policy-making, we noted that while the court "cannot defer to a vacuum," we would defer to "any Commission interpretation of § 110 that is not precluded by the statutory language and traditional methods of statutory construction, and that is reasonable." *Id.* at 774.

We also offered the Commission some guidance. A severance tax is a cost imposed upon producing, while a property tax is a cost imposed upon holding, a resource; the non-recoverability of a severance tax is a disincentive to produce, while the non-recovery of a property tax is not a disincentive and, to the extent that extraction reduces the value of the reserves to which the property tax is applied, might even be an incentive to produce. *Id.* at 771. On the other hand, if in computing the value of a property for the purpose of levying a property tax "a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the [property] tax would plainly be similar enough to a production tax to qualify under § 110." *Id.* at 772.

Upon remand, the Commission identified two essential differences between a severance tax and a property tax:

> First, a ... severance tax is *on* the volume or value of the commodity *removed*, as assessed at the time of removal. A property tax ... is on the value of the gas remaining in the ground as well as on the value of wells and other production assets on the lease, at the time of the tax assessment.
>
> Second, ... once the unit of gas is produced and the severance tax is applied to it, that unit of gas is never again subject to the severance tax. On the other hand, a property tax ... is applied to a unit of gas reserves each year—year after year—until that unit of gas finally is produced and removed from the property being valued.

Colorado Interstate Gas Co., 65 FERC ¶ 61,292 at 62,370–71 (1993) (emphases in original) (hereinafter *Colorado Interstate Remand Order*), *reh'g denied*, 67 FERC ¶ 61,209 (1994) (hereinafter *Colorado Interstate Rehearing Order*). Applying these distinctions, the Commission concluded that the Kansas tax

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did not qualify as a severance tax for three principal reasons: (1) it was based upon the value of the gas property rather than upon its current production; (2) the volume of production was relevant principally for determining the present value of the gas reserves; and (3) the reserves were taxed year after year until removed from the ground and sold. *Id.* at 62,371–72.

The Commission ordered producers to refund the Kansas taxes they had collected since June 1988, the date of our *Colorado Interstate* decision which, in the FERC's view, first put producers on notice that the tax might not be recoverable under § 110. *Id.* at 62,373. The Commission also ordered pipelines to flow-through the refunds to customers as lump sum payments, but the pipelines were not held responsible for guaranteeing payment if a producer failed to meet its refund obligation. *Id.* at 62,374.

Williams, one of the pipelines ordered to refund the Kansas tax, had also collected Wyoming and Colorado *ad valorem* taxes from its customers. In *Williams Natural Gas Co.,* 69 FERC ¶ 61,373 (hereinafter *Williams Order*), *reh'g denied,* 70 FERC ¶ 61,202 (1994) (hereinafter *Williams Rehearing Order*), the Commission held that the Wyoming and Colorado taxes qualified as severance taxes under § 110. The Wyoming tax "is assessed on the volume or value of the gas which is produced" and "varies directly, and exclusively, with actual production." *Id.* at 62,408. The Colorado tax is "assessed only against gas that is severed from the ground." *Id.* at 62,410. Therefore, Williams was not required to refund these taxes to its customers.

II. Analysis

We turn first to the question whether the Commission was reasonable in holding that the Kansas tax was not recoverable under § 110. Next we undertake a similar inquiry with respect to the Colorado and Wyoming taxes. Then we examine the date to which refund liability for the Kansas tax extends; and finally we review the FERC's decision not to hold Williams responsible as a guarantor in the event that a producer does not meet its refund obligation.

A. *The Kansas Tax*

[1] Our review of the Commission's interpretation of § 110 of the NGPA is governed by the familiar analysis of *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984): if the Congress has "directly spoken to the precise question at issue," the court "must give effect to the unambiguously expressed intent of Congress"; otherwise the court will defer to the administering agency's interpretation if it is reasonable in light of the structure and purpose of the statute. *Id.* at 842–43, 104 S.Ct. at 2781–82. In this instance, recall that § 110 of the NGPA permits a producer to "recover ... State severance taxes attributable to the production of ... natural gas and borne by the seller," 15 U.S.C. § 3320(a)(1), and that a severance tax is defined as "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas." 15 U.S.C. § 3320(c). In their application to a particular state tax, any or all of the terms "attributable to the production," "similar," "other levy," and "imposed on the production" may be ambiguous. Plainly, as the Producer Petitioners acknowledge, our standard of review is that of *Chevron* step two.

The Kansas tax is levied primarily upon the value of recoverable reserves and secondarily upon the value of gas well equipment and materials. In estimating the volume of reserves, the volume of current production is an important factor; therefore, because the tax is partly dependent upon production, the Producer Petitioners allege that it is similar to a production tax.

In remanding *Colorado Interstate* we instructed the Commission to come up with a "cogent theory of what makes a tax 'similar' to a production or severance tax under § 110." 850 F.2d at 773. The agency's determination was to hinge upon "how the specific rules of the tax actually function." *Id.* at 774. According to the Producer Petitioners, however, the Commission responded largely by ignoring the practical application of the Kansas tax and its actual effect upon production incentives, and focused instead upon mere labels.

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The principle advanced by the Producer Petitioners is that "a tax whose assessment is measurably affected by a change in the level of production is at least in part attributable to, and effectively imposed on, the production itself." The Petitioners remind us that the Federal Power Commission held that the Kansas tax was recoverable under the Natural Gas Act, Opinion No. 699–D, 52 FPC 915, 915–16 (1974), and that the Congress incorporated into § 110 of the NGPA terms virtually identical to those it had used in the prior statute, *see* Opinion No. 699, 51 FPC 2212, 2301, 4 P.U.R.4th 401, *reh'g denied in relevant part*, 52 FPC 1604 (1974), *aff'd sub nom. Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir.1975)—which suggests that the Congress intended no significant contraction in the range of severance taxes that could be recovered. Indeed, the Conference Committee Report on § 110 states that the term "severance tax" should be "construed broadly" and may extend to "any tax imposed upon mineral or natural resource production including an ad valorem tax or a gross receipts tax." H.R. Conf. Rep. No. 95–1752, 95th Cong., 2d Sess. 91 (1978), U.S.Code Cong. & Admin.News 1978, pp. 8800, 8861.

The two characteristics of a tax recoverable under § 110, in the view of the Producer Petitioners, are that its calculation is directly related to the rate of current production and that its non-recovery would operate as a disincentive to produce. It is not necessary that the tax be attributable exclusively to production, nor that it be computed in the same manner as a severance or production tax; it is enough that the assessed liability be to some extent "attributable to the production of ... natural gas." The Producer Petitioners claim that the FERC's interpretation—under which the tax must be (1) laid upon "the act of severing," (2) "each Mcf or MMBtu of gas production," and (3) assessed "at the time of removal," *Colorado Interstate Remand Order*, 65 FERC at 62,370, 62,371—effectively reads the term "similar tax" out of the statute.

Applying their more liberal construction of § 110, the Producer Petitioners contend that the Kansas tax fully satisfies the criteria for recoverability. First, while the tax is also affected by variables other than production, the amount of the tax increases or decreases as production increases or decreases. For example, as between two wells with the same reserves, the one expected to produce more gas will be taxed at a higher level. This argument, however, does little to dispel our understanding that the Kansas tax is by its terms a tax upon property. The value of a depletable asset is a function of its physical and its temporal dimensions; in the case of a gas well, these are respectively the volume of recoverable reserves and the timing of their recovery, which progressively depletes the reserve. The greater the volume of gas produced in a given tax year, the shorter the time over which all the proceeds will be realized and, consequently, the higher the present value of the asset.

The relevant question, therefore, is the obverse of the one suggested by the Producer Petitioners. We do not ask whether two wells with the same reserves would be taxed differently based upon their different anticipated rates of production; obviously they would be, whether the tax is imposed *ad valorem* upon property or upon production. The value of the reserves would be higher for the well with more rapid production because faster production reduces the time over which the flow of gas is turned into a stream of cash. Instead, we must inquire whether the same tax would be levied upon two wells with different reserves but the same level of production. If the tax is based upon production, then the amount of the tax would be the same; if the tax is based upon property, then the amounts would be different. By this criterion, as we shall see, the Kansas tax is laid upon property, not upon production.

In *Colorado Interstate* we posited that the high initial level of production caused by the pressure in a new well could, when annualized in accordance with Kansas's method of appraisal, yield a higher tax upon a property that started operation late in the year than upon an equally productive property that was in operation for the full year. 850 F.2d at 773. Prompted by that observation, the Producer Petitioners now attempt to explain that the State's use of an annualized figure for production when a new well operates for only

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part of its first tax year does not relax the relationship between the amount of the Kansas tax and the volume of production. To the contrary, they point out that a 1980 amendment to the Kansas tax law was designed to offset the disproportionately high levy on a well in operation less than six months during the tax year by reducing its appraised value by 40 percent.

Again, the Producer Petitioners' argument supports not their position but the Commission's. As the agency properly observes, an adjustment for the exaggerated level of initial production caused by the high pressure in a new well would be unnecessary if the Kansas tax were indeed based upon production. Any gas produced would be taxed; any gas left in the ground would not be taxed. Kansas authorized an adjustment precisely because its tax is based not upon production but upon gas in the ground; *i.e.*, the State needed a reliable estimate of "annual" production to use in calculating the present value of recoverable reserves. Otherwise there would have been no need to annualize the partial year's output from a new well.

The Commission gave three reasons for rejecting the "measurably attributable to production" standard suggested by the Petitioners. First, it is just the type of murky standard that this court had criticized in *Colorado Interstate. Colorado Interstate Rehearing Order*, 67 FERC at 61,654. Second, the standard is cumbersome to administer; it requires "virtually well-by-well analysis to ascertain exactly how much weight the state property appraiser gave to current production." *Id.* at 61,654–55. Third, simply providing that a tax be measurably related to production does not distinguish between a severance tax and an array of other taxes—income, personal property, real estate—that could vary "in a more-or-less direct manner with production." *Id.*

What is required, contends the Commission, is that the tax vary "directly" with production on "essentially" a one-to-one basis. *Colorado Interstate Rehearing Order*, 67 FERC at 61,655. Indeed there is some support for that proposition in the history of § 110. In 1974 the Federal Power Commission interpreted the Natural Gas Act to allow recovery of the Kansas tax. Opinion No. 699–D, 52 FPC at 915–16. As we observed in *Colorado Interstate*, however, when the Congress enacted § 110 it supplemented the FPC's formula for recovery ("all ... production, severance, or similar taxes," Opinion No. 699, 51 FPC at 2301) with the added requirement that the tax be "imposed on the production of natural gas." 850 F.2d at 772. That new qualification is the basis upon which the Commission argues for a one-to-one relationship between the volume of production and the amount of the tax.

The Kansas tax, according to the FERC, is a property tax levied upon the value of recoverable reserves, gas well equipment, and materials, *id.* at 62,374; current production is only a "yardstick by which the value of the leasehold is measured," *id.* at 62,371–72. The appraised value of the reserves depends upon the estimated future production of the well (as determined in part by actual production over the most recent three- or five-year period) and market prices, reduced by operating costs, all forecasted over the probable period of production and discounted to present value. *See Colorado Interstate*, 850 F.2d at 771. Because of differences in the anticipated rate of production and in the estimated quantity of reserves, the tax upon two wells producing the same volume of gas may "vary nearly by a factor of ten." *Id.*

At oral argument, we asked counsel for the Producer Petitioners whether in practice the tax on a well varies over time in direct relation to the well's production. If not, the tax could not properly be characterized as being based upon production. Because the answer to this question has important implications, we take a moment to examine the mechanics of the tax calculation in somewhat greater detail.

The value of recoverable reserves, for the purpose of the Kansas tax, is based predominantly upon the value of the well's average production multiplied by a "present worth factor." The present worth factor, in turn, depends upon the estimated quantity of the reserves, the time value of money, the expected rate of change in the price of gas, and the expected rate of change in production. The Kansas Department of Revenue promul-

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gates a present worth factor for use in valu[illegible]ll properties in a major proven gas field. [illegible]ing that the Department determines present worth factors *ex ante* and does not revise them periodically, then the only variable affecting the annual appraisal of a well is the value of the well's production. Under these circumstances, the Kansas tax would, in our view, be sufficiently like a tax "imposed on the production of natural gas" to be recoverable under § 110. Although the tax is called an *ad valorem* tax and calculation of the tax is based upon the present value of recoverable reserves, any change in the amount of the tax due would depend in practice entirely upon a change in the value of production from year-to-year.

The question, therefore, becomes whether there is a change over time in the present worth factor for a particular well or field. If so, then the tax will depend upon the magnitude of that change (and upon any variation in production, of course). In fact, because increased production diminishes the remaining recoverable reserves, and thus typically reduces the anticipated life of a well, periodically updating the present worth factor could y[illegible] a tax that is completely unrelated to, or e[illegible] negatively correlated with, production. Counsel for the Producer Petitioners was not able to refer us to any evidence in the record indicating that the present worth factor for a single field remains constant over time. Therefore, the Petitioners could not show that the Kansas tax necessarily varied in direct relation to production.

Because the Producer Petitioners bear the burden of showing that the Commission's analysis of the Kansas tax is unreasonable, their inability to demonstrate that the present worth factors are invariant over time could have been an end to the matter. Nonetheless, we searched the record independently—but the result was only to increase our confidence that variables other than production can have a material impact upon the tax assessed. Tables captioned "Major Proven Gas Areas and Fields" show a substantial change in the present worth factor for certain fields over the three years from 1986 to 1989. Indeed, the prevailing pattern is for the present worth factor to decline with the passage of time, which is what we would expect. As the anticipated life of a well declines, the present value of the recoverable reserves decreases correspondingly; that is consistent with our hypothesis that higher production foreshadows a diminished remaining life, which in turn can result in not a higher but a lower tax.

[2] There is more. One appraiser for the Kansas Department of Revenue has identified seven factors other than current production that he considers in determining the present value of reserves: age of the well; quality of the oil and gas; nearness to market; operating costs; character, extent, and permanency of the market; probable life of the well; and the number of other wells being operated. Furthermore, Kansas assesses the tax upon each physical unit of reserves, year after year until the unit is produced. In order to qualify as a severance or production tax under § 110, however, a physical unit must be taxed only once—at the time of production. *Colorado Interstate Remand Order*, 65 FERC at 62,371. The Commission also observes that a typical well in the Permian Basin, roughly 2800 feet deep, will be appraised at a value that includes $56,000 for equipment alone, *i.e.*, exclusive of the value of any gas reserves. Even after a well has been shut-in for two years the equipment on a "normal" well is valued at $4,200. If the Kansas tax were based upon production, then there would be no tax on a non-producing well.

Singly and cumulatively, the Commission's arguments are convincing and neither of the Producer Petitioners' two principal contentions persuade us otherwise. First, the Producer Petitioners contend, mistakenly, that non-recovery of a property tax based in part upon production operates as a disincentive to produce and thus defeats a primary objective of the NGPA. If the present value of reserves is computed by the Kansas formula, then (other things being equal) the higher the tax rate the greater the incentive to produce. Although higher production is a factor tending to increase the Kansas tax this year, it reduces the expected future production from the well, a factor tending to decrease the Kansas tax in all future years.

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The tax-reducing effect of decreased life expectancy will almost always exceed the tax-increasing effect of higher production.[1] In short, if demand is inelastic (as it would be when the ceiling is well below market price), a recoverable tax would have little effect upon production at the margin; but a non-recoverable tax would be an incentive to extract gas more rapidly in order to minimize the impact of the tax.

Second, the Petitioners advance the theory (in their Reply Brief) that "a tax qualifies for reimbursement under § 110 . . . if production is a factor in the calculation." By that standard, an ordinary property tax would qualify as a tax on production; the value of any asset is, after all, the present worth of the benefits that the asset is expected to produce—whether impounded in an established market price or estimated by an appraiser. The Commission reasonably declined to adopt a standard—overbroad, administratively cumbersome, and almost infinitely elastic—with so little to recommend it.

[3] Weighing the various arguments—and mindful that as we said in *Colorado Interstate*, "any Commission interpretation of § 110 that is not precluded by the statutory language and traditional methods of statutory construction, and that is reasonable, will control," 850 F.2d at 774—we conclude that the FERC's interpretation of § 110 of the NGPA is reasonable. Furthermore, applying that interpretation, the Commission reasonably determined that the Kansas *ad valorem* tax is not a severance tax within the meaning of that section.

B. *The Colorado and Wyoming Taxes*[2]

The MPSC, while agreeing with the Commission's interpretation of § 110, urges that the FERC incorrectly applied its own criteria when it allowed recovery of the Colorado and Wyoming taxes. In the *Williams Order*, the Commission stated that "the Wyoming *ad valorem* tax qualifies for recovery . . . in that it is assessed on the volume or the value of the gas which is produced rather than upon the value of gas reserves or lease-hold property. Hence, the tax varies directly, and exclusively, with actual production." 69 FERC at 62,408. The Commission adopted the same rationale in deciding that the Colorado tax could be recovered under § 110. *Id.* at 62,410. The MPSC asserts that this rationale conflates a production-based tax with a property tax.

According to the MPSC, the Wyoming and Colorado taxes are based upon proceeds, not upon production. Taxing authorities administer a proceeds tax as they do a property tax: the underlying property is placed on both state and local tax rolls and aggregated with other property to determine the appropriate state and local *ad valorem* tax rates. A production tax, by contrast, is a state-wide levy subject to a single state-wide rate, administered by and for the benefit of the state and not of the locality. The MPSC contends that the Wyoming and Colorado taxes differ from a typical property tax only in that they

1. Suppose, for example, a well with 1,000 Mcf of reserves at year end 1995 is taxed at the rate of $1 per Mcf remaining on December 31 of each year. The producer would have an incentive to deplete the well as quickly as possible. Production of 500 Mcf on January 1 of both 1996 and 1997 would mean tax assessments of $1,000 and $500 on December 31 of 1995 and 1996 respectively. By comparison, production of 250 Mcf on January 1 of each year from 1996 through 1999 would mean tax assessments of $1,000, $750, $500, and $250 on December 31 of each year from 1995 through 1998—and a much higher total tax. (This assumes of course that the estimated volume of reserves does not change from year to year except to account for the previous year's production.)

2. The Indicated Producers claim that the MPSC is barred from contesting the Colorado and Wyoming taxes because the MPSC was some hours late in filing its request for rehearing the *Williams Order*. The FERC, however, waived the 30-day limit in the NGPA, 15 U.S.C. § 3416(a)(2), and accepted the MPSC request as timely filed, *Williams Rehearing Order*, 70 FERC at 61,633. The Indicated Producers argue that the FERC had until then consistently treated the 30-day limit as a jurisdictional requirement that it could not waive. The MPSC replies that the Indicated Producers failed to request rehearing of the Commission's decision to waive the time limit, and thereby failed to preserve the issue for judicial review. We agree. *See* 15 U.S.C. § 3416(a)(4) (no judicial review unless issue raised before agency in application for rehearing). We proceed therefore to address the question whether the Colorado and Wyoming taxes were recoverable under § 110.

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grant a preference to natural gas property over other types of property. In Wyoming, the preference arises by taxing gas property only once, which is to say when the gas is extracted. In Colorado, gas reserves are taxed annually but their value is assumed to equal a specified percentage of the value of the prior year's production. Otherwise, according to the MPSC, the Wyoming, Colorado, and Kansas taxes are similar and ought to be treated similarly under § 110; the Wyoming and Colorado legislatures may be free to favor gas producers over other property owners, but the Congress did not intend to favor gas producers in states with a tax based upon proceeds over gas producers in states that impose upon them a traditional property tax.

The Commission responds, first, that the Wyoming *ad valorem* tax meets the criteria set forth in the *Colorado Interstate Remand Order* and applied in the *Williams Order*, 69 FERC at 62,408. The tax is assessed upon the volume of gas removed from the well, Wyo. Stats. § 39–2–208; payable "one time only ... as a result of production," *Union Pac. Resources Co. v. State*, 839 P.2d 356, 372 (Wyo.1992); and based upon the "full value" of the gas when produced, *id.* at 372 n. 7. Second, that the tax may benefit local taxing units is not pertinent; a tax imposed "by any political subdivision of a State" is recoverable under § 110. 15 U.S.C. § 3320(c)(2). Third, as this court has recognized, "a tax nominally on property may be functionally identical to a production tax," *Colorado Interstate*, 850 F.2d at 772. Fourth, a tax need not be labeled a "severance tax" in order to be "recoverable" within the meaning of § 110; the term "severance tax" is to be "construed broadly," and may include an *ad valorem* tax, H.R. CONF. REP. NO. 95–1752 at 91, U.S.Code Cong. & Admin.News 1978 at 8861, as well as any "similar tax, fee, or other levy imposed on the production of natural gas," 15 U.S.C. 3320(c).

[4] Finally, the Commission argues that administrative differences between a tax based upon production and an *ad valorem* tax are irrelevant to the question whether the tax may be recovered under § 110. Indeed, Wyoming has a separate severance tax, which no one here doubts is recoverable within the meaning of § 110. In distinguishing that tax from the state's *ad valorem* tax based upon proceeds, the Wyoming Supreme Court observed: "[T]he severance tax is an excise tax upon the current and continuing privilege of extracting minerals.... An ad valorem tax is a property tax which taxes the value of the minerals produced." *Wyoming State Tax Comm'n v. BHP Petroleum Co., Inc.*, 856 P.2d 428, 434 (1993). This characterization of the Wyoming *ad valorem* tax supports the Commission's conclusion that it is based upon production.

Colorado, too, imposes a severance tax in addition to an *ad valorem* tax. The Indicated Producers point out, however, that 87.5% of the *ad valorem* tax may be taken as a credit against the severance tax. This, say the Indicated Producers, proves that the two taxes are "directed at the same activity and intended to accomplish the same purpose, *i.e.*, to tax production as it occurs." Moreover, as the Tenth Circuit noted—albeit in the course of determining whether the Colorado tax is a real estate or a personal property tax, not whether it is sufficiently similar to either a severance or other production-related tax to be recovered under § 110—"[p]ast production is used in the Colorado ad valorem tax system only as a gauge for the valuation of the mineral interest. Use of this admittedly imperfect gauge does not rule out the conclusion that the mineral interest itself is being taxed." *Federal Land Bank of Wichita v. Board of County Comm'rs*, 788 F.2d 1440, 1442 (1986).

[5] The Commission nonetheless argues persuasively that the Colorado *ad valorem* tax "varies directly with production" and is "assessed only against gas that is severed from the ground." *Williams Order*, 69 FERC at 62,410. The irreducible fact is that the tax is computed as a set percentage of the market value of the gas removed from a well during the tax year. Colo.Rev.Stat. §§ 39–7–101 and 39–7–102. As we stated in *Colorado Interstate*: When computing the value of property, "[i]f a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the [property] tax

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would plainly be similar enough to a production tax to qualify under § 110." 850 F.2d at 772. That is precisely how the Colorado tax is computed.

In sum, the clear weight of the arguments supports the Commission's determination. Both the Colorado and Wyoming *ad valorem* taxes are based upon production and as such may be recovered under § 110 of the NGPA.

C. Retroactivity

[6] Next we take up the question whether the Commission properly ordered producers to refund Kansas taxes recovered since, and only since, our *Colorado Interstate* decision in June 1988. The governing principle is that when there is a "substitution of new law for old law that was reasonably clear," the new rule may justifiably be given prospectively-only effect in order to "protect the settled expectations of those who had relied on the preexisting rule." *Williams Natural Gas Co. v. FERC,* 3 F.3d 1544, 1554 (D.C.Cir. 1993). By contrast, retroactive effect is appropriate for "new applications of [existing] law, clarifications, and additions." *Id.* The Commission concluded that "[t]he 'settled expectations of those who had relied on the preexisting rule' ... were changed by the [court's June 1988] *Colorado Interstate* decision, not really [by the FERC's] own decision" in the 1993 *Colorado Interstate Remand Order,* 65 FERC at 62,373.

The Producer Petitioners maintain that the Commission did indeed substitute a new rule for a reasonably clear old rule when, in the *Remand Order,* it first refused to let them recover the Kansas tax. Our decision in *Colorado Interstate,* the Petitioners point out, was a remand, not a reversal, of the Commission's decision in *Sun Exploration* allowing producers to recover the tax. The court directed the Commission only "to exercise its interpretive authority, to identify the features of the Kansas tax that point toward one classification or another, and to offer sensible distinctions between taxes that it chooses to treat differently." 850 F.2d at 775. We did not indicate that we expected a particular result, and consequently we did not disturb the settled expectations of producers who were relying upon the old rule. Upon this view of the matter, it was precisely the Commission's ruling in the *Remand Order* that did change the governing law; prior to that decision, the Petitioners contend, they did not have reason to anticipate that the Commission would change the rule. As they point out, that the agency had not previously engaged in reasoned decisionmaking did not mean that it could not reasonably reach the same result upon remand. Accordingly, the Producer Petitioners argue that their refund liability should extend back not to June 1988 but only to December 1993.

PSCC, on the other hand, argues that regardless of when the Commission first determined that recovery of the Kansas tax was unlawful, it necessarily had been unlawful since the NGPA was enacted in 1978. After first arguing before the Commission for full retroactivity back to 1978, however, PSCC conceded that "fundamental fairness ... [dictates] that the date on which interested parties were put on notice of the dispute should control the date of retroactivity." Request for Rehearing, *Colorado Interstate Gas Co.,* Dkt. Nos. GP83–11–003 and RI83–9–004, at 6 (FERC Jan. 3, 1994). Therefore, suggested PSCC, liability for refunds should extend back at most to August 1983, when Northern Natural petitioned the Commission for a determination that the Kansas tax was not recoverable under § 110, or at least to October 1983, when all interested parties received notice of the petition by publication in the Federal Register. *Id.* at 4.[3] As between the two, the later date is obviously the correct one. *See Associated Gas Distribs. v. FERC,* 899 F.2d 1250, 1256 (D.C.Cir.1990) (FERC gives notice of petition by publication in Federal Register).

3. The MPSC argues for full retroactivity back to 1978, but we agree with the Producer Intervenors that it is precluded from raising that argument before us. The MPSC did not make a retroactivity argument in its request for rehearing before the FERC, and it does so here only as an intervenor, not as a petitioner. *See Illinois Bell Tel. Co. v. FCC,* 911 F.2d 776, 786 (D.C.Cir. 1990) ("An intervening party may join issue only on a matter that has been brought before the court by another party").

To recapitulate, the various parties now urge that when the Commission issued its *Colorado Interstate Remand Order* in December 1993, it should have made liability for refunds (per the Producer Petitioners) prospective-only; (per the Commission) retroactive to June 1988, when we issued our decision in *Colorado Interstate;* or (per PSCC) retroactive to October 1983, when notice of Northern Natural's petition to disallow recovery of the Kansas tax was published in the Federal Register.

PSCC, the MPSC, and the Commission all argue against prospective-only application. By December 1993 gas at the wellhead was no longer subject to a maximum lawful price; deregulation had rendered § 110 moot almost a year before. *See* Natural Gas Wellhead Decontrol Act of 1989, Pub.L. No. 101–60, 103 Stat. 157. Accordingly, producers would have no liability under a rule that limited refunds to taxes paid on post-December 1993 production. Their point seems to be that customers should not lose their entitlement to refunds merely because the Commission took five years after our decision in *Colorado Interstate* to issue the *Remand Order.*

The FERC makes a more convincing argument against prospective-only application of its 1993 decision based upon this court's criticism in *Colorado Interstate* of both the logical and the factual bases for the agency's prior policy; that sent a "clear signal" to producers that their recovery of the Kansas tax under § 110 might not be lawful. After that "the parties no longer would have been justified in relying on the Commission's earlier rulings with any assurance that they would not later be required to make refunds." *Colorado Interstate Remand Order,* 65 FERC at 62,373.

The Commission marshals the events leading up to the *Colorado Interstate* remand in further support of this compromise view. As we have seen, under the Natural Gas Act, the Federal Power Commission had held in 1974 that the Kansas tax could be added to the maximum lawful rate. Opinion No. 699–D, 52 FPC at 915–16. Four years later the Congress carried forward into the new NGPA a provision nearly identical to the provision of the NGA that the FPC had earlier applied to the Kansas tax. *See* Opinion No. 699, 51 FPC at 2301. Furthermore, in the legislative history of the NGPA the Congress specifically anticipated that producers might recover an *ad valorem* tax under § 110. H.R. CONF. REP. No. 95–1752 at 91, U.S.Code Cong. & Admin.News 1978, at p. 8861. In 1986 the Commission reaffirmed that the Kansas tax was recoverable under that section. *See Sun Exploration,* 36 FERC ¶ 61,093. Not until our 1988 decision in *Colorado Interstate,* remanding *Sun Exploration,* was there any official suggestion that the law might be otherwise. Finally, in 1993 the Commission effectuated a change in the law by developing new standards for determining whether a tax may be recovered under § 110. Thus, according to the Commission, the producers had no indication that the rule might be any different until our *Colorado Interstate* decision in 1988, and requiring them to refund taxes recovered with respect to gas produced prior to that date is not justified.

The agency also concludes that requiring refunds back to the date of our decision in June 1988 properly balances the producers' equitable claim to notice against the consumers' legal right to receive a refund of all unlawfully collected charges. On the one hand, prospective-only application of the law would permit producers to retain sums collected from June 1988 to December 1993 in excess of the maximum lawful prices prescribed in the NGPA—without any supporting rationale. On the other hand, a fully retroactive remedy would penalize producers, by requiring disgorgement of sums they innocently collected prior to June 1988—even though our 1988 *Colorado Interstate* decision was the first authoritative indication that the Kansas tax might not be recoverable after all.

In support of making the Commission's decision retroactive to 1983, PSCC offers a different account, or at least one with a different emphasis, of the transition from the NGA to the NGPA. In this version the key point is that the Commission does not have the expansive remedial powers under the NGPA that it wielded under the NGA, 15

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U.S.C. § 717c(e). Specifically, whereas the NGA gave the Commission discretion to order refunds if it determined that a rate was not just and reasonable, the NGPA established maximum lawful prices and gave the customer a right to a refund if it was overcharged.

PSCC also points out that when it issued the *Remand Order* the Commission was not engaged in rulemaking but in adjudicating the rights of the parties before it; therefore the agency was necessarily articulating and giving retroactive effect to existing law. When it is clarifying existing law, rather than substituting new law for old, the agency need not be as attentive "to protect[ing] the settled expectations of those who had relied on the preexisting rule." *Williams*, 3 F.3d at 1554. Indeed, as PSCC points out, the producers never explain how their "settled expectations" led them into detrimental reliance upon being able to recover the Kansas tax.

As we see the issue, the apparent lack of detrimental reliance on the part of the producers is the crucial point. What would they have done differently if they had known in 1983 that they were not entitled to recover the Kansas tax? They could not have raised their prices above the maximum lawful level regardless whether the traffic would have borne such an increase. Nor do they contend that existing prices were below the lawful limit; and if they were, price increases might still have been foreclosed by competitive constraints. The producers may have shut in some wells or refrained from exploring for new wells if their inability to recover the tax would have rendered the wells unprofitable, but neither the producers nor the Commission has even suggested these possibilities. All the producers do suggest is that "[a] prudent producer would have cut back on production to the extent that non-recovery of the tax increased [the] current marginal cost of production," Petition of Producer Petitioners for Rehearing of Order on Court Remand, *Colorado Interstate Gas Co.*, Dkt. Nos. GP83–11–003 and RI83–9–004, at 23 (FERC Jan. 3, 1994), but in this they are mistaken; as noted above, the more slowly a well is depleted, the greater the remaining reserves and the higher the tax thereon. Moreover, neither party has even roughly quantified the harm (*e.g.*, the expenditures made and lost in detrimental reliance upon being able to recover the Kansas tax) that the producers might suffer should they have to refund the full amount that they unlawfully collected. In these circumstances, we are hard pressed to see how the producers would be harmed in any cognizable way even if they were required to disgorge every dollar they received in recovery of the tax (assuming any party were seeking such extensive relief).

Not only is the producers' "detrimental reliance" purely notional; if it were real it would not have been reasonable. The enactment of a substantially new regulatory regime in 1978 undermined any assurance that the FPC's treatment of the Kansas tax under the NGA would withstand scrutiny under the NGPA; reliance would have been foolhardy. If that were not enough, the status of the Kansas tax was expressly drawn into question in 1983 when Northern Natural first petitioned the Commission for a ruling that producers could not lawfully recover the tax under § 110. Once the recoverability of the tax was in dispute, we do not see how the Commission could possibly find that producers reasonably relied upon continuing to recover it.

[7] Because no seller of natural gas could justifiably be confident that it was entitled to recover the tax until the legal question was settled anew under the new statute, we hold that the producers' liability for refunds extends back to October 1983, the date when all interested parties were given notice in the Federal Register that the recoverability of the Kansas tax under § 110 of the NGPA was at issue, and the earliest date advocated by any party before this court. Absent detrimental and reasonable reliance, anything short of full retroactivity (*i.e.*, to 1978) allows the producers to keep some unlawful overcharges without any justification at all. The court strongly resists the Commission's implication that the Congress intended to grant the agency the discretion to allow so capricious a thing. Still, we do not require refunds of taxes recovered with respect to pro-

duction before October 1983 because there is before us no controversy over those monies.

D. e Pipeline as Guarantor

In the *Colorado Interstate Remand Order* the Commission required interstate pipelines to "pass through any *ad valorem* tax refunds they receive from first sellers," 65 FERC at 62,374, but made it clear that "pipelines will not be required to be guarantors of refunds." *Id.* The MPSC, on behalf of the customers of the Williams pipeline, was the only party to challenge that decision. The FERC adhered to its position, however, adding that Williams should not be treated differently than other similarly situated pipelines. *Williams Natural Gas Co.*, Dkt. Nos. TA89–1–43–004 and RP89–39–005, slip op. at 5 (FERC order June 2, 1994), *clarification denied, Williams Order*, 69 FERC ¶ 61,373. The MPSC properly dispatches the FERC's afterthought with the observation that it is routine for one pipeline to be required to make refunds while others are not—because the one is challenged and the others are not.

In its petition for review, the MPSC raises three objections to this aspect of the Commission's decision. First, it observes that § 4 of the NGA the Commission is authorized to order refunds of any amounts collected from consumers in excess of what is just and reasonable. 15 U.S.C. § 717. Second, the MPSC contends that until the *Colorado Interstate Remand Order* was issued in December 1993, Williams should have understood that when it was allowed to continue collecting from its customers the amount of the Kansas tax "subject to refund," it became conditionally obligated to refund any amount later determined to be unlawful. Indeed, Williams received explicit notice in 1989 that the Commission was considering whether monies collected in recovery of the Kansas tax would have to be refunded. *Williams Natural Gas Co.*, 47 FERC ¶ 61,114 at 61,-341. According to the MPSC, this notice should have prompted Williams to take reasonable steps to assure that it could in turn obtain refunds from its suppliers. Third, the MPSC asserts that the Commission should have required Williams to put the monies it received for the Kansas tax into escrow (or post a bond or obtain a letter of credit) in order to assure their return if need be. Escrow arrangements are commonly used when a rate increase is conditionally allowed to take effect until the agency determines whether it is lawful. *See, e.g., Transcontinental Gas Pipe Line Corp. v. FERC*, 866 F.2d 477, 479 (D.C.Cir.1989).

The Commission responds, first, that there is well-established precedent for treating pipelines as mere conduits for the flow of refunds from producers to consumers. *See, e.g., Public Utils. Comm'n of Cal. v. FERC*, 24 F.3d 275, 278 (D.C.Cir.1994). Second, the FERC explains that accepting Williams' rates "subject to refund" means simply that the agency would order refunds if appropriate after the remand proceedings in *Colorado Interstate*, not that Williams was expected to pay the tax monies into escrow (or take equivalent steps) in order to assure that they would be available if refunds were ordered. Third, the Commission maintains that it could not have directed Williams to set up an escrow arrangement because the pipeline was obligated by contract to pay producers the amount of the Kansas tax. The Commission points to § 601(c) of the NGPA, 15 U.S.C. § 3431(c), which guarantees a pipeline full recovery of its gas purchase costs.

The Commission's arguments are not convincing. Surely Williams' contractual obligation does not extend to paying to producers sums unlawfully recovered. While § 601(c) requires that a pipeline be allowed fully to recover its gas purchase costs, that provision also authorizes the Commission to deny recovery of costs that are unjust or unreasonable. Moreover, the Commission would not have violated § 601(c) by requiring that the taxes be placed in escrow while the agency determined whether they could indeed be recovered under § 110. An escrow arrangement would have preserved the rights of all parties. If the Commission ultimately decided that the taxes were recoverable under § 110, then the producers would be entitled to the amount in escrow, including any accrued interest. If, as happened, the Commission decided that the taxes were not recoverable, then the amount in escrow could have been refunded to the ratepayers (again,

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with interest). In either event, the pipelines would have recovered their full gas purchase costs.

[8] Regardless whether the Commission abused its discretion by failing to require an escrow or its equivalent—a matter we need not decide today—the MPSC's petition for review must be denied. Insofar as it seeks prospective relief, the issue is moot: Wellhead prices have been totally deregulated since 1993, there are no longer any maximum lawful prices for producer sales, and whether a producer recovers severance taxes is a matter of negotiation between buyer and seller. As for monetary relief, it is too late now for the Commission to require that Williams pay the severance taxes into escrow; the pipeline has long since paid the monies to the producers.

[9] Nor does the MPSC make out any legal or equitable principle that would suggest holding Williams accountable for the Commission's failure to protect consumers. The pipelines were, as the Commission has reminded us, mere conduits; they had no financial interest in this dispute. The Commission's failure to impose an escrow or other arrangement did not benefit the pipelines, and it is not clear why they should be at risk because the FERC may have been remiss. Nor was Williams obliged either by contract or by regulation to take any precaution against the possibility that a producer would fail to refund monies due to consumers. Therefore, there is no ground upon which the court can say that the Commission was required to hold the pipeline—which was charged first with the task of collecting tax payments and then of distributing tax refunds—liable if the responsible producer defaults on its refund obligation.

III. Conclusion

The Commission's interpretation of § 110 of the NGPA is in all respects reasonable. The Commission properly rejected the Producer Petitioners' proposal that it allow recovery of any tax that was "measurably attributable" to production. That standard is overbroad and unwieldy, and we criticized it as ambiguous in *Colorado Interstate*. The agency reasonably determined that the Kansas *ad valorem* tax is not a severance tax within the meaning of § 110. The Kansas tax is a function of numerous factors other than production, with the result that producers of equal volumes of gas may be taxed very different amounts; and the tax falls upon each unit of reserves each year, rather than once at the time of extraction. Further, the Producer Petitioners are mistaken in their assertion that non-recovery of a property tax based in part upon production is a disincentive to produce.

The Commission reasonably determined that both the Wyoming and the Colorado *ad valorem* taxes were recoverable as severance taxes under § 110 of the NGPA. The Wyoming tax is assessed upon the volume of gas removed from the well; it is a "one time only" tax, based upon the value of the gas when produced. That the state treats the tax as a property tax is of no moment if, in the terms of § 110, it is "imposed on the production of natural gas." 15 U.S.C. 3320(c). The Colorado tax, also administered as a property tax under state law, is computed as a set percentage of the market value of the gas removed from a well during the tax year. That is "plainly ... similar enough to a production tax to qualify under § 110." *Colorado Interstate*, 850 F.2d at 772.

Producers are liable to refund all Kansas *ad valorem* taxes collected with respect to production since October 1983. An agency adjudication should be applied retroactively unless new law is replacing clearly defined old law and reasonable reliance interests must therefore be protected. Here the agency did not change the law—rather, the Congress did when it enacted the NGPA in 1978—nor was there any showing that the producers had relied, let alone detrimentally or reasonably relied, upon the continuing validity of the agency's interpretation of the NGA. There is no substantive reason, therefore, to deny customers all the relief to which they are entitled. The customers are limited, however, to recovery of taxes paid with respect to production since October 1983 because that is the earliest date for which any argument has been preserved in this proceeding for review.

Finally, the court will not require the Commission to make the Williams pipeline a guarantor of the producers' obligation to refund the Kansas tax. Although an escrow arrangement would likely have preserved the rights of all parties, the Commission did not impose one, and no party has pointed to any legal or equitable principle by which the agency can be required to hold a pipeline accountable for the agency's own oversight.

For these reasons, we deny the petitions for review filed by the Missouri Public Service Commission and the Producer Petitioners, and we grant the petition for review filed by the Public Service Company of Colorado.

So ordered.

SENTELLE, Circuit Judge, concurring:

I join without reservation in the holding of the court. I write separately only to place a little distance between myself and what I deem to be an overstated dictum. After describing a hypothetical tax, the majority states that with the majority's proposed variations "the Kansas tax would, in our view, be sufficiently like a tax 'imposed on the production of natural gas' to be recoverable under § 110." Maj. op. at 1485. As no such tax is before us, for us to authoritatively render an opinion on what it would be constitutes nothing less than the advisory opinion that Article III courts have held ourselves unable to render since the earliest days of constitutional jurisprudence. *See, e.g., Flast v. Cohen,* 392 U.S. 83, 96, 88 S.Ct. 1942, 1950, 20 L.Ed.2d 947 (1968) ("[T]he oldest and most consistent thread in the federal law of justiciability is that the federal courts will not give advisory opinions." (Internal quotations and citations omitted)); WRIGHT, MILLER & COOPER, 13 FEDERAL PRACTICE AND PROCEDURE § 3529.1 (1984) (detailing the long history of the rule forbidding advisory opinions). We have already, in my view, crossed the line of appropriate Article III jurisprudence in dealing with § 110 tax treatment when the prior panel stated "[i]f a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the [property] tax would plainly be similar enough to a production tax to qualify under § 110." *Colorado Interstate Gas Co. v. FERC,* 850 F.2d 769, 772 (D.C.Cir. 1988). I think it time we quit advising state legislatures on how to draft their tax statutes and confined ourselves to construing the statutes actually before us.

BRISTOL-MYERS SQUIBB COMPANY, Appellant,

v.

Donna E. SHALALA, Secretary of Health and Human Services, and David A. Kessler, M.D., Appellees.

No. 95-5399.

United States Court of Appeals, District of Columbia Circuit.

Argued March 22, 1996.

Decided Aug. 16, 1996.

Drug manufacturer brought action challenging Food and Drug Administration (FDA) regulations governing approval of new generic drug based on research paid for by manufacturer of "pioneer" drug with which generic product was therapeutically interchangeable. The United States District Court for the District of Columbia, Thomas F. Hogan, J., dismissed. Manufacturer appealed. The Court of Appeals, Ginsburg, Circuit Judge, held that FDA may approve abbreviated new drug application (ANDA) for new generic drug even though label of generic product will not include one or more indications that appear on label of pioneer drug upon which ANDA is based.

So ordered.

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HEIN AND WEIR, CHARTERED

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Testimony re: HB 3050
House Utilities Committee
Presented by Ronald R. Hein
on behalf of
Pioneer Natural Resources U.S.A., Inc.
April 5, 2000

Mr. 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 3050. 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 about 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. (This was 1981-83.) 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 3050 may need some further revision, but it certainly is one method for the State of Kansas to correct the manifest injustice that occurred pursuant to the FERC and court rulings.

Pioneer would respectfully request that the committee approve HB 3050 for passage or request it be referred for interim study as the Senate Energy and Natural Resources Committee has done with Substitute for SB 571 which is the same subject matter as HB 3050.

Thank you very much for permitting me to testify, and I will be happy to yield to ques[illegible]

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DATE: 4-6-00
ATTACHMENT 4

**TESTIMONY OF WILLIAMS GAS PIPELINES CENTRAL, INC.
BEFORE THE ENERGY AND NATURAL RESOURCES COMMITTEE
IN OPPOSITION TO HOUSE BILL 3050**

**Presented by Gary W. Boyle
Senior Counsel
The Williams Companies, Inc.**

March 13, 2000

Williams appreciates the opportunity to provide the Senate Energy and Natural Resources Committee with information concerning House Bill 3050. Williams opposes the Bill for several reasons.

The proposed legislation, if enacted, would be an unconstitutional violation of both the Commerce and Supremacy clauses of the United States Constitution. Those parties that are negatively impacted by the law, including the federal government, the interstate and intrastate pipelines that will pay the tax, and state agencies that represent consumers in states other than Kansas, will challenge it in the courts. Those challenges will eventually and certainly result in the law being struck down at significant and unnecessary cost to all parties, including the State of Kansas.

Even if the inevitable court challenges do not overturn the law, the proposed legislation should not be enacted because it is bad for Kansas. If enacted, House Bill 3050 would remove from Kansas consumers $48 million in tax refunds from Williams alone. While those legislators who represent gas producing constituents may view this legislation as beneficial, those legislators who represent gas consumers must take into account the undeniable fact that their constituents will suffer financial loss if this tax bill is enacted. The Legislature cannot, consistent with its duty to the citizens of Kansas, and should not, in the performance of its constitutional duties, grant perceived relief to

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ATTACHMENT 5

Kansas producers at the expense of Kansas consumers. A realistic understanding of the proposed legislation compels the conclusion that Kansas producers will also be harmed over the long-term. Kansas should not enact a tax that will benefit primarily large, wealthy, out-of-state corporations at the expense of Kansas consumers and producers.

1. Background

Williams is a diversified energy and telecommunications company with a significant presence in Kansas and a significant interest in this state. As a result of its investment in Kansas and its presence on a continuing basis, Williams has an important interest in House Bill 3050 separate and distinct from its interest as a pipeline company.

In 1998, Williams paid Kansas property taxes of more than $12.7 million on assets valued at nearly $900 million. Williams' significant energy and telecommunications assets in Kansas are summarized in the following table.

Miles of Transportation Pipe	3119
Miles of Existing Fiber	528
Miles of Planned Fiber	453
Miles of Gathering Pipe	1905
Miles of Ammonia Pipe	375
Miles of Liquid Pipe	3101

In addition to these pipe and fiber assets, Williams owns and operates numerous terminals, offices, facilities, and compressor stations. At year-end 1999, Williams employed nearly 400 Kansans with a combined annual payroll of almost $19 million. Williams' activities in Kansas are significant and impact nearly every part of the state.

2. House Bill 3050 is Unconstitutional.

The proposed bill would violate both the Commerce and Supremacy clauses of the United State Constitution. The legislature should avoid enacting this law because it is clear that it will be struck down by the courts following a long and expensive legal battle that will enrich only the lawyers at the cost of various parties including, most prominently, the citizens of the State of Kansas. Under these circumstances, it would be irresponsible and fiscally unwise to enact this bill.

The United States Supreme Court has considered a tax law very similar to that under consideration here and has found it unconstitutional. In Maryland v. Louisiana, 451 U.S. 725 (1981), the Court struck down a Louisiana law that attempted to impose a tax on Outer Continental Shelf gas that moved through Louisiana. The Court found that the proposed tax violated both the Commerce and Supremacy clauses of the United States Constitution. A complete review of the Court's decision in that case clearly demonstrates the constitutional infirmity of House Bill 3050.

The Court began its substantive inquiry into the constitutional viability of the tax by considering the Supremacy clause arguments. The Court noted that the Supremacy clause provides that the "Constitution and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Constitution Art VI, cl. 2. The Court applied the Supremacy clause to the regulation of natural gas transmission by the Federal Energy Regulatory Commission pursuant to the Natural Gas Act and the Natural Gas Policy Act. Based on a thorough analysis, the Court determined

that FERC was invested with the supreme power to regulate natural gas that has flowed in interstate commerce and the pricing of that gas. Maryland at 747-48.

Having determined that the Supremacy clause applies to the regulation of the movement and pricing of natural gas in interstate commerce, the Court found it easy to conclude that a tax imposed by Louisiana on that gas violated the constitution. The Court found that the Louisiana tax, like the one proposed here, interfered "with the FERC's authority to regulate the determination of the proper allocation of costs associated with the sale of natural gas to consumers." Id. at 749. The real impact of House Bill 3050 vividly demonstrates that it is an attempt to interfere with FERC's exclusive authority. The ad valorem tax refunds to which the bill is addressed were ordered by FERC in an effort to return to consumers money that they paid in violation of the Natural Gas Policy Act. The pipeline tax imposed by the bill to fund the tax refunds would be passed through to consumers through pipeline rates approved by FERC.[1] The pass through of the proposed tax would reverse FERC's decision that producers rather than consumers should bear these costs. This is much more than an interference. It is an attempt to directly reverse FERC's decision.

The United States Supreme Court summarized its decision in very clear language. "[D]etermining . . . producer costs is the task of the FERC in the first instance, subject to judicial review. . . . To the contrary, *the State may not trespass on the authority of the federal agency*." Id. At 751 (emphasis added). The Court invalidated the Louisiana use

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1 FERC allowed pipelines to recover the Louisiana use tax from their customers pending resolution of the constitutional questions raised by the legislation. Louisiana First-Use Tax in Pipeline Rate Cases, 4 FERC ¶ 61,233 (1978). It is likely that FERC will follow its precedent and allow pipelines to pass through to consumers the tax proposed in House Bill 3050 at least until the legislation is struck down by the courts.

tax and would most certainly do the same with House Bill 3050 because it trespasses on FERC's authority to establish the maximum lawful price of natural gas.

The Supreme Court relied in part on its earlier review of actions of the Kansas Corporation Commission in Northern Natural Gas Co. v. KCC, 372 U.S. 84 (1963). The KCC had enacted a rule requiring interstate natural gas pipelines to purchase gas ratably from all the wells in a field. The Court struck down the rule finding that it violated the superiority of the federal government's regulation of the intricate relationship between the pipeline purchasers' cost structure and the eventual costs to be charged to pipeline customers. There the Court determined that the cost structure relationship and the relative interests of the producers and consumers are matters that Congress has granted exclusively to FERC. House Bill 3050 offends the Supremacy clause in the same manner that the KCC's ratable take rule is contrary to the Constitution. It is clear that the proposed legislation would meet the same fate in the courts.

The bill's inconsistency with the Constitution will most certainly be raised in the courts if the bill becomes law. Among the parties with an interest in striking down the legislation are state commissions and consumer groups who represent consumers in states other than Kansas. Those consumers will be saddled with a portion of the cost of this tax as a result of the pipelines' inevitable ability to pass through these increased costs to all of their customers. Local distribution companies will be interested in overturning the legislation as will pipeline companies. Any party whose competitive interests in the natural gas transportation industry would be impacted by additional costs would fight especially hard to reverse this unconstitutional tax and, if litigation would not reverse it they would be prepared to avoid the tax. Finally, the federal government and especially

FERC would be very interested in defending their right to comprehensively regulate interstate natural gas transportation. The combination of the federal and various state governments and some of the largest commercial enterprises in the country obviously have more than sufficient resources to vigorously challenge this new tax in the courts. Passage of the tax will require that the state of Kansas defend the statute in the courts at great expense even though it is painfully obvious that the tax cannot withstand a constitutional challenge. It would be irresponsible in the extreme for the legislature to pass a tax that it knows will be invalidated after an illusory battle that must be financed by the taxpayers of Kansas.

House Bill 3050 is clearly unconstitutional. The legislature should decline to pass legislation that clearly offends the constitution and that will surely be overturned by the courts after a legal struggle that will cost various parties including the Kansas taxpayers.

3. House Bill 3050 Would Significantly Harm Kansas.

Even if a responsible member of the Kansas Legislature could reasonably reach the conclusion that House Bill 3050 is consistent with the constitution, it would be an unwise tax because it would deny to Kansas consumers significant monetary refunds and would have a detrimental impact on Kansas gas production.

Williams is not in a position to quantify the potential benefits to Kansas consumers of the overall ad valorem tax refund process but Williams is quite familiar with the potential benefits to consumers of tax refunds generated from its producers. As the pipeline with the largest ad valorem tax refund claim and the largest refund for Kansas consumers, Williams is in a position to quantify the majority of the benefits of the refund procedure for Kansas consumers. Through May 31, 1999, Williams billed

producers for $126 million in Kansas ad valorem tax refunds including interest in accordance with FERC's decisions.[2] If that amount can be collected, fully $48 million will be refunded to Kansas gas consumers through refunds paid by Williams to local distribution companies that operate in Kansas.[3] If Kansas enacts House Bill 3050, however, those refunds will never reach Kansas consumers. The proposed legislation would establish a tax, which the pipelines (including Williams) would pass through to their customers. That tax, which would be paid by consumers in Kansas and other states, would completely eliminate the monetary benefits to consumers of the FERC-ordered Kansas ad valorem tax refund.

Williams understands that the Kansas ad valorem tax refunds will impose a cost on large and small producers. Large producers like Amoco, Mobil, and others are obviously well-equipped to pay these refunds even though such a payment will adversely impact their profits over the short-term. Small producers and royalty owners may be more profoundly impacted by the refund obligation and it is obviously this group that the legislature is attempting to assist with House Bill 3050. As a result, Williams understands that those legislators whose constituents are mostly small producers and royalty owners may favor the tax legislation since it will disproportionately benefit their constituents. Legislators who represent constituencies made up primarily of gas consumers rather than gas producers, however, should squarely oppose the legislation since it would significantly and negatively impact their constituents. Williams is

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[2] The total amount currently due from Williams' producers is greater than $126 million by virtue of the fact that interest has continued to accrue on the amount due from some producers.

[3] Williams believes that Kansas consumers will enjoy more than $60 million in refunds from all pipelines if collection efforts are successful.

confident that the majority of responsible Kansas legislators, regardless of the nature of their respective constituencies, will do what is best for the state as a whole and vote no on this ill-conceived, and constitutionally infirm tax.

Legislators who represent primarily producing and royalty interests ought to carefully consider the impact that House Bill 3050 will have on the Kansas gas business. It is clear that the imposition of a tax on gas that passes through Kansas or is produced in Kansas will put that gas at a competitive disadvantage in the marketplace. Pipelines, marketers, producers, and others who control the movement of gas will find a way to avoid paying it by assuring that the gas they buy, sell, or transport is not produced in Kansas and does not touch Kansas along its transportation route. This will have a devastating impact on the Kansas gas industry and on the state's collection of severance taxes from production. While it may seem on its face that the proposed legislation is good for producers and bad for consumers, the immediate short-term benefit for producers will surely be eaten up by the competitive disadvantage that Kansas gas will suffer in the marketplace. These detriments are especially unwise when one realizes that the primary beneficiaries of the proposed tax and reimbursement scheme will be several very wealthy multi-national companies with billions of dollars in assets and annual profits.[4]

Williams opposes House Bill 3050 because it is unconstitutional and unwise. Williams urges the legislature to decline to enact this improvident legislation.

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[4] Amoco, Cabot, Chevron, Mesa, Mobil, OXY, Texaco, and Union Pacific Resources account for almost $120 million of the $126 million in principal and interest due from Williams' producers as of May 31, 1999.

GOVERNMENT AFFAIRS & PUBLIC RELATIONS

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Testimony of Colorado Interstate Gas Company and
ANR Pipeline Company

Regarding House Bill 3050: Pipeline Tax

Presented by Ron Gaches
McGill, Gaches and Associates, Inc.

Before House Utilities Committee
Wednesday, April 5, 2000

HOUSE UTILITIES
DATE: 4-6-00
ATTACHMENT 6

Good Morning, Mr. Chairman and members of the Committee. I am Ron Gaches of McGill, Gaches and Associates appearing today on behalf of Colorado Interstate Gas Company, or CIG, and for ANR Pipeline Company. Both companies are subsidiaries of Coastal Corporation and are strongly opposed to HB 3050, as I will explain further.

HB 3050 deals with a set of issues that have confronted the gas industry in Kansas for several years. Very simply, the Federal Energy Regulatory Commission and the U.S. Court of Appeals have ordered gas producers operating in Kansas to pay back overcharges. CIG has been a central participant in these cases, as has our largest customer, Public Service Company of Colorado. ANR Pipeline has been only a minor participant, but–as I'll explain later–stands to be the "poster child" of the accidental victim of HB 3050.

The refunds ordered by FERC and the court are for overcharges in producers' gas prices from the 1983-1988 period when those producers were Federally regulated. The refunds are substantial, something approaching $400 million. Producers who owe refunds to CIG represent about ten percent of the total dollars, or $40 million.

The role of CIG is as a conduit, a collector of those refunds who must then get the money back to <u>our</u> customers, such as Public Service Company of Colorado, who will in turn pass the money on to consumers who were overcharged in the first place. The FERC already has the procedures in place for CIG to flow the money back to its customers when CIG gets it. In other words, CIG is in the middle. In the specific case of CIG, it is utility consumers in Colorado and Wyoming who will receive the money to make them whole for the overcharges.

HB 3050 seeks to take this refund and turn it into a 40-year future problem for CIG and ANR

Pipelines, their customers, and the retail consumers they serve. HB 3050 would use the credit of the State of Kansas to issue bonds, for the sole purpose of restoring the refunds to the producers' bottom line. HB 3050 would then levy a new tax on all the pipelines in Kansas to pay off those bonds, over their 40-year life.

In other words, the same consumers who are supposed to get their money back for these overcharges would be paying the cost of a new tax for the next four decades. You should not forget that a large share of that four-decade burden on consumers, as much as twenty percent or more of it, would fall on consumers in Kansas itself.

Not only would the burden of the tax be long and heavy for consumers, but the impact among pipelines and regions would be very arbitrary. ANR Pipeline is probably the most extreme example of this arbitrary impact. ANR, which serves the upper Midwest, would receive only a little over one million dollars in refunds from producers, but would pay <u>one hundred million dollars</u> of the proposed tax. That is simply not fair, and it can be expected to cause the consumers of Michigan, Wisconsin, and ANR's other states to weigh in heavily in any court review of the tax.

Are the proposed bonds a good idea? No. Bonds that get wrapped up in years of legal challenges don't really sell very well.

Will they get wrapped up in years of legal challenges? Absolutely.

Will the tax that funds the bonds be overturned? Absolutely. Louisiana tried a similar tax back in the 1970s, the "first use tax". The United States Supreme Court found that tax to be unconstitutional, as a burden on interstate commerce.

Can the consumers who are supposed to be made whole for the producers' overcharges be expected to point this out? Absolutely.

But I am not really here to talk about the legality of HB 3050–that's for the lawyers to do at a later time in a courtroom if this new tax ever becomes law. I'm here to explain the reason the bill was proposed in the first place–to defray the impact of a large refund obligation on the small producers and the royalty owners of Kansas.

I know the bill is not intended to be simply a bailout for huge, multinational oil companies--at the expense of the consumers of Kansas and other states. It is meant to benefit the thousands of businesses and property owners in Kansas who are affected by these Federal orders.

CIG shares this concern for small producers and royalty owners. This was really never their fight. The big producers helped push through the Natural Gas Policy Act, the NGPA, that raised gas prices dramatically in 1978. The big producers participated in all the Federal deliberations over what kind of "add-ons" they might have to their prices once the NGPA was the law. And it's the big producers who have slugged it out every step of the way trying to keep from having to pay the overcharges back.

The small producers and the royalty owners have not participated in any of these things to that same degree, so we absolutely understand the surprise and the burden that this refund obligation represents for them.

So CIG believes that the refund process should be changed, to relieve small producers and royalty owners of their burden. We believe that if this were done right, and done across enough of the pipelines in Kansas to make a difference, we could put this problem behind us and avoid years of legal fights over initiatives like HB 3050.

Because CIG believes it makes sense to relieve small producers and royalty owners of the burden of this refund, we began a process last summer, talking and negotiating with our customers

and with the representatives of the consumers in Colorado and Wyoming–our primary markets. We reached agreement on a proposal that we then exchanged with representatives of the producers who owe the refunds.

This went back and forth for several months. I cannot say we reached agreement with the producers. However, we do have agreement with the consumer side of the equation, the recipients of the refunds. So we have gone ahead and filed a proposal at the FERC, an offer of settlement in CIG's refund case significantly different from the proposals that have been filed earlier on other pipelines.

On March 8 we filed this proposal, in concert with Public Service Company of Colorado, our largest customer, and supported by the state commissions of Colorado and Wyoming, the Colorado Office of Consumer Counsel, the Colorado Energy Assistance Fund, and the major utility customers of CIG.

The proposal is pretty simple: It would forgive one eighth of each producer's refund bill to represent royalties, and it would provide a credit against the remaining bill sufficient to relieve the vast bulk of producers of any refund liability at all.

To give you an idea, there are 572 individual producers involved in CIG's refund process. Our proposal would wipe out the refund liability for 431 of them–75 percent. All the producers, including the remaining 25 percent, would be relieved of the one-eighth-royalty portion of the refund and would receive a credit against the remaining bill.

In total, CIG's proposal would forgive approximately 22 percent of the refunds ordered by the FERC and the court. The remaining payors should be nothing but large producers, paying only their non-royalty share of the refunds.

I say "should be nothing but large producers" because we have had a lot of trouble getting the data from well operators necessary for us to be sure of any producer's refund liability. It's the operators that we paid, and it's the operators who sent the money along to the individual producers. So it's the operators who have the information we need to know with certainty who owes what. And they have not been very good about following FERC orders to share it with us.

This is all by way of preamble to saying that CIG filed a second document on March 8. It was a FERC complaint against the operators. It goes into a lot of detail as to the trials and tribulations CIG has faced getting information from operators.

I want it to be very clear that the CIG complaint against operators only has one primary goal, to get the data CIG needs to be able to implement a settlement as quickly as possible–to let as many producers as possible know with certainty whether they owe refunds to CIG consumers.

Other settlement proposals were filed on behalf of other pipelines last Fall. Producers pointed out several problems with those proposals. Specifically, any credits would happen at the operator level, so no one knew how the proposals would actually affect the individual working-interest owners, the producers who actually owe the refunds. The proposals did not directly address royalty owners in any way–so, again, this key group of stakeholders did not know how they would be affected.

The CIG/PSCo offer addresses both of these concerns. Its credit is to each of the 572 working-interest owners, rather than the 60 operators through whom the gas was aggregated. It directly forgives a one-eighth-royalty share for every working-interest owner, regardless of size. In short, the CIG proposal is a much closer fit to the concerns being addressed here.

I am sure there will be further negotiations at the FERC following the filing of the CIG

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settlement offer. I am hopeful that those negotiations with the various producer representatives will be able to come up with a final deal that's acceptable to everyone. However, if FERC would simply approve what CIG has filed as-is, the CIG piece of the problem you're trying to address will have pretty much gone away.

The willingness of the Colorado and Wyoming consumer representatives to support this offer shows that they are sensitive to the impact on small producers and royalty owners. But they are also very serious about getting back, from the large producers, the overcharges that have now been held for over twelve years. They are equally serious about preventing a forty-year-long tax burden into the future, the result of which is to bail out some big investor-owned companies.

As I said at the outset, CIG is in the middle. CIG wants to get this resolved and behind us. We believe that a fundamental choice is being made here in Kansas right now: (1) Pass legislation that will gum up the legal works and lead to years more of court cases, without changing where things ultimately come out; or (2) Work out an industry supported resolution of the issue that targets small producers and royalty owners for relief from the refund obligation. If the industry and Kansas do not pursue the second option, we have all made a very bad mistake.

Along those lines, we commend Senator Morris and the Kansas Corporation Commission for the industry-wide conferences that have been held in recent weeks. These meeting have been a chance for many of the parties to speak directly to each other, rather than through our Washington lawyers. We strongly believe the CIG/PSCo proposal can provide a template for how this problem can be worked out. Regardless of the progress there, however, the filing of the CIG offer at the FERC shows that CIG and PSCo are very serious in their commitment to get it worked out as to their ten percent of the total refund.

In considering HB 3050, CIG and ANR urge the Committee to embrace efforts such as the industry-wide conference and such as the CIG/PSCo settlement offer as a legitimate means to put these problems behind us. We urge the Committee to recognize that any initiative such as HB 3050 is destined to muddy the water for several more years, make it that much harder to reach a fair resolution of the refunds, and further polarize consumer interests and gas producers.

HB 3050 will not succeed legally, but even if it did, it would impose an unwarranted burden on consumers for the next forty years. This should not happen. Thus, we strongly recommend that you vote "No" on HB 3050 and that you encourage the efforts underway in the industry to work out the refund issues once and for all. Thank you.

Exhibit G

ESTIMATED ALLOCATION OF *KANSAS AD VALOREM TAX REFUNDS* *(INCLUDING INTEREST)* *BY STATE* AS OF MARCH 31, 1999

#	STATE	ESTIMATED %	TOTAL REFUNDS DUE
1	Kansas	22.556	$60,466,040
2	Missouri	16.856	$45,186,007
3	Minnesota	13.276	$35,589,074
4	Nebraska	10.262	$27,509,421
5	Colorado	6.567	$17,604,207
6	Illinois	6.335	$16,982,283
7	Iowa	5.460	$14,636,663
8	Indiana	4.764	$12,770,891
9	Michigan	3.534	$9,473,621
10	Wisconsin	2.227	$5,969,936
11	Ohio	1.754	$4,701,961
12	California	1.581	$4,238,199
13	Oklahoma	1.431	$3,836,093
14	Texas	1.129	$3,026,519
15	South Dakota	0.981	$2,629,774
16	Wyoming	0.871	$2,334,896
17	Arizona	0.242	$648,731
18	New Mexico	0.061	$163,523
19	Nevada	0.048	$128,674
20	Louisiana	0.039	$104,548
21	Arkansas	0.022	$58,976
22	Utah	0.003	$8,042
23	Tennessee	0.001	$2,681
	Total	100.00	$362,968,627

HOUSE UTILITIES

DATE: 4-6-00

ATTACHMENT 7

Exhibit D

Summary of 1983-88 Kansas Ad Valorem Tax Reimbursements Due from First Sellers
Principal plus Interest through 11/30/97 or 12/31/97
Based upon Statement of Refunds Due filed by all Pipelines

	Pipeline	Principal	Interest	Total
Docket No. RP98-43	Anadarko Gathering Company	$5,432,295	$9,770,838	$15,203,134
Docket No. RP98-42	ANR	$409,903	$777,829	$1,187,732
Docket No. RP98-54	Colorada Interstate Gas Company	$13,343,681	$21,659,966	$35,003,647
Docket No. RP98-44	El Paso Natural Gas Company	$18,589	$35,248	$53,836
Docket No. RP98-53	KN Interstate GasTransmission Company	$12,104,346	$18,831,617	$30,935,962
Docket No. RP98-38	Natural Gas Pipelines Company of America	$84,412	$155,254	$239,666
Docket No. RP98-39	Northern Natural Gas Company	$30,162,203	$50,216,236	$80,378,439
Docket No. RP98-40	Panhandle Eastern Pipe Line Company	$20,000,859	$33,594,414	$53,595,273
Docket No. RP98-52	Williams Natural Gas Company	$45,774,748	$72,472,287	$118,247,034
	TOTAL	$127,331,034	$207,513,689	$334,844,723

The Missouri PSC staff estimates that approximately 45-50% of the Williams Natural Gas refunds and 5-10% of the Panhandle Eastern refunds are due to Missouri natural gas consumer.

Exh

Summary of 1983-88 Kansas Ad Valorem Tax Reimbursements Due from First Sellers
Principal plus Interest through 11/30/97 or 12/31/97
Based upon Statement of Refunds Due filed by all Pipelines

	First Sellers (in descending order by Interest Due)	Principal	Interest	Total
1	Amoco Production Company	$24,207,052.89	$38,100,733.73	$62,307,786.62
2	Mobil Oil Corp	$19,703,648.88	$32,512,675.28	$52,216,324.16
3	Oxy USA Inc.	$11,758,538.02	$18,572,234.61	$30,330,772.63
4	Mesa Operating Limited Partnership	$9,237,894.11	$14,341,879.60	$23,579,773.71
5	Anadarko Petroleum Corp	$7,469,406.74	$11,826,352.60	$19,295,759.34
6	Helmerich & Payne	$4,803,827.33	$7,743,954.73	$12,547,782.06
7	Pan Eastern Exploration Cc	$3,938,696.32	$6,772,496.97	$10,711,193.29
8	Barrett	$4,449,459.79	$5,963,694.58	$10,413,154.37
9	Duke Energy Field Services	$2,461,276.71	$5,343,228.39	$7,804,505.10
10	Mobil Natural Gas	$2,995,694.20	$5,282,814.60	$8,278,508.80
11	Cities Service Oil & Gas Corp	$2,650,251.11	$4,620,195.21	$7,270,446.32
12	Mesa Petroleum Co.	$2,209,502.05	$3,772,487.83	$5,981,989.88
13	Osborne Heirs	$1,895,174.57	$3,533,602.54	$5,428,777.11
14	Kansas Natural Gas Inc	$1,521,183.50	$2,710,357.69	$4,231,541.19
15	Texaco Inc.	$1,449,950.82	$2,472,565.94	$3,922,516.76
16	Energy Devel. Corp	$1,555,736.48	$2,400,622.07	$3,956,358.55
17	Union Pacific Resources d/b/a Champlin Petroleum Co	$1,410,173.36	$2,398,667.03	$3,808,840.39
18	UPRC	$1,359,526.80	$2,347,098.64	$3,706,625.44
19	Northern Pump Co	$931,990.67	$1,727,051.49	$2,659,042.16
20	Union Pacific Resources	$1,317,926.70	$1,648,841.56	$2,966,768.26
21	Petro-Lewis Corp	$796,341.28	$1,389,471.13	$2,185,812.41
22	Beren Corp.	$696,420.77	$1,260,279.79	$1,956,700.56
23	George A. Angle, D/B Frontier Oil Co.	$500,863.36	$941,653.07	$1,442,516.43
24	Kuhn Drilling Co	$476,947.92	$937,186.59	$1,414,134.51
25	Continental Energy	$481,004.24	$876,394.05	$1,357,398.29
26	Champlin Petroleum Company	$519,163.84	$837,701.47	$1,356,865.31
27	Holl, FG	$475,414.98	$774,015.31	$1,249,430.29
28	Chevron USA, Inc.	$565,227.13	$758,325.25	$1,323,552.38
29	Kaiser-Francis Oi	$447,110.28	$734,663.83	$1,181,774.11
30	Stevens County Oil & Gas Cc	$380,640.26	$729,343.05	$1,109,983.31
31	APX Corp	$604,751.57	$711,759.41	$1,316,510.98
32	McKelvy Operating Corp	$458,726.64	$700,658.34	$1,159,384.98
33	Benson Mineral Group	$354,759.27	$676,761.77	$1,031,521.04
34	Lebosquet, John R.	$364,359.52	$625,536.52	$989,896.04
35	Southland Royalty Co	$370,156.43	$624,587.70	$994,744.13
36	White, Robt. F.	$346,374.92	$613,182.29	$959,557.21
37	Irex Corp	$300,375.03	$608,932.31	$909,307.34
38	Graham Michaelis Corp.	$383,708.92	$569,907.35	$953,616.27
39	Kansas Petro Inc.	$343,662.84	$562,506.35	$906,169.19
40	Cabot Petroleum Corp.	$365,451.23	$528,777.73	$894,228.96
41	Mapco Oil & Gas Company	$207,510.69	$442,789.97	$650,300.66
42	Santa Fe Minerals Inc	$308,134.36	$425,699.33	$733,833.69
43	Coastal Oil & Gas Corp.	$234,052.27	$391,903.59	$625,955.86
44	Halliburton Oil Co.	$200,029.17	$385,051.19	$585,080.36
45	Energy Exploration & Prod Inc	$207,395.09	$381,394.11	$588,789.20
46	Arco Oil & Gas Co.	$303,107.18	$362,243.52	$665,350.70
47	Lowry's Lease Management Inc.	$240,082.66	$358,049.16	$598,131.82
48	Wilson, Robt. P.	$196,013.39	$328,326.50	$524,339.89
49	Graham Michaelis Drilling Co	$211,980.51	$322,823.78	$534,804.29
50	Marden Producing Co	$180,316.01	$311,547.21	$491,863.22
51	Trees Oil Co	$192,815.47	$301,471.37	$494,286.84
52	RJ Patrick Operating Co	$139,143.93	$297,462.32	$436,606.25
53	Gould Oil	$173,470.45	$279,152.12	$452,622.57
54	Upstream Energy. Service.CMY	$171,409.21	$278,439.99	$449,849.20
55	Raymond Oil	$130,246.58	$245,888.20	$376,134.78
56	Molz Oil	$145,265.22	$243,219.97	$388,485.19
57	Petroleum Inc.	$149,383.44	$238,462.09	$387,845.53
58	Dorchester Hugoton Ltd.	$153,640.28	$234,331.77	$387,972.05
59	Mull Drilling Cc	$159,178.16	$229,005.86	$388,184.02
60	Mid-Continent Energy Corp	$112,843.96	$216,630.02	$329,473.98
61	Pickrell Drilling Cc	$108,786.61	$215,976.21	$324,762.82
62	Green Wolf Oil Co.	$120,119.66	$210,634.47	$330,754.13

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BEFORE THE HOUSE UTILITIES COMMITTEE

Testimony of the Citizens' Utility Ratepayer Board
By Walker Hendrix, Consumer Counsel
April 5, 2000

H.B. 3050

House Bill No. 3050 establishes an elaborate financing arrangement which would authorize the issuance of bonds to pay back natural gas producer refund obligations through the establishment of a pipeline privilege tax. As such, the bill attempts to nullify the effects of decisions by the D.C. Circuit Court of Appeals and the Federal Energy Regulatory Commission to refund to consumers unlawful charges for natural gas that were collected by natural gas producers between 1983 and 1988 as well as interest. The bill also places considerable future burdens on natural gas consumers, who will ultimately bear the financial consequences of the privilege tax when the pipelines pass through the tax in their rates for wholesale transportation service.

The Citizens' Utility Ratepayer Board opposes H.B. 3050 because it forces Kansas consumers to fund anticipated refunds for overcharges that producers made under the Natural Gas Policy Act of 1978. These refunds were the result of prolonged litigation before the United States Circuit Court for the District of Columbia and FERC. See, *Public Service Company of Colorado, v. FERC*, 91 R.3d 1478 (D.C. 1996), cert. denied, 117 S. Ct. 1723 (May 12, 1997) and *Colorado Interstate Gas Company*, 65 FERC ¶ 61,292 (1993), order denying reh'g and granting clarification, 67 FERC ¶ 61,209 (1994). Total refunds are approximately $362,968,627, including interest, out of which Kansas consumers

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are entitled to $60,466,040.

The Kansas Legislature has traditionally avoided entering into areas which involve the effects of litigation. Yet, H. B. 3050 proposes the issuance of bonds to fund the liability of Kansas producers. The bonds would be paid off with a privilege tax against the pipeline companies which ultimately would be borne by consumers. In essence, this arrangement would require Kansas consumers to repay producers for money which was wrongly collected at the outset.

Kansas producers no doubt think that this arrangement is fair because their liability was based on a change in the treatment of the ad valorem tax by the FERC as an expense which could be charged to pipeline companies. The producers spent many years trying to convince the Circuit Court and FERC that the change in policy was not appropriate. However, once Kansas adopted a severance tax and essentially imposed two taxes on natural gas, the prior treatment by FERC was no longer applicable. With the passage of the severance tax, Kansas producers were placed in the same position as Texas producers, who were no entitled to charge for ad valorem assessments when a severance tax was in place. Both the Circuit Court and FERC determined that it was inappropriate to include the ad valorem tax as a charge under Section 110 of the Natural Gas Policy Act of 1978, when Kansas had a severance tax on production. Consequently, there is a binding decision against the producers requiring them to make refunds to consumers.

H.B. 3050 would prolong litigation and would effectively increase the liability of the producers as the interest component of the FERC orders

continues to grow. H.B. 3050 raises a number of legal issues. First, H.B. 3050 would seem to violate the Commerce Clause of the United States Constitution, which states: "The Congress shall have Power ... [t]o regulate Commerce ... among the several States ...." Art. I, 8, cl. 3. H.B. 3050 is not enacted for a public purpose, but it merely is designed to shift liability for overcharges under federal law back to consumers. As such, the privilege tax violates the commerce clause, because it is a tax on interstate commerce which is not fairly related to the services provided by the State. See, *Washington Revenue Dept. v. Washington Stevedoring Assn.*, 435 U.S. 734, 750 (1978). Secondly, H.B. 3050 would seem to violate the Supremacy Clause of the United States Constitution, which provides: "This Constitution and the Laws of the United States which shall be made in Pursuance thereof ... shall be the supreme Law of the Land ... any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." Art. VI., cl. 2. H.B. 3050 attempts to circumvent the liability determined under federal law by both the Circuit Court and the FERC for unlawful overcharges and redirects that liability back to the consumers who were overcharged in the first instance. As such, H.B. 3050 attempts to reassign the liability back to consumers and to avoid the pronouncements of the FERC on the refund obligation under federal law.

Assuming that H.B. 3050 could withstand legal attack, it raises serious policy questions for public officials who have to balance the interest of producers against the rights of consumers. I am sure it is not lost on anyone that the top ten producers owe 60% of the refunding obligation. Included within this category are

multinational oil and gas companies who are currently benefitting at the expense of consumers at the gasoline pumps. Should the Legislature pass a privilege tax on pipelines which will be borne by consumers in pipeline rates to compensate large multinational oil and gas companies?

There is no question that producers have been significantly affected by the reversal in policy by the FERC as directed by the D.C. Circuit Court. However, the FERC has attempted to deal with hardships by permitting individual producers to request relief by way of an adjustment to their refund obligation. FERC has stated that it would entertain individual requests for adjustment relief for both principal and interest to alleviate hardship that is demonstrated by producers. It has also permitted the refund payments to be made over a period of five years. These measures are set forth under section 502 (c) of the NGPA, which provides for adjustments where "necessary to prevent special hardship, inequity, or an unfair distribution of burdens." We believe that it would be better for individual producers to pursue the remedies afforded under federal law rather than to construct a new set of remedies under state law. To do otherwise, would cause state and federal law to be in conflict.

H.B. 3050 also suffers because the payment to the State to retire the bonds is predicated on gas moving through the pipelines. Kansas production is moving in downward direction. Peak production occurred in 1995. The volumes moving through the State are expected to continue to decline in the future as Hugoton Production pressures continue to drop. If the bonds are to be paid back on the basis of gas production moving through the pipelines in Kansas, it will mean that

over time the funding and taxing mechanisms will have to increase the assessment in order to pay off the bonds. This would cause significant increases in the expenses of pipelines and the rates that consumers will ultimately have to bear in the future. Because of the problems associated with attaching the funding mechanism for the bonds to an unpredictable situation such as the volumes of gas flowing through Kansas, it is also difficult to see how the bonds will be marketable. Moreover, since H.B. 3050 does not establish the extent of the funding or the term for the repayment of the bonds, it is hard to see how the bonds can be successfully issued.

Given the debate that H.B. 3050 has raised, the Citizens' Utility Ratepayer Board would recommend that the parties continue to negotiate in order to bring these matters to conclusion. It is obvious that the royalty owners are so numerous and are so difficult to identity that collection efforts would be very difficult and expensive. As a practical matter, the royalty owner liability should be excused and the pipelines should reimburse consumers for the refunds which are related to royalty interests. Because of the impact on small producers, CURB would recommend that similar treatment be afforded small producers. It would be a very expensive effort to track down all small producers (many who have disappeared from the scene), and the pipelines should reimburse consumers for the liability of small producers. With the relief afforded under Section 502 (c) of the NGPA, CURB maintains that larger producers should be required to refund for the overcollection of maximum lawful prices and should expeditiously make refunds to the pipelines so that consumers can receive compensation for the over charges.

In conclusion, CURB encourages the Committee to reject H.B. 3050 and to protect the interest of consumers. H.B. 3050 has no public purpose and is in serious conflict with federal law. Relief is afforded under federal law, and the State should avoid setting up an expensive financial arrangement which will penalize consumers.

KANSAS STATE LEGISLATIVE COMMITTEE

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CCTF COORDINATOR
VACANT

Testimony of Charles "Sonny" Freeman
AARP Kansas State Legislative Committee
On House Bill 3050

April 5, 2000

My name is Charles "Sonny" Freeman and I am a volunteer member of AARP's Kansas State Legislative Committee (SLC). In Kansas, AARP represents more than 350,000 residents age 50 and over. We have a strong interest in utility rates and services, including natural gas, electricity and telephone and therefore greatly appreciate the opportunity to present this testimony.

The AARP Kansas State Legislative Committee has taken interest in this legislation because affordable basic natural gas service is an essential component of life. Older Americans are particularly vulnerable to rapid increases in energy prices. Although they consume approximately the same amount of energy as non-elderly, they devote a higher percentage of total spending to residential energy than do younger consumers. Too often, low-income older persons are faced with the choice of risking their health by cutting back on energy expenditures or reducing spending for other basic necessities.

The natural gas consumers in many states and especially the consumers of Kansas paid the Kansas ad valorem tax from 1983 to 1989. The Federal Energy Regulatory Commission (FERC) and the United States Court of Appeals for the DC Circuit have since found this tax to be illegal. We understand the FERC has ordered the companies to refund this money to consumers.

Now is the time for consumers to get the refunds we deserve, with interest. Millions of

consumers of natural gas in 23 states are entitled to refunds of this tax. Nationwide, the refund totals approximately $335 million with about $207 million in accrued interest.

This bill makes the ratepayers and taxpayers of Kansas pay twice for this ad valorem tax. We paid for it when it was imposed, and now HB 3050 will make us pay for it again so that the state can issue bonds to pay us back. So, under this bill it seems that natural gas ratepayers will pay to get the money back that we are owed anyway. This makes no sense.

The refunds of this tax are long overdue. We encourage you to work to ensure that the refunds are paid in full, with interest, now. Please ensure that any legislation that you consider and pass on this issue only hastens and does not add to the delay that has already held up these refunds for so long. Thank you for your consideration.

Charles H. Freeman

COMMENTS OF JACK GLAVES
IN BEHALF OF
PANHANDLE EASTERN PIPE LINE COMPANY
AND
KINDER/MORGAN, INC.
ON H.B. 3050 BEFORE
HOUSE UTILITIES COMMITTEE

It's hard to keep the villains and the victims straight in the hapless events giving rise to this legislation. The question arises as to whether the producer and royalty owners that are faced with repaying ad valorem taxes levied between 1983 and 1988, which were paid by gas consumers, are the real victims of the unfortunate time lapse in the judicial process that makes the payback obligation so burdensome, or is it the consumers that paid the taxes that should be the subject of our concern. Many would say both. We earnestly believe that this Bill is not the answer to the problem. The cure is worse than the malady. Its concept is harmful to consumers, pipelines and ultimately to the people it purports to help, producers and royalty owners by rendering Kansas gas less competitive.

This Bill mistakenly assumes that it is the pipelines rather than the consumers that are the real parties in interest.

Section 1 (f) postures the pipelines as "claimants" of the refunds ordered by FERC and Section 2 (2) requires the pipelines to file with the KCC "...a claim for payment of refunds.." and requires pipelines to release producers and royalty owners from liability "for any claims for such refunds and interest". The

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State's taxing power is imposed in Section 5 (a), "for the privilege of transporting natural gas from, within and through this state by pipeline" to raise revenue to pay the bonds issued "for the purpose of paying refunds on behalf of producers," (Section 4 (a)). In fact, the "claim" is by gas consumers for the FERC ordered refund of the ad valorem taxes that were paid by gas consumers. Pipelines are merely the conduits designated by FERC to make demand on the producers to remit the amount owing for transmittal within 30 days to the pipeline customers who are entitled to the money. How that qualifies the pipelines to be inflicted with a "privilege tax" is difficult to understand.

The interstate pipes "privilege" of flowing gas through Kansas exists as a result of certificates of public necessity and convenience issued under the Federal Natural Gas Act. Our rates are regulated by FERC. Pipeline property in Kansas is assessed at the 33% public utility rate, resulting in 1999 Kansas ad valorem taxes of nearly $60 million dollars. The proposed "privilege tax" is wholly unrelated to the existence or activity of the pipeline operations. It is solely for the purpose of paying the $360 million dollars worth of bonds that would be issued for reimbursing producers for their reimbursement obligation to gas consumers who paid the producers' tax obligation in the 1983 to 1988 era. Ironically, it would ultimately be gas consumers, who would pay for their own refund by virtue of the allowance by regulators of taxes as a part of the pipelines cost of service. Thus, the tax imposed by this

Bill can result in taxes of millions of dollars on Kansas gas consumers. The attached schedule reflects Kansas based consumers as being entitled to reimbursement of over $60 million dollars, or about 22 1/2% of the total obligation. Likewise, the bond payment obligation would presumably be shared on a comparable basis by Kansas consumers. A vote for this Bill could unfortunately be construed as a vote for a $360 million dollar (plus interest) tax increase.

This Bill is defective in concept, impaired constitutionally and would constitute an impediment to alternative resolution of the very real problem which it seeks to resolve. It can only result in endless litigation.

THE BILL IS UNWORKABLE.

The revenue bonds (up to $360 million dollars, plus all amounts required for issuance and interest) would be paid by a tax imposed on the pipelines at $.02 per mcf for gas transported "from, within and through this State." (Sec. 5 (a)) No fiscal note has been issued for this Bill. That is understandable given the fact that we do not know the term of the bonds, the projected interest rate, nor the volumes to which the tax would be applicable. Without such information the viability of the $.02 tax is unknown. The only fiscal note issued to date is on S.B. 571, which proposed a tax of $.01 per million cubic feet, which was estimated by DOR to raise $8,400.00 per year. This Bill has restructured the pipelines subject to the tax by making it applicable to either the last transporting line prior to leaving

the State, or as to volumes being delivered to LDCs or direct sale customers of the pipeline (Sec. 5 (a)) It is made applicable to interstate pipes regulated by FERC and intrastate pipes regulated by KCC (Section 1 (e)). Apparently, intrastate lines not subject to KCC jurisdiction would be exempt. The most critical problem is the fact that gas volumes traversing Kansas are declining dramatically. The fiscal note for S.B. 571 recites that Kansas interstate volumes in 1998 declined 20% from 1997. This decline is also reflected by Kansas production statistics and national data, which are attached, reflecting a decline of 25% in Kansas production from 1995 through 1999. This decline is irreversible, given the maturity of the Kansas gas fields as well as the Texas and Oklahoma Panhandle fields that are the primary source of the gas coming into Kansas. Thus, the Legislature would have the responsibility of increasing the rate of tax on an annual basis, if the bond payment obligation were to be maintained. It does not appear that the amount of tax required by this Bill has been determined with any degree of certainty. Future levels of required taxation are mere speculation at this point. It is doubtful that bond investors would feel comfortable with that prospect. Additionally, a bond purchaser would insist on assurance that the validity of the bonds would remain unchallenged legally. Obviously, given the constitutional issues discussed below, such assurance could not be given. The bonds would simply never be marketed.

CONSTITUTIONAL OBSTACLES

1. The tax proposed to be levied is not for a public purpose. The attempt in the preamble, to clothe the Bill with a public purpose of effectuating a State tax policy (that producers should be allowed to recover both the ad valorem tax and severance tax as a cost of production) cannot obscure the fact that the tax is, in fact, levied for the purpose of benefiting producers and royalty owners by the payment of their tax obligation debt that has been mandated by administrative and judicial decisions. It would benefit one segment of our population, the gas producers and royalty owners in the event the Kansas Courts determine that royalty owners are required to reimburse the producers for their part of the obligation.

The law that taxes can only be imposed for a public purpose is deeply embedded in Kansas. An 1874 case, <u>Savings and Loan Association vs. Topeka</u>, 87 U.S. 655, 22 L.Ed. 455, said it well,

> "Lay, with one hand, the power of government on the property of the citizen, and with the other to bestow it upon favored individuals to aid private enterprises and build up private fortunes, is none the less a robbery because it is done under the forms of law and is called taxation. This is not legislation. It is a decree under legislative forms.
>
> Taxes are burdens or charges imposed by the legislature upon persons or property to raise money for public purposes..We have established, we think, beyond cavil, that there can be no lawful tax which is not laid for a public purpose.."

Bottom line, public purpose is synonymous with governmental purpose.

"Public purpose" may have been expanded in more recent

times, but clearly, the issuance of bonds for payment of private debt is not a public purpose.

2. Secondly, the Commerce Clause of the Federal Constitution creates an area of free trade among the states. The power of states to tax interstate commerce is very limited. The tax in H.B. 3050 is clearly laid upon the privilege of engaging in interstate commerce. The 1954 U.S. Supreme Court decision, Michigan-Wisconsin P.L. Co. v. Calvert, 347 U.S. 157, 98 L.Ed. 583, 74 S.Ct. 396, which happened to involve my client, Panhandle Eastern, over a Texas tax on the occupation of gathering gas, based on the volume of gas taken, summarizes the problem involved:

> "The tax is on the privilege of carrying on interstate commerce itself. When gas has been lawfully produced, it, like any other commodity, is a lawful article of commerce; and the right to transport the gas to other states, which necessarily includes the right to take possession of it for such transportation, is not derived from the State. The right arises under and is protected by the Commerce clause. It may not be taxed by the State, 'no matter how specious may be the pretext' for imposing the tax." 98 L.Ed. 583, 586

In any event, a state tax on interstate commerce must fairly relate to the services provided by the State. Washington Rev. Dept. v. Washington Stevedoring Assn., 435 U.S. 734, 750. (1978) A compensatory tax first requires identification of the burden for which the state is attempting to compensate. The "privilege' tax proposed in H.B. 3050 does not purport to the related to services provided by the State in any manner. It is apparently imposed simply for the privilege of doing business in Kansas. If every state were free to impose a tax for the privilege of

flowing gas across its borders, the cost to the ultimate consumer would be prohibitive. The founding fathers opted for free traverse of commerce and the wisdom of that decision is obvious. Additionally, H.B. 3050 discriminates against interstate commerce in that the proposed tax is levied only on intrastate pipeline volumes that are regulated by the KCC. Accordingly, the proposed tax would be applied to interstate volumes of gas moving in Kansas, but would be inapplicable to some intrastate gas. Clearly a proscribed burden on interstate commerce, and violative of the Commerce Clause of the federal constitution.

3. H.B. 3050 also violates the Supremacy Clause of the U.S. Constitution. Maryland vs. Louisiana, 452 U.S. 456, (1981) is in point on both the Commerce and Supremacy Clause issues. The U.S. Supreme Court concluded that a Louisiana proposed tax on natural gas produced from the outer continental shelf was unconstitutional under both clauses. That tax was equal to the state's severance tax and imposed for the stated purpose of reimbursing Louisiana for damages to the state's wet lands and coastal areas, and was further designed to equalize competition between the gas producers of Louisiana that were subject to the state severance tax and the offshore gas that was not. Even with this attempt to vest the tax with a public purpose, the Court struck it down on both counts, noting that the Natural Gas Act and the Natural Gas Policy Act were intended to provide FERC with authority to regulate the wholesale pricing of natural gas in interstate commerce from wellhead to delivery to consumers.

Interestingly, the Court relied on the Kansas case of Northern Natural Gas Company vs. The State Corporation Commission, 372 U.S. 84, 92 (1963), which overturned a KCC regulation requiring ratable takes by pipelines from the Hugoton field, holding that the KCC rule violated the superior interests of the Federal Government in the matter.

H.B. 3050 puts the KCC on a collision course with the FERC by vesting the KCC with the power to "determine eligibility" for payment of pipeline claims and for the approval of the payment thereof. (Sec. 2 (b)) Additionally, the "discretion" vested in the KCC, for the approval of claims for refunds, "without interest" (Sec. 2 (c)) is clearly violative of the FERC Order and federal judicial decisions. The attempt to vest the KCC with jurisdiction in these areas and given the apparent purpose of H.B. 3050 of subverting the FERC decision by requiring reimbursement of producers for their FERC ordered repayment obligation to consumers, through a "privilege tax" that ultimately would be borne by interstate gas consumers, it is clear that this Bill would be violative of the Supremacy Clause.

We submit that the absence of a public purpose for H.B. 3050, and its impermissible burden on interstate commerce and the federal preemption issue renders it not only bad public policy, but violative of the Federal and Kansas Constitutions.

H.B. 3050 WOULD FRUSTRATE ALTERNATIVE RESOLUTION OF THE PROBLEM.

A. LIABILITY OF ROYALTY OWNERS. FERC does not have jurisdiction over royalty owners, to order them to refund taxes

because they were not the sellers of the gas. The producers are responsible for the royalty owners portion of the tax reimbursement obligation and have a claim against the royalty owner to recover the overpayment when the producer makes the refund. The FERC Order issued September 10, 1997, outlining procedures for refund of the tax reimbursement, provides that FERC will grant waivers to producers who can demonstrate that the refund from the royalty owner is "uncollectible". The standards of uncollectability are set out in Wylee Petroleum Corp., 33 FERC. (CCH) 61,014 (1985) to-wit:

> "If the royalty owner (1) is deceased and the estate is closed, or (2) if bankrupt, and the bankruptcy proceedings are closed, or (3) cannot be located, or (4) the statute of limitation has run."

As a response to the royalty owner problem, the legislature enacted what is now K.S.A. 55-1624 in the 1998 session, declaring that recovery from the royalty owners is barred by the statute of limitations. (See attachment) Suits have been filed by Amoco, Plains Petroleum, OXY USA, and Anadarko, which have been consolidated for trial in Stevens County, Kansas, in which the issue of "collectability" from the royalty owners will be decided. The Attorney General has been permitted to intervene in behalf of the State of Kansas in defense of the challenges to the constitutionality, validity and legality of K.S.A. 55-1624. Judge Tom Smith of Liberal has set alternative hearing dates of April 6th and July 26th for determination of "dispositive motions" on the statute of limitations issue. The liability of the royalty owners will thus be determined by Kansas Courts, and

apparently within a reasonable time frame. The FERC is simply not involved in that issue. If the royalty owners prevail, under the Wylee standard, producers should also be "off the hook" for that part of the reimbursement obligation. Hopefully the legislature will not try to anticipate the judicial outcome by enacting this Bill.

B. PRODUCER LIABILITY: Offers of settlement have been filed with FERC by the Missouri Public Service Commission, Panhandle Eastern Pipe Line Company, Williams, Colorado Interstate Gas Company, the Colorado Public Service Commission and others, proposing reductions designed to alleviate the burden of the refund obligation on small producers and royalty owners. Discussions are ongoing to this end and meetings will be forthcoming with the producers, pipelines and most importantly, the affected customers and regulatory commissions. Although some may contend that legislative action will spur the settlement process, in fact, the threat of this legislation frustrates the ability to negotiate on a pipeline by pipeline basis, which all parties have concluded is the only practical way to proceed. Obviously, no single pipeline, nor most particularly, its customers, are going to agree to a settlement that still leaves them exposed to the possibility of having a tax burden imposed on them by passage of this legislation. Rather than a club to achieve settlement, the legislation is a barrier to it. The proponents of this legislation fail to appreciate the great divergence of views held by the pipeline customers and regulators

that would be foregoing the tax refund by entering into settlement agreements. They fail to recognize the inability of the pipelines to achieve a settlement satisfactory to the producers, without the consent of their affected customers and the regulatory agencies involved. Passage of this legislation would bring an instant halt to the settlement process. The threat of its pendency totally frustrates achievement of individual settlements. A legislative "solution" can only result in continued interminable litigation.

The understandable concern of the legislature for the pay-back obligation of the small producers and royalty owners tends to overlook the fact that Kansas gas production in the 1983/1988 era that is at issue, was dominated by a few large producers. Ten companies currently produce over three-fourths of all Kansas gas. Just two multi-national companies would receive over 1/3rd of the entire refund derived from the bond issue.

However desirous you may be for legal or political relief for this whole unhappy scenario, H.B. 3050 does not constitute a viable remedy. It is not the answer. It is legally impermissible and an economic nightmare.

We urge your rejection of this measure.

Respectfully submitted,

Jack Glaves
Legislative Counsel in behalf of
Panhandle Eastern Pipe Line Company
and Kinder/Morgan, Inc.

Exhibit G

ESTIMATED ALLOCATION OF *KANSAS AD VALOREM TAX REFUNDS (INCLUDING INTEREST) BY STATE* AS OF MARCH 31, 1999

#	STATE	ESTIMATED %	TOTAL REFUNDS DUE
1	Kansas	22.556	$60,466,040
2	Missouri	16.856	$45,186,007
3	Minnesota	13.276	$35,589,074
4	Nebraska	10.262	$27,509,421
5	Colorado	6.567	$17,604,207
6	Illinois	6.335	$16,982,283
7	Iowa	5.460	$14,636,663
8	Indiana	4.764	$12,770,891
9	Michigan	3.534	$9,473,621
10	Wisconsin	2.227	$5,969,936
11	Ohio	1.754	$4,701,961
12	California	1.581	$4,238,199
13	Oklahoma	1.431	$3,836,093
14	Texas	1.129	$3,026,519
15	South Dakota	0.981	$2,629,774
16	Wyoming	0.871	$2,334,896
17	Arizona	0.242	$648,731
18	New Mexico	0.061	$163,523
19	Nevada	0.048	$128,674
20	Louisiana	0.039	$104,548
21	Arkansas	0.022	$58,976
22	Utah	0.003	$8,042
23	Tennessee	0.001	$2,681
	Total	100.00	$362,968,627

Kansas — Natural Gas 1998

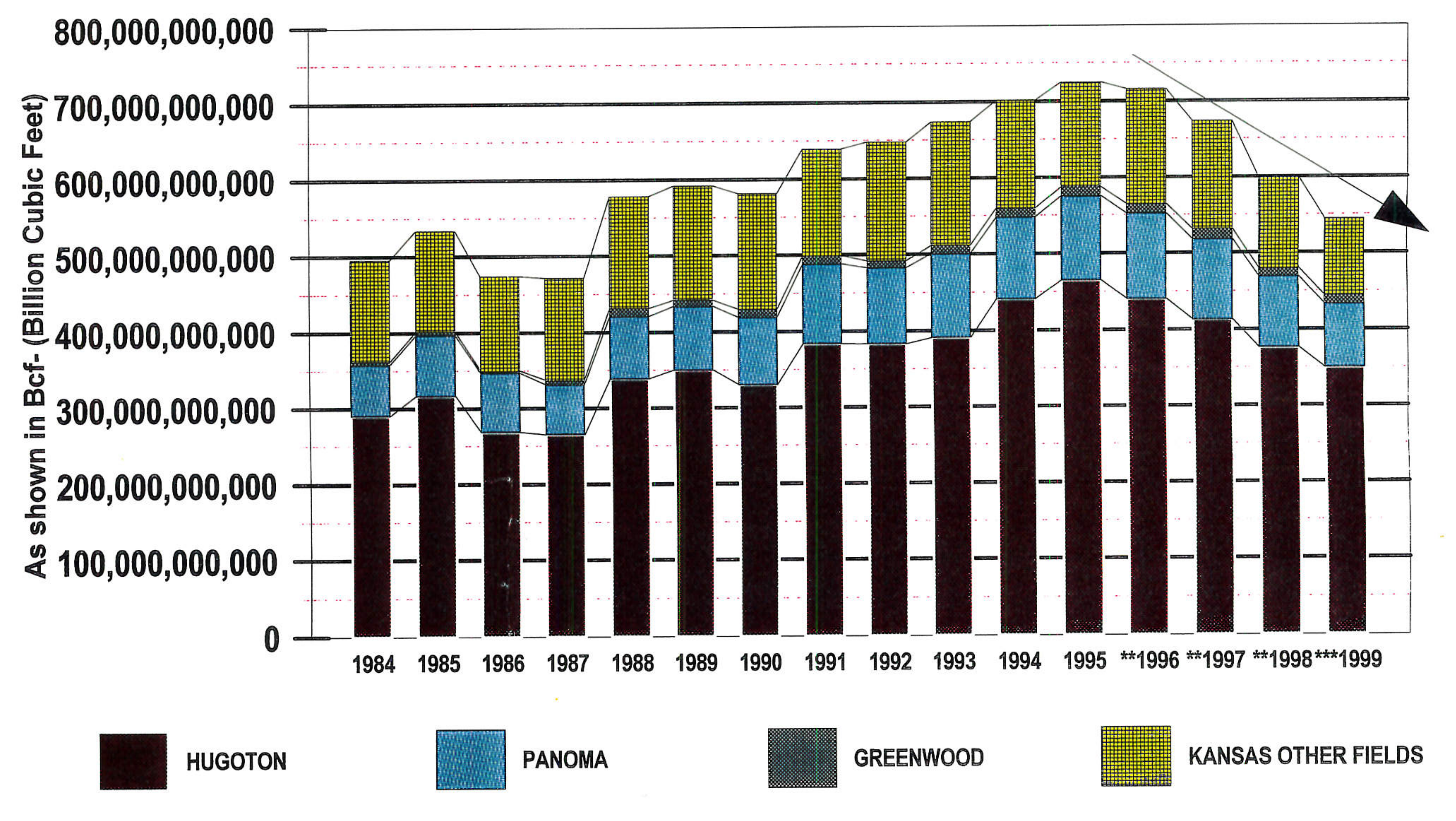
	Million Cu. Feet	Percent of National Total		Million Cu. Feet	Percent of National Total
Net Interstate Movements:	-80,882		Industrial:	111,143	1.28
Marketed Production:	603,586	3.07	Vehicle Fuel:	0	0.00
Deliveries to Consumers:					
Residential:	70,217	1.55	Electric Utilities:	36,896	1.13
Commercial:	41,788	1.39	Total:	260,044	1.34

Table 63. Summary Statistics for Natural Gas — Kansas, 1994-1998

	1994	1995	1996	1997	1998
Reserves (billion cubic feet)					
Estimated Proved Reserves (dry) as of December 31	9,156	8,571	7,694	6,989	NA
Number of Gas and Gas Condensate Wells					
Producing at End of Year	19,365	22,020	21,388	21,500	21,000
Production (million cubic feet)					
Gross Withdrawals					
From Gas Wells	628,900	636,582	629,755	618,016	532,594
From Oil Wells	85,759	86,807	85,876	71,037	72,626
Total	**714,659**	**723,389**	**715,631**	**689,053**	**605,220**
Repressuring	1,215	1,230	2,120	1,157	1,029
Nonhydrocarbon Gases Removed	NA	NA	NA	NA	NA
Wet After Lease Separation	713,444	722,159	713,511	687,896	604,191
Vented and Flared	715	723	716	680	605
Marketed Production	712,730	721,436	712,796	687,215	603,586
Extraction Loss	46,936	47,442	47,996	38,224	45,801
Total Dry Production	**665,794**	**673,994**	**664,800**	**648,991**	**557,785**
Supply (million cubic feet)					
Dry Production	665,794	673,994	664,800	648,991	557,785
Receipts at State Borders					
Imports	0	0	0	0	0
Intransit Receipts	0	0	0	0	0
Interstate Receipts	1,127,799	1,140,230	1,219,027	1,201,629	1,070,930
Withdrawals from Storage					
Underground Storage	99,851	110,567	116,989	103,475	98,402
LNG Storage	0	0	0	0	0
Supplemental Gas Supplies	0	0	0	0	0
Balancing Item	20,703	8,173	-3,039	R-50,157	-144,189
Total Supply	**1,914,147**	**1,932,964**	**1,997,776**	**R1,903,939**	**1,582,927**

See footnotes at end of table.

10-13



DPW/KCC - 1/10/2000 . ** 1996-1999 GAS % MAY BE SUBJECT TO K.D.O.R. REVISIONS. ***1999 Volumes Have Been Estimated.

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.

TOP TEN LIST OF OIL & GAS PRODUCERS IN KANSAS*

FOR CALENDAR YEAR - 1997

EXHIBIT 4

CO. NAME-OIL	ANNUAL PRODUCTION (Bbl.)& (% KS.TOTAL)	-CO. NAME-GAS	ANNUAL PRODUCT (MCF)&(% KS. TOTAL)
1. BEREXCO INC.	2,538,672 (6.2)%	1. MOBIL OIL CORP.	107,305,936 (16)%
2. OXY USA INC.	2,393,009 (5.9)%	2. ANADARKO PET.	95,603,488 (14.3)%
3. ANADARKO	1,415,803 (3.5)%	3. AMOCO PROD.	94,760,235 (14.1)%
4. HUGOTON ENERGY	1,054,297 (2.6)%	4. OXY USA INC.	80,954,512 (12.1)%
5. N. AMERICAN RES.	621,354 (1.5)%	5. PIONEER (MESA)	71,577,699(10.7)%
6. VESS OIL CORP.	612,497 (1.5)%	6. HELMERICH & PAYNE	19,990,057 (3)%
7. McCOY PET. CORP.	608,006 (1.5)%	7. PLAINS (BARRETT)	15,747,195 (2.3)%
8. RITCHIE EXPL.	564,363 (1.4)%	8. VASTAR (ARCO)	11,713,793 (1.7)%
9. EQUINOX OIL	503,265 (1.2)%	9. HUGOTON ENERGY	11,375,881 (1.7)%
10. MURFIN DRILLING	492,315 (1.2)%	10. KS. NATURAL GAS	8,962,288 (1.3)%

KCC/DPW 8/20/98 *DATA Source : From K.D.O.R. & Compiled by K.G.S. on 8/19/98.

HOUSE UTILITIES
DATE: 4-6-00
ATTACHMENT 11

Length of Amortization

	10 Years	15 Years	20 Years	25 Years	30 Years	40 Years
Required Annual Revenue:	$ 66,725,000	$ 50,860,000	$ 42,532,000	$ 38,110,000	$ 35,535,000	$ 33,680,000
Annual Natural Gas Transportion (cubic feet in 000s for year 2001):						
Level Transportation:	1,582,927,000 → ~~15,829,270~~	~~15,829,270~~	~~15,829,270~~	~~15,829,270~~	~~15,829,270~~	~~15,829,270~~
2% Annual Decline:	1,489,838,229 → ~~14,898,382~~	~~14,898,382~~	~~14,898,382~~	~~14,898,382~~	~~14,898,382~~	~~14,898,382~~
10% Annual Decline:	1,153,953,783 → ~~11,539,538~~	~~11,539,538~~	~~11,539,538~~	~~11,539,538~~	~~11,539,538~~	~~11,539,538~~
Implied Tax Rate:						
Level Transportation:	$ 0.0422	$ 0.0321	$ 0.0269	$ 0.0241	$ 0.0224	$ 0.0213
2% Annual Decline:	$ 0.0470	$ 0.0375	$ 0.0327	$ 0.0305	$ 0.0290	$ 0.0285
10% Annual Decline:	$ 0.0810	$ 0.0725	$ 0.0700	$ 0.0682	$ 0.0670	$ 0.0660

This analysis should be used for estimation purposes only. Assumptions made for this analysis are based on the best available information at the time of this analysis. No representation is made as to the accuracy of these assumptions. Changes to these assumptions may have a material impact on these projections.

Prepared by Kansas Development Finance Authority 4/6/00