Approved: March 17, 2000
Date

MINUTES OF THE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES.

The meeting was called to order by Chairperson Senator David Corbin at 8:00 a.m. on March 13, 2000 in 245-N of the Capitol.

All members were present except: Senator Pugh who was excused.:

Committee staff present:
Raney Gilliland, Legislative Research Department
Mary Ann Torrence, Revisor of Statutes Office
Lila McClaflin, Committee Secretary

Conferees appearing before the committee:
Senator Steve Morris
Carla Stovall, Attorney General
Gordon Gooch, Kansas Independent Oil and Gas Association
Robert Krehbiel, Kansas Independent Oil and Gas Association
Eric Nordling, Southwest Kansas Royalty Owners Association
Gregg Stuckey, Southwest Kansas Royalty Owners Association
James Ramsberg, Wichita, KS
Jack Glaves, Pan Handle Eastern Pipe Line Co., and Kinder Morgan Inc.
Gary Boyle, Williams Company
Rick Smead, Coastel Corporation
Mary Kay Miller, Northern Gas Company
Jim Bartling, Greeley Gas
Linda Wood, Chief Financial Analyst, Kansas Development Finance Authority
Walker Hendrix, Citizens Utility Ratepayer Board
Bill Dirks, AARP's, Kansas State Legislative Committee

Others attending:
See attached list.

The hearing was opened on **SB 571**–natural gas producer ad valorem tax refund.

A fiscal note was distributed notifying the committee that the Division of the Budget was awaiting a response from agencies in order to complete the fiscal note.

Steve Morris, Senator 39th District, reviewed the FERC Ad Valorem Tax Refund Issue, going back to 1974. He said **SB 571** will solve the problem, as it sets up a mechanism that allows the state to sell bonds and actually make refunds, and he explained how the bonds would be repaid (Attachment 1).

Carla Stovall, Attorney General, urged the support of the bill, as it redresses an unjust ruling having detrimental effects on a significant sector of the Kansas economy. She urged the committee to support the bill to correct the effects of an unjust and unreasonable decision by a federal administrative agency against the sovereign state of Kansas (Attachment 2). Attorney General Stovall responded to questions.

Gordon Gooch, former general counsel of the FERC, gave a historic review of the issue. He urged support of the bill, since neither the federal courts, FERC nor congress appear included to alleviate this injustice, and this legislature through **SB 571** can alleviate the detrimental affect on the Kansas economy (Attachment 3).

Robert E. Krehbiel, Kansas Independent Oil and Gas Association, supported the bill, as it is the most significant issue facing the members of their association. He said **SB 571** is an attempt to correct, at the state level, what has been appropriately described as 'the worst tax atrocity ever perpetrated by a federal agency". Attached to his testimony are many supporting documents (Attachment 4).

Erick E. Nordling, Executive Secretary, Southwest Kansas Royalty Owners Association, Hugoton, KS, testified on behalf of all of their royalty owners in support of the bill, which would relieve those royalty owners of the threats of payment of those unjust and ancient claimed debts associated with the discharge of the assessment of Kansas ad valorem taxes over a decade ago (Attachment 5). Included with his

testimony is a copy of an executive summary by John Majeroni, Cornell University Real Estate Department giving eight reasons why he thought the royalty owners should be granted relief from refunds and interest on taxes dating back to 1983-1988.

James C. Remsberg, President of Argent Energy, Inc., said he could not comprehend that a regulatory body constituted in this county could hold his company liable for repayment of reimbursement which it did not receive, on properties it did not own, during a time period before it existed, and having no possibility of recoupment from the now non-existent seller (Attachment 6).

Jack Glaves, Panhandle Eastern Pipe Line Company and Kinder/Morgan, Inc., urged the rejection of the bill, as it was not the answer. He said it is legally impermissible and an economic nightmare (Attachment 7).

Gary Boyle, Williams Gas Pipelines Central, Inc. opposed the bill because it is unconstitutional and unwise (Attachment 8). He responded to questions.

Richard G. Smead, Colorado Interstate Gas Company and ANR Pipeline Company, urged 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 this problem behind us. **SB 571** would not succeed legally, but even if it did, it would impose an unwarranted burden on consumers (Attachment 9).

Walker Hendrix, Citizens' Utility Ratepayer Board, encourage the rejection of the bill to protect the interest of the consumers. **SB 571** serves no public purpose and is in serious conflict with federal law (Attachment 10).

Mary Kay Miller, Northern Natural Gas, requested the committee look for other methods of existing processes to settle this issue. They believe that mutual agreement of some form of resolution is the only timely way this complex issue can be resolved (Attachment 11).

James W. Bartling, Manager Public Affairs, Greeley Gas Company and Atmos Energy Corporation, opposed the bill. It is a tax they would have no recourse but to pass along to their customers, and it would be difficult for their business to support this added cost to their customers (Attachment 12).

Linda Wood, Chief Financial Analyst, Kansas Development Finance Authority, presented an issues paper outlining some of the difficulties they see with selling the bonds and other conflicts and questions that they see with the bill (Attachment 13).

Bill Dirks, AARP Kansas State Legislative Committee, opposed the bill as FERC and the United States Court of Appeals for the DC Circuit have found this tax to be illegal, and they asked that the refunds they deserve be refunded to consumers (Attachment 14).

Written testimony supporting the bill was submitted from:
Senator Pat Roberts (Attachment 15)
Congressman Jerry Moran, (Attachment 16)
Ron Hein, on behalf of Pioneer Natural Resources U.S.A., Inc. (Attachment 17)
Written testimony submitted opposing the bill:
Kansas City Power and Light (Attachment 18)

The hearing on **SB 571** was closed.

The meeting adjourned at 10:00 a.m., and the next scheduled meeting will be on March 14, 2000, at 8:00 a.m.

SENATE ENERGY & NATURAL RESOURCES COMMITTEE GUEST LIST

DATE: MARCH 13, 2000

NAME	REPRESENTING
ELISABETH MYERS-KERBAL	SHOOK HARDY & BACON FOR KANSAS CORPORATION COMM'N
R Gordon Gooch	Travis & Gooch / KIOGA
Jack McClaves	Panhandle Eastern & Kinder Morgan
WILLIAM W. GRYGAR	PANHANDLE EASTERN PIPE LINE CO.
merLin Rommenger	" " "
Brady Cantrell	CURB
Carmen Morrissey	Missouri Public Service Commission
ALAN HOFFMAN	KANSAS NATURAL GAS, INC.
Gene Elrod	Plains Petroleum Company
TIM MCKEE	PLAINS PETROLEUM COMPANY
David Seely	Southwest Kansas Royalty Owners Assn.
Gregory J. Stucky	Southwest Kansas Royalty Owners Ass'n
ERICK E. NORDLING	" (SWKROA)
BRUCE GRAHAM	~~KCPCO~~ KEPCo
Pat Hubbell	Anadarko
DICK CARLTON	ENRON
D J Wa	BEARING
Bob W. Ison	WNG
Whitney Damron	ONEOK/KGS

SENATE ENERGY & NATURAL RESOURCES COMMITTEE GUEST LIST

DATE: 3-13-2000

NAME	REPRESENTING
Tim Kissner	Northern Natural Gas Co.
N. Vandenberg	Coastal States Mgmt
Jim Talcott	Enron
James G. Flaherty	Anderson Byrd Richeson Flaherty + Haskins.
James W. Bartling	Atmos Energy Corporation Greeley Gas Company
Bob Aderson	"
Beverly Mohr	Mobil oil
Mary Kay Miller	Northern Natural Gas
Steve Johnson	Kansas Gas Service
David Francis	Utilicorp United
Russell Freeman	Self
Jim Bob Mobil	Mobil Oil Co
Nancy Lindberg	AG
Dixie Wood	KDFA
Diana Edmiston	KCC

SENATE ENERGY & NATURAL RESOURCES COMMITTEE GUEST LIST

DATE: 3-13-2000

NAME	REPRESENTING
Ron Eaches	CIG & WILLIAMS
Chuck Dehart	Williams
Bob Krehbiel	KCCGA
Donald L. Pitts	KS AG office
Nancy J. Skancke	Pioneer, Helmerich + Payne, Harken Energy, Dorchester, Midgard, Eastman Dillon
Ron Hein	Pioneer
Barb Morris	
Debbie Beaver	Williams
Tim Thuston	Williams
DARYL JOHNSON	WILLIAMS
James D. Albright	Public Service Co. of Colorado, Cheyenne Light, Fuel & Power Co.
KAROLYN NEWMAN	Public Serv Co. of Colorado, Cheyenne Light, Fuel & Power Co.
Woody Moses	KAPA
Martin Haaver	Haaver's Capitol Report
Ben Breland	Kinder Morgan
JOE STERRETT	KINDER MORGAN
Cynthia Smith	KCPL
Rick Smead	CIG & ANR
Kraig Gross	Kansas Natural Gas, Inc.

SENATE ENERGY & NATURAL RESOURCES COMMITTEE GUEST LIST

DATE: 3-13-2000

NAME	REPRESENTING
Joseph W. Jeter	Ks Nat'l Gas, Inc
Steve M. Dillard	Pickrell Drilling Co., Inc. KIOGA
Wm Jack Rebio	Western Resources
Dave Holthaus	" "
Ken Peterson	Ks Petroleum Council
Susan Cunningham	KCC
WALKER HENDRIX	CURB

STATE OF KANSAS

STEVE MORRIS
SENATOR, 39TH DISTRICT
600 TRINDLE
HUGOTON, KS 67951
(316) 544-2084

STATE CAPITOL BUILDING, ROOM 143-N
TOPEKA, KS 66612
(785) 296-7378

TOPEKA

SENATE CHAMBER

COMMITTEE ASSIGNMENTS
CHAIRMAN: AGRICULTURE
SRS TRANSITION OVERSIGHT
VICE CHAIR: ENERGY AND NATURAL RESOURCES
MEMBER: CHILDREN'S ISSUES
ORGANIZATION, CALENDAR AND RULES
STATE BUILDING CONSTRUCTION
UTILITIES
WAYS AND MEANS

SENATE ENERGY AND NATURAL RESOURCES COMMITTEE
March 13, 2000
SB 571

Background on FERC
Ad Valorem Tax Refund Issue

In 1974 the Federal Power Commission told Kansas gas producers that they could pass on their property tax expense as a cost of production. These Kansas companies did pass this cost on as it was a routine procedure at that time.

In 1978 the Federal Power Commission became the Federal Energy Regulatory Commission (better known as FERC). FERC reaffirmed this policy when the Natural Gas Policy Act of 1978 was passed. FERC continued to reaffirm this policy throughout the 1970's and 1980's.

In 1993 FERC reversed their position and required producers to refund this expense item, plus interest for the period of 1988-1993. This action is equivalent of the IRS telling you that you no longer can deduct mortgage interest from your taxes and have to refund the deduction plus interest for the last 40 years.

Later several pipeline companies went to FERC telling them they were not satisfied with the dates of 1988-1993. FERC decided in September of 1997 to require producers and royalty owners to refund those monies from 1983-1988, including interest. I believe this is terrible public policy, totally unfair and unreasonable. I just cannot imagine any government agency, federal or state, doing something that is so grossly unfair.

The 1998 Kansas Legislature passed a statute that would have exempted royalty owners based on the statute of limitations and that fact that FERC has no jurisdiction over royalty owners. FERC totally ignored this legislation.

In February, 1999 a meeting was set in Washington, D.C. with Governor Graves, Senator Roberts, Senator Brownback, Congressman Moran, the KCC, KIOGA, Southwest Kansas Royalty Owners and others to meet with FERC. The meeting took place but no one from FERC would attend. During the meeting they (FERC) sent word that they would respond to written questions if they liked the questions. Needless to say, that showed the continued arrogance of this federal agency.

Senate Energy & Natural Resources

Attachment: 1

Date: 3-13-2000 1-1

Shortly after this meeting, Senator Roberts and Senator Brownback were successful in getting an amendment placed on a federal appropriations bill that removed all of the interest from this equation. This measure made it through the Senate process and to a conference committee with the House. At that time some lobbyists convinced the neighboring states' congressional delegations that their consumers were due to get millions in refunds from this process, and we lost the provision to remove the interest.

It appears that every solution we have proposed has been vigorously opposed by the "parties" on the other side of this issue.

Senate Bill 571 is a bill that will solve the problem. It sets up a mechanism that allows the state to sell bonds and actually make these refunds. The bonds would be repaid by a one cent per thousand cubic foot fee on the natural gas passing through Kansas natural gas pipelines. Originally the rationale (and I use this term very loosely in this instance) behind FERC's decision was to provide consumers refunds from this money. Under SB 571 consumers would actually get this money. Also, when the state is involved with these refunds, the total amount reverts back to the principle amount (roughly $120 million) instead of the $360 million which has all of the interest included.

Many of our small Kansas gas producers could be headed to bankruptcy if forced to pay these millions of dollars. The vast majority of royalty owners are not wealthy people and may never see another royalty check during their lifetimes, which many use to supplement their social security checks.

This is a very sad chapter of unprecedented government arrogance and abuse of power. SB 571 can be used to help undo much of the damage that has occurred because of this action. I would be glad to answer questions.

State of Kansas

Office of the Attorney General

CARLA J. STOVALL
ATTORNEY GENERAL

SENATE ENERGY AND NATURAL RESOURCES COMMITTEE
TESTIMONY REGARDING
SENATE BILL 571

by
Carla J. Stovall
Attorney General
March 13, 2000

Mr. Chairman, members of the committee, thank you for the opportunity to appear before your committee in support of SB 571, introduced by Senator Morris. I would like to give a brief overview of the laws and legal decisions which have brought us to the current situation, followed by a brief statement in support of the bill. The details of the bill itself will be presented to the committee by Gordon Gooch, former General Counsel of the FERC, who will testify following me.

Historic Review

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

In 1974, in Opinion No. 699, the FPC authorized producers to recover "production, severance, or other similar taxes." The effect of this was to allow producers to add onto the MLP an amount equal to these taxes. At this time, Kansas

120 S.W. 10TH AVENUE, 2ND FLOOR, TOPEKA, KANSAS 66612-1597 ■ PHONE: (

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did not have a severance tax, but an *ad valorem* tax, and in 1974 after Opinion No. 699 was issued, the Kansas Corporation Commission filed a request with the FPC to clarify whether Kansas producers were specifically allowed to recover the Kansas *ad valorem* tax. The FPC responded by issuing Opinion No. 699-D which ruled that Opinion No. 699 allowed producers to recover the Kansas *ad valorem* tax in excess of the MLP.

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

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

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

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

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

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

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

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

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

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

I would also note that neither the producers nor the royalty owners are the J.R. Ewings we remember from the television show, living in mansions and driving expensive automobiles. The royalty owners are retired farmers who have come to rely on the little "gas check" each quarter to supplement their Social Security. The producers are often small family companies that are now on the brink of bankruptcy as

they face this court's mandate to pay refunds.

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

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

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

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

Judicial, Administrative and Legislative Remedial Action

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

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

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

Congress has also been a forum in which we have sought relief. Petitions for redress of grievances have been presented to Congress and have been pursued vigorously by Senators Roberts and Brownback and Congressman Moran and the rest of the Kansas delegation. The bills did not seek waiver of the entire debt, but just of the obligation to pay interest. It is probably not surprising that our delegation has been unable to get this issue high on leadership's agenda as it affects only producers and

royalty owners with interest in Kansas natural gas. It is a essentially viewed as a parochial problem and not one likely to receive Congressional remediation. Thus, it is up to us to help ourselves.

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

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

SB 571

Remedies have all but been exhausted, however, there is a bright spot of hope. There is one way that the State of Kansas can right this terrible injustice: it can legislate in areas where the FERC, indeed the federal government, has no jurisdiction. This is the genesis of SB 571, which mounts an effective and just solution desperately needed to protect Kansas' vital gas interests from the excessive and unreasonable exercise of power by the FERC and the Federal Courts. This Legislature can extinguish all liability for both principal and interest.

When the D.C. Circuit dismissed Kansas' argument in our September argument regarding the disastrous impact the refund obligation would hold for the Kansas

economy in general and the gas industry in particular, it held voiced its recognition that we could remedy our own problems. The Court stated, Kansas "...retains numerous avenues for aiding" producers if it so desires. *Anadarko Petroleum Corp. v. FERC, 196 F.3d 1264 (D.C. Circ. 1999).* The passage of SB 571 would allow us to capture the opportunity to right the unfathomable wrong which has been perpetrated upon Kansas government, Kansas business, and Kansas citizens.

Conclusion

I urge you to support this bill. It redresses an unjust ruling having detrimental effects on a significant sector of the Kansas economy. I also urge you to support this bill to correct the effects of an unjust and unreasonable decision by a federal administrative agency against the sovereign state of Kansas. Since neither the federal courts, FERC nor Congress appear inclined to alleviate this injustice, this legislature can through SB 571 alleviate the detrimental affect on the Kansas economy.

Although I will continue the fight on all fronts to right this terrible injustice perpetrated by the FERC and the federal courts, you can do more than is within my power. "Fools" though you and I may be in the eyes of the DC Circuit, fools for trusting in the federal government to honor its precedents or, if not, to make only prospective adjustments, you are not powerless to rectify this injustice. Indeed, you are the only institution with the power to eliminate the liability. That power rests soundly in the passage of SB 571. Let us work together to achieve justice.

BEFORE THE
SENATE ENERGY AND NATURAL RESOURCES COMMITTEE

Senate Bill No. 571
(Hearing March 13, 2000)

TESTIMONY OF R. GORDON GOOCH

Summary

The State of Kansas has the rare opportunity to exercise the basic Constitutional principle of "checks and balances" to correct a terrible injustice and, if desired, to raise revenues for the citizens of Kansas without necessarily imposing a tax upon them. Some or all of the tax may never be passed on to consumers, either in Kansas or in some other State. If the pipelines did try to recover, say, a 1 cent per Mcf tax in rates, an average householder in the Midwest would have to pay about $1.20 a year, if the Federal and State Commissions with jurisdiction so permitted. Although I personally expect the pipelines to absorb some or all of this cost because of their excess profit margins, I recognize that it is standard public utility law that taxes paid by a regulated company can be recovered in rates. That it is why it is so outrageous that Kansas producers and royalty owners are denied the fair application of the same principle.

The FERC and its allies want some $360,000,000 in cash from Kansas producers and royalty owners, with the amount growing constantly due to claims of interest. In the year 2000 it was finally determined that producers and royalty owners should not have collected a reimbursement of the Kansas ad valorem taxes after October 4, 1983, from gas pipelines, if the amount received exceeded the maximum regulated price caps. Refunds of principal in the amount of $127,308,227 and interest at the floating prime rate, compounded quarterly, in the amount of $207,458,722 were claimed against some 750 groups of working and royalty interest owners in 1997.

Complete relief from this retroactive liability can only be provided by the State of Kansas. All federal remedies have either been exhausted or offer only partial relief. In order to pay off the pipeline claims, the State can refund to cover the liability being asserted against producers and royalty owners, without cost to the taxpayers of Kansas.

The plan is straight forward: first raise refund money, enough to cover all claims of principal and interest, through the sale of bonds. Second, fund the amortization of the bonds through a tax on transportation of natural gas by all pipelines operating within the protection of the State of Kansas, whether interstate or intrastate.

If the pipelines are not already earning profits in excess of the "guaranteed" profits built into their rates, then the pipelines can seek permission to recover the additional tax in rates. If their profits are already unjust and unreasonable, then no rates will be increased. These latter pipelines will then pay the tax out of their own excess profits. In the meantime, the funds received from the sale of the bonds will be cycled to consumers, at least that part that is not going to be skimmed off by the pipelines and distributors.

I. INTRODUCTION

My name is Gordon Gooch. I am a lawyer associated with the firm of Travis & Gooch in Washington D.C. I have the honor to be special counsel to the Kansas Independent Oil and Gas Association.

I also have the honor of representing Joel T. Strohl, Scott T. Strohl, and Sid Strohl, of Pretty Prairie, before the FERC in Docket Nos. GP99-16 and GP99-17. The Strohls believe that they owe nothing in either refunds or interest. So far, the FERC has refused to provide a full and fair hearing to determine whether the Strohls are, in fact, "guilty" of any overcharge. The pipeline involved, Northern Natural, has again objected to any hearing for the Strohls, claiming that there is no right to a hearing. If Nothern is correct, then there is no Constitutional right to due process of law before a person's property can be taken.

I am tendered as a witness by KIOGA in the hope that my years of experience in and around the federal regulation of energy in the Congress, the Courts, the independent agencies and the Executive Branch, including a stint as General Counsel of what is now the Federal Energy Regulatory Commission, might be useful to the State of Kansas. I also had the honor to serve as an advisor to Bill Clements on energy issues, both when he was Deputy Secretary of Defense and also when he was Governor of the State of Texas, representing the Governor in multi-State conferences on energy issues. I have testified numerous times before both House and Senate committees, sometimes as a committee witness. I have consulted with White House and Department of Energy officials in the legislative and regulatory process, and I have argued energy related cases in several of the United States Courts of Appeals and in the Supreme Court of the United States, as well as trying energy related cases in both Federal and State courts of original and appellate jurisdiction. I am a former Chair of the ABA Section of Public Utility, Transportation, and Communication Law, an organization that hopefully broadens my perspective on public utility issues. If I can be of any assistance, I certainly wish to do so.

I also have knowledge of the attempts to induce the FERC to provide due process of law to the producers and royalty owners who now hang in limbo, facing ever spiraling claims of interest. The interest claims are so high and growing that only the most intrepid producer can hold out and not capitulate. One has to have faith in the Constitution of the United States and hope that justice will be served. I will be pleased to answer questions of this nature also.

My task is to present views and comments on a solution tendered by Senator Morris and endorsed by the Southwest Kansas Royalty Owners Association and the Kansas Independent Oil and Gas Association.

II. KANSAS PRODUCERS AND ROYALTY OWNERS HAVE BEEN DECLARED TO BE OUTLAWS AND FOOLS

In order to understand the problem and this proposed solution, it is necessary to enter the arcane world of public utility regulation, as generally practiced in the United States.

First, public utilities regulated by the federal government through the Federal Energy Regulatory Commission are allowed to collect reimbursement of all taxes from their customers. That is, whether the tax is an income tax, state or federal, or an ad valorem tax, or any other kind of tax, the shareholders are free to shift the tax to customers. The taxes are "flowed through" in rates to be paid by the gas consumer. Public utility type regulation for interstate gas pipelines began in this country in 1938.

Second, in 1954 the Supreme Court of the United States held that producers of natural gas who sold to interstate pipelines were also "natural gas companies" subject to public utility type regulation. Within 20 years, gas supply had been wrecked, and the nation was plunged into serious curtailments of service.

In this era of curtailments in the 1970s, as the lack of incentives for producers in Kansas and elsewhere to risk their own money for a pittance bore its predictable fruit, the FERC (then known as the Federal Power Commission) tried to ease the burden on producers, although bound to stay within the public utility mold.

One of the things that the FPC did was to allow producers, like pipelines, to flow through production taxes and income taxes, just like the electric utilities and natural gas pipelines are allowed to do today.

An issue arose as to whether the Kansas ad valorem tax qualified as a production tax, and the Commission held "YES." This decision was requested by the State of Kansas. Obviously, if the answer had been "No", the State would have simply changed the form of the tax. This is purely a matter of form. After this decision, the FERC again had occasion to reconfirm that the Kansas tax did qualify for recovery in prices.

In 1978, as the curtailments were being brought under control and the nation vowed never to make the same mistake again, the Natural Gas Policy Act was passed. That act specifically recognized the validity of producers' recovery of production taxes in the sales price for their regulated gas. The legislative history noted the Kansas ad valorem tax as an example of the kind of taxes that could be passed on to the pipelines.

Kansas producers and royalty owners were thus reimbursed for the taxes paid, in the routine and usual regimen for public utilities, from the early seventies onward, beyond the passage of the NGPA. Since Kansas has always been generous with her natural resources, Kansas shared its production with a number of other states, via interstate pipelines. The ultimate customers of the pipelines and any intermediate distribution companies thus quite properly paid this cost of doing business.

In 1983, Nothern Natural, an interstate natural gas pipeline now part of the Enron Empire, asked the FERC to reopen the record and declare that "Northern is no longer required to

reimburse Kansas sellers of gas for said ad valorem tax." On October 4, 1983, a notice appeared in the Federal Register with this language in it.

Forgive me if I say that this language seems unambiguously to refer to a future, prospective change in the law. But that is not the law of the land, and all of us must and do respect the law of the land. (See the Federal Register notice, attached)

From that notice all persons in the United States were presumed to know what the law would be declared to be in the year 2000: that any collections of the Kansas ad valorem tax after October 4, 1983 would be retroactively unlawful, if the price thereby exceeded the price caps established by federal regulation.

While in hindsight, aided by the Court's year 2000 decision, this may be clear as crystal, it apparently did not appear to be clear to Northern and other pipelines. They continued to pay the reimbursement and continued to included charges for reimbursement in their rates. They did not, for example, escrow that money and let it earn interest. No, the payments shielded the bottom line of the pipelines, who now stand to profit by some $50,000,000.

This certainly did not seem clear to the Commission; the Commission again held that the Kansas tax did qualify, rejecting Northern's petition.

Six FERC Decisions and four Court of Appeals decisions later, spread over the intervening seventeen years from 1988 to and including the year 2000, it now has been settled that any payment for reimbursement for the Kansas ad valorem tax that caused the price received to exceed the regulated price for gas is unlawful -- retroactively to October of 1983.

If averages counted, four of the six Commission decisions held that there was no unlawful collection between 1983 and 1988, but the federal Courts and the Commission, working in tandem, have now made outlaws of thousands of Kansas producers and royalty owners, and mocked the producers and royalty owners as "foolhardy" for having had faith in their own government.

Thus, Kansas producers became both outlaws and fools.

The State of Kansas was also duped, since it would have been extremely simple to convert the ad valorem tax into a "pure" production tax in 1983. In fact, the State clearly knew how, since an additional production tax was added and that tax has never been challenged. But Kansas also trusted the federal government to honor its own precedents.

To add insult to injury, the FERC demands interest, starting in 1983, at the prime rate, compounded quarterly.

Here are the basic claims, as of November of 1997, when the pipelines were allowed to make the claims-- and the operators ordered to pay the claims in full, no questions asked or allowed. For consistency, no updates have been made to the original claims, as reported

by KIOGA to the honorable Joe Barton, Chair, and subcommittee on Energy and Power, Committee on Commerce, United States House of Representatives on August 4, 1999.

A. Total claims for refunds of principal and interest

Total Refunds claimed over period 1983-1988: $127,308,227

Total interest claimed through 1997 $207,458.723

Total Claims as of 1997 $334,766,949

Interest claims were over 162% of principal and growing.

The FERC was asked to waive interest on equity grounds, due to the long delay and the retroactivity involved, but the FERC declined and the Court of Appeals agreed. The Supreme Court has been asked to review this decision.

The Congress was asked to waive the interest on equity grounds, to no avail as yet. Pending legislation sponsored by the excellent Kansas delegation would operate to waive interest, thus reducing the maximum claims to $127,308,227.

B. Breakdown between producers and royalty owners (using conservative convention of 20% royalty and overriding royalty)

	Principal	Interest	Total
Producers	$ 101,846,582	165,966,978	267,813,560
Royalty Owners	$ 25,461,645	41,491,745	66,953,390

C. Breakdown of Dollars in 1997 Claims

Intrastate pipelines $15,128,359 (KCC jurisdiction)

Interstate pipelines intend to keep for selves: upwards of $47,028,857

Interstate pipeline affiliated producers, $44,453,309
(Incentive for pipeline to settle with own affiliate)

Local Distribution Companies keeps (unknown amount)

Whatever is left over is a potential refund to current consumers, including affiliates of the distribution companies. Estimates of the refunds to householders ranges from zero (on those pipelines that are keeping all of the refunds) to a maximum of about a one time refund of $40 out of an estimated annual $500 gas bill

D. Breakdown by size of claim

Individual Claims range from $22 to about $30,000,000, and some faced multiple claims up to a level of about $60,000,000. As the attached schedule shows, 10% of the total claims account for 91% of the amounts claimed. Stated the other way, 90% of the claims for refunds add up to $11,336,028 in alleged overcharges spread over a five and a half year period. That is, on average, the claim is for $16,794 per group of working and royalty owners, or $3,053 per year or fraction thereof. These amounts would further be allocated among the individual working and royalty interest owners.

Hearings, continuously demanded under the quaint notion that the Constitution of the United States forbids the taking of property without due process of law, have been ignored by the FERC.

The Congress of the United States has been petitioned for redress of grievances, but, despite the valiant efforts of the Senators and the Members from Kansas, as well as Chairman Joe Barton of Texas, no relief has been secured. What State would not like a share of some $360,000,000 or so extracted from Kansas producers and royalty owners?

In fact, no complete relief is even on the table in the Congress.

In the federal courts, there is no hope of reversing the decisions of the FERC and of the Court of Appeals, finding that some or all Kansas producers were outlaws; only a slender chance of perhaps getting some mitigation on interest remains.

There is no avenue of relief through the Executive branch, not even the Department of Energy.

III. COMPLETE RELIEF EXCLUSIVELY IN THE HANDS OF THE KANSAS LEGISLATURE

While all producers and royalty owners could be forgiven if they lapsed into despair, if not bankruptcy, there remains one hope: that the State of Kansas will exercise its undisputed jurisdiction under the Constitution of the United States and, in doing so, check and balance this excess of the federal government.

The Tenth Amendment, the inherent limitations of the Commerce Clause and of the Preemption Clause all provide the basis for achieving four results:

-- protecting the opportunity for current consumers to receive cash or credits as surrogates for past consumers

-- affording complete relief to all Kansas producers and royalty owners

-- providing potentially over $207,500,000 of new revenues without a direct tax on Kansas citizens and, to boot,

-- with the costs being placed first and perhaps last on those pipelines who make claims.

The two basic premises on which these results are possible are:

Who can dispute the jurisdiction of the State of Kansas to impose a tax on the transportation of gas to, from, through or within Kansas?

Who can challenge the justice and right of the State of Kansas to refund taxes that were collected in good faith by the State or its instrumentalities?

The plan is straightforward: first raise refund money, enough to cover all claims of principal and interest, through the sale of bonds. Second, fund the amortization of the bonds through a tax on transportation of natural gas by all pipelines operating within the protection of the State of Kansas, whether interstate or intrastate.

May I now tender my views on how the plan can impact on each of the constituencies noted above. In doing so, I do not mean to suggest that there are no other options to consider; I present what I believe to be the "base case."

A. Positive Impact on Gas Consumers in Kansas and other States.

There are two "barriers" standing in the way of some portion of claims in excess of $360,000,000 being distributed to current customers of natural gas on certain pipelines doing business in Kansas. An estimate furnished to the Congress by one of the protagonists to this case and controversy, the very large distribution utility, is that a residential customer may get a one-time credit of up to $20, after deduction of "expenses" by the local distribution companies. Other estimates range to a high end of about $40 for a one-time credit, assuming that no amount is kept by the local distribution companies.

The first barrier is that the FERC has allowed the interstate natural gas pipelines to retain some or all of the potential refunds for their own use and benefit. About $50,000,000 off the top will be kept by the interstate pipelines.

The second barrier is that the amount of the total refund due is not known. You see, the collection of the Kansas ad valorem tax for the benefit of producers and royalty owners was not declared per se illegal, in whole or in part. What was declared illegal is any portion of the reimbursement of the Kansas ad valorem tax, if any there be, that exceeded the maximum regulated price cap on each of thousands of wells, a price cap that changed virtually every month in this period.

There are potentially over 750 cases to be tried or adjudicated in some manner. Since the FERC procedures have separate process for "law" questions and for "equity" questions-- just as England had when Charles Dickens was a court reporter in Chancellor's Equity Court-- that means 1,500 cases to resolve.

Since the FERC has so far denied all demands for a hearing in order to determine whether, in fact, liability exists, the trend is for it to take eternity to arrive at an answer-- but for one thing.

While denying a hearing to those who have requested it, the FERC continues to threaten ever-growing interest payments. In 1997, the interest claims alone were 160% of the claims for principal, and three years have passed. The only way to stop the exponential interest growth is to pre-pay the claims of the pipelines, as is, with some vague promise that any overpayment ultimately determined will be reimbursed. Having been judicially determined to be fools for trusting the FERC, this promise holds cold comfort.

Millions of dollars remain in dispute and have not been pre paid. Some are in escrow, some are in the form of bonds, and some producers are in pure defiance of the Commission order to surrender property without a hearing or any due process of law.

How does this legislation handle this problem? First by paying off the CLAIMS for refunds asserted against qualified producers and all royalty owners. Thus, whatever dollars trickle down to the ultimate consumer through the pipeline and distributor screens will arrive sooner and without a string attached.

By paying off the claims, there is no need to drag multiples of 1,500 parties to Washington for a hearing, and the consumers who will receive a share of the refunds will not have to await the completion of this process, with its uncertain results.

B. Affording complete relief to Kansas producers and royalty owners.

First, there is an issue of justice here, and justice is priceless.

Second, if these producers and royalty owners are fools for trusting the federal government, are they also fools for trusting the State Government?

Refunds of the Kansas ad valorem taxes to those who paid them with the good faith belief that the taxes could be recovered in the sales price will allow the claims to be extinguished.

This is particularly important in a second respect: the FERC is forcing producers to sue royalty owners, and the Courts of Kansas are now clogged with unnecessary litigation.

Here is the situation: the FERC has no jurisdiction over royalty owners, as the State well knows. When the State passed legislation to relieve the producers and royalty owners from claims based upon the royalty portion of each claim, the FERC took it upon itself to nullify the State statute, impugning the motives of the Kansas legislature, and refusing to consider the statute for purposes of its equity jurisdiction. Kansas is appealing that decision, and it has been held in abeyance.

This issue is held in abeyance because of litigation on the "law" side of the Commission's jurisdiction, the Strohl cases, wherein the FERC is charged to honor the State statute as a matter of law, whether the FERC likes the motives of the Kansas legislature or not.

Still, while all this litigation is pending, the FERC is, metaphorically speaking, holding a gun to the head of all producers saying: either you collect the royalty portion from the royalty owners or you underwrite the royalty portion yourself.

Relieving the producers from all claims would moot the many cases now pending, where two groups, interlocked in interest despite occasional differences of opinion, now must be at each other's throats, and the administration of justice in Kansas must accommodate this unnecessary litigation.

C. Providing potentially over $207,000,000 in new state revenues

According to the precedent now in effect at the FERC, if the State refunds principal only, ALL CLAIMS OF INTEREST ARE BARRED! (See 18 C.F.R. Section 154.102(d).)

Now, since only fools trust in FERC precedent being followed, it is necessary to raise sufficient funds to pay the entire claims for both principal and interest.

However, if the first payment eliminates all claims for principal, then it will be seen whether the FERC honors its own precedent or changes that one too, retroactively.

If the payment of principal operates to extinguish all liability for both principal and interest now being asserted, then over $207,000,000 raised to cover this contingency can be put as the legislature directs. I would not presume to suggest how, but the options include an early retirement of the bonds, with suitable interest to make the bonds attractive to investors, to covering any shortfalls in the current or future State budget process.

I believe that this is pure legislative discretion.

However, if the FERC still allows interest claims to be asserted, dishonoring its own precedent, then the funds are there to pay off these claims, also.

D. with the costs being placed first if not last on the pipelines.

I know so little about the Kansas regulation of pipelines that I will confine my remarks to what I do know something about: FERC regulation of interstate gas pipelines.

Objectively, there are two potential polar outcomes:

First, the FERC allows the interstate pipelines to include a recovery of the new Kansas tax in rates, upon application of the pipeline, just as the FERC now allows the interstate pipelines to recover the present Kansas taxes, including ad valorem taxes.

If the FERC does receive applications to do so and grants the authority, then some consumers in various States, some of whom may be in Kansas, may have to add a cent or two or

less to their gas bills, perhaps $1.20 to $2.40 a year. This is not a desirable result; it is also not the expected result, but it may be the result. The next outcome is the more likely outcome.

The second outcome is that the interstate pipelines do not seek permission to increase their rates to include the new Kansas tax, absorbing it instead from their obscenely high profit margins.

Why would the interstate pipelines refrain from even asking the FERC to allow them to flow through the new tax? Because asking for permission to increase the rate opens their entire rate structure to review, with the potential that rates would be lowered!

In my personal view, it would be a godsend if the Kansas legislature did impel interstate pipelines to file a rate case at the FERC. Both ends of the pipeline-- the producers and royalty owners at one end and the consumers at the other-- could benefit substantially. It has literally been years since the FERC has had the opportunity to review the pipeline rates to ensure that the rates are just and reasonable and not unduly discriminatory, and I believe that the rates being charged have substantial excess profits over and above the "guaranteed" profits incorporated in rates. My opinion, however, does not count; only the FERC's does, and the FERC is effectively precluded from reviewing the pipeline rates.

It is not in the public interest to allow these public utilities to depress prices at the wellhead and to dampen demand at the other end by taking too much out of the transportation in the middle-- the essential facilities. The FERC would doubtless agree with this proposition. Implementing it is another thing.

The FERC used to require the pipelines to justify their rates every three years, but this requirement was removed. With the removal of this requirement, the FERC is rendered virtually impotent to review the rates, except by an archaic and unworkable "complaint" procedure with roots now two centuries back. Unless the pipeline now "voluntarily" files for a rate increase, then the FERC can do little or nothing.

So, if the pipelines do file a rate case, then the words of that great philosopher, Brer Rabbit apply: Please don't throw ME into that briar patch!

The odds are that the present interstate pipeline profit levels are too high to risk a reduction; better to absorb this "small" amount--- to an interstate pipeline. An average of about $5,000,000 a year is virtually a rounding error when hundreds of millions in revenues are at stake.

However, the legislature need not be concerned. If the pipelines are earning profits at or below the "guaranteed" level built into the rate structure set years ago, they have a remedy: file at the FERC. Nothing that the Kansas legislature does even purports to restrict this federal statutory right.

By the same token, the Bill would not limit any intervention protest by consumers or producers or State Commissions, including the KCC, to an effort by the pipelines to pass on the new Kansas tax, including by calling for a reduction in the rates below current levels.

IV. SECTION-BY-SECTION ANALYSIS OF HOW PLAN IS IMPLEMENTED

A. The Big Picture: Law and Policy.

This section will not address the technicalities of State law with respect to bonds, taxes, and the administration thereof. Rather, this deals with factors thought to be germane to the inevitable attempts to frustrate the will of the legislature by (a) raising spurious Constitutional claims and (b) trying to divert the tax back to the producers and royalty owners. The following are summaries of my personal opinions.

As to the United States Constitution, I am of the view that this bill is consistent with the Commerce clause, the Preemption clause, and the Tenth Amendment. As to the Kansas Constitution, I can claim no experience nor expertise. I did consult with a prominent New York City law firm specializing in bond work who did do the research and assured me that the legislation is consistent with the Kansas Constitution. However, I defer to Kansas lawyers on this point.

Section 2(a) makes it clear that the tax is on the transportation of gas under the aegis of the State of Kansas, a right preserved by the Tenth Amendment and well within the Commerce Clause. Like other taxes on both interstate and intrastate gas pipelines, there is no federal preemption power vested in the FERC. There is no problem of a "burden on interstate commerce", since the tax applies equally to both interstate and intrastate pipelines.

It is extremely important to note that the bill specifically excludes local distribution companies and all production and gathering of natural gas. This tracks the federal standard found in the Natural Gas Act. It is good public policy, otherwise there would be cumulative taxes, one at each stage of the movement of gas, from the wellhead, through gathering lines, through transportation lines, and then through distribution lines. Further, by following the wording of the federal act and excluding those other entities specifically, the incidence of the tax will fall on the natural gas pipelines and only on them, as the Bill intends. Thus, the FERC and the KCC will have the jurisdiction preserved to deal with the question of who, if anyone, pays the tax besides the pipeline itself. All pipelines are free to pursue their remedies under State and Federal regulation, respectively.

Section 6(a) provides for the funding of the amortization of the bonds, thus granting assurances to those who will invest.

Section 8(a) provides for the sale of bonds and the use of the proceeds to pay the CLAIMS being asserted by gas pipelines, whether the claim covers producers, royalty owners, or both. It is important that the refunds be made to eliminate claims, thus sparing the producers and royalty owners from having to litigate, with all of the attendant delays and costs. This also speeds final "refunds" to the current customers.

The claims being asserted are for interest as well as principal, so the authority to pay both is granted. However, as pointed out, it should only be necessary to refund the principal and then hold the balance for the pleasure of the legislature.

Section 8(b)(2) allows the determination of the interest rate, albeit capped. Some might think that the rule of "sauce for the goose" should apply, with the ability to set the same interest rate that is being claimed by the pipelines: floating prime, compounded quarterly. In any event, it is necessary to have the freedom to set the interest rate, not only to meet or exceed market conditions, but in order to be able to offset any delays that might occur as a result of spurious litigation seeking to block the bonds. The more the delay, the higher the interest should be. There is authority to issue 40 year bonds.

Section 13 provides that the exclusive use of the bond proceeds is to free the Kansas producers and royalty owners from the retroactive claims for refunds and interest as a result of obtaining reimbursement after October 4, 1983, and the summer of 1988. This is the reference to "orders issued by the FERC". Again, however, if the total claims can be extinguished by payment of principal only, then the amounts raised for interest payments will have to be disbursed at the instance of the legislature. That is about $207,000,000.

No comment is made on the unit size of the tax; this is obviously a place holder number pending the will of the legislature in controlling inferentially how long the bonds would have to go until redemption. I believe that the number in the bill is a surrogate for one cent per Mcf, (as written, the tax would yield one mil per Mcf, not one cent per Mcf) As a rule of thumb, since the average household in the Midwest uses about 120 Mcf/yr, according to the federal Energy Information Association, a 1 cent per Mcf tax, if in fact passed on intact to all consumers, would cost the average householder $1.20 a year. Please bear in mind that the same householder gets a credit in advance of up to $40 as part of the refund process. Thus, a tax rate of 2 cents or 3 cents an Mcf would have minimal impact, in my view.

B. Possible "Technical Corrections."

I may have to confess ignorance of Kansas law, but I am somewhat familiar with the legislative process in Washington and at least suspect that there are some similarities.

Sometimes peripheral issues get escalated into cosmic proportions, when only a small and non-substantive adjustment is necessary to handle the situation. In Washington, those issues are called "technical corrections."

I thus wish to raise subjects for consideration as "technical corrections", not that they have anything to do with the merits or the substance, but merely to preempt or mitigate concerns that can easily be handled by legislative counsel These concerns are doubtlessly meritorius and deserving of a considered answer; they just do not affect the substance.

(1) What is the total amount of the bond issue to be authorized? I would say that $360,000,000 ought to be enough, but this is a policy call.

(2) Would revenues at $.01 per millon cubic feet generate revenues sufficient to retire the bonds? Obviously not. As stated above, this number is obviously a "placeholder" until the legislature can settle on an Mcf rate(not a million cubic feet) rate. "Mcf" means "thousand cubic feet", the usual volumetric unit for pricing and taxing purposes. (See next question and answer).

(3) What is the projection of the volumes of gas that will go through Kansas? Obviously, the revenue stream, both literally and figuratively, is important. I believe that the latest EIA figures-- 1998-- indicate that some 1,151,811,000 Mcf was transported within and out of Kansas and that some 313,000,000 Mcf was consumed within Kansas. A tax of 1 cent per Mcf (not million cubic feet, the "M" being the Roman symbol for 1,000) would thus yield revenues of about $14,621,000. 2 cents per Mcf would double that amount. As to the future, the FERC has a policy goal of increasing total gas supply in this country by about 50% in the next few years. Kansas will play a significant role both in production and in transportation of gas. No interstate pipeline will deny this, because substantially all are planning significant increases in capacity. It is important to note again that the tax applies equally to interstate and intrastate pipelines doing business in Kansas.

(4) The Interstate Commerce Commission is now known as the Surface Transporation Board, or, in short, the "Surf board."

(5) What State administrative agency should manage the bonds and implement the policy decisions of the legislature? I have nothing to suggest, although I understand that some prefer the KDFA over the Kansas Water Office. This seems to me to be purely a technical point.

(6) Here I do trespass a little. Is it necessary to put a cap on the interest rate? After all, the interstate pipelines are claiming that Kansas producers and royalty owners should pay interest at a floating prime rate, compounded quarterly. Why should not sauce for the goose be sauce for the gander? It seems to me that an interest rate at these levels should command something of a premium over face value and perhaps create still more funds for the State's general expenditures

V. JUSTICE AND THE PUBLIC INTEREST COINCIDE HERE

While it is not the least in the public interest to squeeze $360,000,000 or so out of the Kansas producers and royalty owners who are most likely to risk the capital to meet the FERC's apparent goal of a 50% increase in gas supply in the next few years, the public interest requires that Constitutional rights be vindicated..

The basis for this legislation is Justice, pure and simple, for the Kansas producers and royalty owners. It is also just that those who enjoy the protection of the State of Kansas for the transportation of gas, whether pipelines or even ultimate consumers in Kansas or other States, pay the tax. This burden should not be shifted to the taxpayers of Kansas. Those persons in the United States who benefit directly from the transportation of natural gas should pay. That is standard public utility doctrine, and Kansans are entitled to the equal protection of the law.

Vindication by the State of the genius of our Constitutional form of government -- the "check and balance" -- is a result devoutly to be wished. It is indeed fitting that the State of

Kansas has the opportunity to show that States can still "check and balance" the excesses of the federal government in the year 2000, as we start this current millenium. This is a test case in more ways than one.

Citation
48 FR 45287-03
1983 WL 112880 (F.R.)
(Cite as: 48 FR 45287)

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NOTICES

DEPARTMENT OF ENERGY

[Docket No. RI83-9-000]

Natural Gas Policy Act; Notice of Petition To Reopen, Reconsider and Rescind Opinion No. 699-D

Tuesday, October 4, 1983

***45287** September 29, 1983.

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

On August 22, 1983, Northern Natural Gas Company, Division of Internorth, Inc., (Northern) filed a petition pursuant to Section 1(b) of the Natural Gas Act, (15 U.S.C. 717o) and Rule 207 of the Commission's Rules of Practice and Procedure (18 CFR 385.207), requesting that the Commission reopen the record in Docket No. R-389-B and reconsider and rescind its Opinion No. 699-D entered therein. Opinion No. 699-D was issued by the Federal Energy Regulatory Commission's (FERC) predecessor--the Federal Power Commission. More specifically Northern in its petition requests (1) that the Commission issue an order reopening proceeding in Docket No. R-389-B; (2) that a hearing be convened so that Northern and other interested parties may introduce evidence relative to the operation of the Kansas ad valorem tax; (3) that after the conclusion of the hearing the Commission issue an order stating that the Kansas ad valorem tax is not a State "production, severance, or similar tax" within the meaning of Ordering Paragraph (A) of Opinion No. 699 (18 CFR 2.56a(b)), Opinion No. 749 and 770, and Section 110 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3301, et seq.); and (4) that Northern is no longer required to reimburse Kansas sellers of gas for said ad valorem tax.

Northern is the operating division of Internorth Inc. Internorth is a natural gas company and holds certificates of public convenience and necessity issued by the Federal Power Commission.

Northern states that Opinion No. 699-D was issued in response to a request for clarification from the State Corporation Commission of the State of Kansas concerning the rights of producers to adjust upward the national rate prescribed in Opinion No. 699 by the amount of the Kansas ad valorem ***45288** tax. Northern asserts further that in Opinion No. 699-D the Commission determined that the Kansas ad valorem tax was a tax similar to a severance or production tax. Northern avers that it has reimbursed Kansas producers $28,022,637 for ad valorem taxes paid by such producers to the state under Opinion Nos. 699, 749, and 770, and Section 110 of the Natural Gas Policy Act of 1978 during the period from 1974 to 1982. Moreover, Northern states that in 1983 Kansas enacted a severance tax payable on all natural gas produced

48 FR 45287-03
(Cite as: 48 FR 45287, *45288)

in the state. Also Northern states that the severance tax is levied at the rate of 8% of the volume of produced gas, with a credit of 1% being given to those tax payers paying ad valorem tax on gas properties. Northern estimates that it will reimburse Kansas producers approximately $10,000,000 annually in severance taxes.

Northern asserts that, based on another Commission case, Kansas case law, and Kansas statutory law, the Kansas ad valorem tax should be determined to be a property tax rather than a production, severance or similar tax.

Any person desiring to be heard to make protest with reference to said petition should on or before October 20, 1983, file with the Federal Energy Regulatory Commission, Washington, D.C. 20426, petitions to intervene or protests in accordance with the requirements of the Commission's Rule of Practice and Procedure (18 CFR 385.214 or 385.211). All protests filed with the Commission will be considered by it in determining the appropriate action to be taken but will not serve to make the protestants parties to the proceeding. Persons wishing to become parties to a proceeding or to participate as a party in any hearing therein must file petitions to intervene in accordance with the Commission's Rules.

Kenneth F. Plumb,

Secretary.

[FR Doc. 83-27027 Filed 10-3-83; 8:45 am]

BILLING CODE 6717-01-M

48 FR 45287-03, 1983 WL 112880 (F.R.)

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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
ON BEHALF OF THE KANSAS INDEPENDENT OIL & GAS ASSOCIATION
IN SUPPORT OF S.B. 571
BEFORE THE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES
MARCH 13, 2000

Mr. Chairman and members of the Committee:

My name is Robert E. Krehbiel, and I am appearing on behalf of the Kansas Independent Oil and Gas Association. The Kansas Independent Oil and Gas Association is an organization of approximately 800 independent oil and gas producers and associated service companies working in the Kansas oil and gas patch.

Thank you very much for the opportunity to appear in support of S.B. 571. S.B. 571 is an attempt to correct, at the state level, what has been appropriately described as "the worst tax atrocity ever perpetrated by a federal agency". This description was in reference to the 1993 reversal by the Federal Energy Regulatory Commission of its own opinion issued 19 years earlier in 1974. This was Opinion 699-D which was requested by the General Counsel for the Kansas Corporation Commission and which was relied on for 19 years not only by Kansas producers, but by the Kansas Legislature in developing tax policy for the State of Kansas.

Today, because of that reversal, Kansas tax policy, established in 1983, has been emaciated. Today, because of that reversal, thousands of Kansas operators and working interest owners are threatened with refunds in excess of $340 million of Kansas ad valorem taxes previously recovered as a cost of production from the major interstate pipelines who purchased Kansas' gas at the wellhead. All the time Kansas producers were acting in accordance with Federal Energy Regulatory Commission direction, at rates established by federal law and pursuant to contracts written by the interstate pipeline purchasers. And, today, because of the retroactive application of the FERC reversal of Opinion 699-D, an estimated 20,000 Kansas royalty owners have been sued in four separate court actions for sums estimated to total in the range of $60-90million. This is a virtual cluster bomb set off in Kansas by this unbelievable action by the FERC.

This is the most significant issue facing the members of my Association. Many have received letters from the Federal Energy Regulatory Commission directing them to refund alleged overcharges for natural gas sold in interstate commerce beginning seventeen years ago, October 4, 1983, and continuing through June 28, 1988. Please understand that all gas sales were made pursuant to gas contracts written by the interstate pipeline purchasers to purchase Kansas gas at the wellhead, at prices established either by the interstate pipeline purchaser or by the federal

government itself, and all in accordance with the direction of the FERC and opinions issued by the FERC.

Some producers are threatened with bankruptcy and some will have their operations significantly curtailed. Many are deceased or dissolved since the period at issue from 1983 to 1988, and their heirs, successors and assigns are threatened with refund letters with respect to transactions to which they were not parties and concerning issues of which they have no knowledge or record. Many of the wells involved have been plugged or sold, contracts have been canceled and contractual issues of potential liability will be litigated in Kansas Courts for years to come. The issue has the potential to consume the entire drilling budget for the State of Kansas for the next three to five years and waste enormous resources. The impact will ripple through the Kansas economy.

The following list includes just a few typical examples of Kansas producers facing refunds:

Kansas Natural Gas at Hays, Kansas,..... $4 million.
Beren Corporation, Wichita, Kansas..... $1.95 million.
Molz Oil Company, Kiowa, Kansas..... $388 thousand.
Hasada Industries, Overland Park, Kansas.....$122 thousand.
Petroleum Production, Lawrence, Kansas.....$116 thousand.
R.J. Patrick, Liberal, Kansas.....$436 thousand.
Lester Smith, Syracuse, Kansas.....$56 thousand.
F.G. Holl, Wichita, Kansas.....$1.25 million.
Pickrell Drilling, Wichita, Kansas.....$325 thousand.
Suerte Oil Company, Howard, Kansas.....$68 thousand.
Edgar White, Elkhart, Kansas.....$138 thousand.
Aurora, Inc, Wichita, Kansas.....$19 thousand.

Kansas producers have requested hearings but none have been granted. My friend and neighbor, Joel T. Strohl, a working interest owner in a single well, requested a hearing, but the FERC will not respond. What a hearing would show is that for the period at issue, October, 1983, through June of 1988, the well in which Mr. Strohl owned a working interest was actually paid as much as $125,000 less than the maximum lawful price during the period in question. The major interstate pipeline purchaser, Northern Natural Gas Company, now Enron, is using their legal forces to prevent Mr. Strohl from getting a hearing before the FERC.

Most of you are familiar with the issue as it first came before the Kansas Legislature in 1998. To refresh your memory I have attached a series of articles which provide brief history. (See Attachment List-AP Articles by Lew Ferguson and 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.

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.

In December, 1999, Kansas was joined by 29 member states of the Interstate Oil and Gas Compact Commission urging Congress to pass legislation providing relief from the retroactive reversal by the Federal Energy Regulatory Commission. A copy of IOGCC Resolution 99.121 is included.

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 Sam Brownback Representative Todd Tiahrt, Representative Dennis Moore and Representative Jim Ryun. We are particularly indebted to Attorney General Carla Stovall who personally faced the power of the legal forces of the interstate pipelines in the unfriendly courts of the eastern establishment.

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

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

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

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

A Background paper attached will discuss the private ownership of land and minerals and is my attempt to simplify the rights and issues leading to the introduction of S.B. 571.

CHRONOLOGY

1938 Congress passed the Natural Gas Act to provide for the orderly development of interstate pipelines and to regulate their rates and charges as a public utility. The Natural Gas Act stated that "the Act shall not apply to the production or gathering of natural gas".

1954 In *Phillips Petroleum Co. v. Wisconsin*, 347 U.S.672 (1954), the United States Supreme Court ruled that the Natural Gas Act allows the federal government to control the price paid for natural gas at the wellhead if such gas is sold to an interstate pipeline. As a result, the Federal Power Commission (FPC) was forced to regulated thousands of individual producers as if they were public utilities. They could not handle the load on an individual producer basis and instead began to establish area rates by location and date of drilling and costs of production that could be recovered by producers.

1974 In FPC Opinion No. 699, the FPC allowed pipelines to be paid area ceiling rates pursuant to the Natural Gas Act and to recover the cost to producers of "production, severance, or other similar taxes."

1974 In Opinion No. 699-D, the FPC clarified its prior ruling at the request of the State of Kansas and stated that it was proper under Opinion 699 to increase the area ceiling rate to allow producers to recover their costs of the Kansas ad valorem tax.

1978 The Natural Gas Policy Act (NGPA) was passed codifying the FPC's treatment of the Kansas ad valorem tax continuing to allow producers to recover this cost. Section 110 of the NGPA allowed the recovery of production, severance and other similar taxes above the maximum lawful price charged for natural gas at the wellhead. The Joint Explanatory Statement to the Conference Committee Report accompanying the NGPA noted that this cost included any tax imposed upon mineral or natural resource production including an ad valorem tax or gross receipts tax.

1979 The Federal Energy Regulatory Commission (FERC) (successor to the FPC) affirmed the Opinion 699 and 699-D in *Independent Oil and Gas Association of West Virginia*, 7 FERC ¶ 61,094 (1979). This decision was based upon the policy and law prior to the NGPA.

1982 FERC again affirmed its Opinion 699 and 699-D in *Trio Petroleum*, 18 FERC ¶ 61,203 (1982). This decision was based upon the policy and law prior to the NGPA.

1983 The Kansas Legislature, **relying upon Opinion 699-D**, as reflected in the legislative history, passed the severance tax. The Kansas Legislature believed at the time that Kansas producers could recover the cost of the severance tax and the ad valorem tax.

1983 Nine Years after the Opinion 699-D authorized the recovery of the Kansas ad valorem tax, Northern Natural Gas Co. filed an application to FERC to "reopen, reconsider and rescind" Opinion 699-D.

1986 Three years later, FERC rejected Northern's request stating it was **clear beyond question**, that the Kansas ad valorem tax is based, in large part, on gas production," and reaffirmed its policy contained in Opinion 699 and 699-D. This decision was based upon NGPA.

1986 FERC reaffirmed its decision under the NGPA in *Sun Exploration and Production Co.*, 36 FERC ¶ 61,093 (1986).

1987 FERC reaffirmed its decision in Northern Natural Gas Co. and denied Northern Natural Gas Company's request for rehearing. 38 FERC ¶ 61,062 (1987).

1988 Colorado Interstate Gas Co. appealed the Northern decision to the Federal D.C. Circuit which, on June 28, held that FERC had not adequately explained its order and remanded the case to the Commission. *Colorado Interstate Gas Co. v. FERC*, 850 F.2d 769 (D.C. Cir. 1988)

1993 Five years pass before FERC issued an Order on Remand. **FERC reversed Opinion 699-D, thereby overturning 19 years of reliance on an opinion, which FERC previously described as "clear beyond question."** FERC also held the refund obligation resulting from this reversal should be retroactive to June 28, 1988, the date on which the D.C. Circuit remanded the case to the FERC.

1993 Section 110 of the Natural Gas Policy Act, 15 U.S.C. § 3320 repealed. The recovery of the ad valorem tax is not regulated. The recovery of the tax will be controlled by the contract terms between the purchaser and the producer.

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

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

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

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

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

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

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

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

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

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

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

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

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

DETAIL
GREAT LAKES
IROQUOIS
EMPIRE
CIG
ANR PIPELINE
Capacity Rights on NorAm System
HIOS
Interconnections

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.

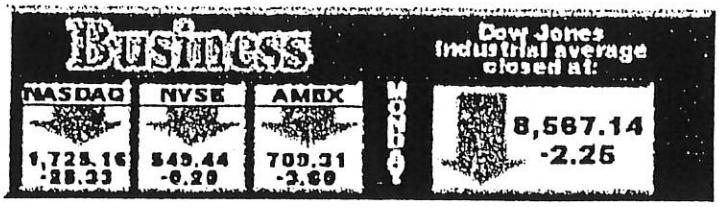
8. August 26, 1974, request by the General Counsel of the Kansas Corporation Commission for Clarification of Opinion 699 and a Declaratory Order on Petition for Clarification issued October 4, 1974.

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.



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.

4-10

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."

file name: refund reports
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12/2/97

KANSAS AD VALOREM

REFUND REPORTS

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

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

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

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 (property taxes paid on gas property in Kan...s 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.

4-13

Session of 1998

Senate Concurrent Resolution No. 1616

By Committee on Utilities

2-4

A CONCURRENT RESOLUTION urging the Congress to enact legislation providing relief from the order of the Federal Energy Regulatory Commission requiring Kansas natural gas producers to pay penalties and interest on certain refunds to customers.

WHEREAS, Since 1974, the Federal Energy Regulatory Commission (FERC) and its predecessor, the Federal Power Commission, had allowed natural gas producers in Kansas to include the cost of state property taxes in their rates; and

WHEREAS, In 1983 a petition challenging the inclusion of the costs of property taxes in rates was filed with FERC and FERC affirmed its prior rulings allowing recovery of those costs; and

WHEREAS, In 1993, after the D.C. Circuit Court ordered FERC to review its rulings, FERC reversed itself and ordered the payment of refunds retroactive to the year 1988; and

WHEREAS, Kansas producers paid the refunds ordered, including interest, but in 1996 the D.C. Circuit Court reversed the FERC decision and required instead payment of refunds, including interest, back to 1983, the time of filing of the initial petition in the case; and

WHEREAS, The retroactive reversal of a practice that had been legal for 19 years places an unjust and punitive financial burden, possibly exceeding $500 million, on the Kansas natural gas industry; and

WHEREAS, The ordered refunds threaten serious financial harm not only to the Kansas natural gas industry but to the state and local economies and governmental budgets that rely on the industry's economic base: Now, therefore,

Be it resolved by the Senate of the State of Kansas, the House of Representatives concurring therein: That the Kansas Legislature urges the Congress to enact S. 1388 and H.R. 2903, providing relief from penalties and interest that FERC has ordered Kansas natural gas producers to pay on refunds for property tax costs included in natural gas rates, retroactive to 1983; and

Be it further resolved: That the Secretary of State be directed to send enrolled copies of this resolution to each member of the Kansas Congressional Delegation, to the chairperson of the United States Senate

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

4-14

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

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.

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.

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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.

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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-

Paul Gilman -
Bob Tenden -
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.

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

RATES-INDEPENDENT PRODUCER

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

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

Opinion No. 699-D

DECLARATORY ORDER ON PETITION
FOR CLARIFICATION

(Issued October 9, 1974)

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

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

CONTINUED ON BACK

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

The Commission orders:

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

By the Commission.

(S E A L)

Kenneth F. Plumb,
Secretary.

4-23

COMMITTEE ON BANKING AND FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL MONETARY POLICY
COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON REGULATORY REFORM AND PAPERWORK REDUCTION
SUBCOMMITTEE ON EMPOWERMENT

Congress of the United States
House of Representatives

DENNIS MOORE
Third District, Kansas
www.house.gov/moore

506 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-1603
PHONE: 202-225-2865
FAX: 202-225-2807

8417 SANTA FE DRIVE, #101
OVERLAND PARK, KS 66212
PHONE: 913-383-2013
FAX: 913-383-2088

500 STATE AVENUE, #176
KANSAS CITY, KS 66101
PHONE: 913-621-0832
FAX: 913-621-1533

647 MASSACHUSETTS ST., #207
LAWRENCE, KS 66044
PHONE: 785-842-9313
FAX: 785-843-3289

MIAMI COUNTY
PHONE: 913-294-4122

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.

4-24

State of Kansas
Senate Chamber

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

HOME ADDRESS:
2226 S.E. VIRGINIA AVENUE
TOPEKA, KANSAS 66605-1357
(785) 232-1944—HOME

Office of Democratic Leader

ROOM 347-N, STATE CAPITOL
TOPEKA, KANSAS 66612-1504
(785) 296-3245
1-800-432-3924

COMMITTEE ASSIGNMENTS
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MEMBER EDUCATION
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KANSAS INC
LABOR EDUCATION CENTER ADVISORY COUNCIL
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LEGIS. POST AUDIT
STATE FINANCE COUNCIL
UTILITIES
WORKERS COMPENSATION FUND OVERSIGHT

June 18, 1999

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

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

Dear Congressman Dingell:

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

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

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

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

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

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

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

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

What could the Kansas Legislature have d[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]ve no more than $15 over a period of time. However, the total of these de minimis refunds, and what is not passed through to the consumer, equals the estimated drilling and exploration budget for all of Kansas for the next three and one-half years.

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

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

Sincerely,

Anthony Hensley
Kansas Senate Minority Leader

cc: Congressman Jerry Moran
Congressman Dennis Moore

4-27

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)

Syllabus

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

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

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

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

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

Kansas Legislative Research Department

February 17, 1981
Revised March 18, 1981

SEVERANCE AND PROPERTY TAXES ON OIL AND GAS

Background

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

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

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

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

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

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

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

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

National Summary

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

Kansas

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The 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:

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.

"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.

SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION
P. O. Box 250
Hugoton, Kansas 67951
(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

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

(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

SWKROA

SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION

SWKROA IS A PUBLICATION OF THE 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

P.O. Box 250, Hugoton, Kansas 67951 Phone (316) 544-4333 Fax (316) 544-2230
E-Mail: SWKROA@pld.com Website: http://users.pld.com/swkroa

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,

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 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.

4-4-06

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

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

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

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

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

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

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

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

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

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

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

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

ELECTION OF DIRECTORS

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

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

Eulogy for Ted Julian

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

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

Sincerely,

Erick E. Nordling
Executive Secretary

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BACKGROUND

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

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

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

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

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

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

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

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

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

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

Much of our nation's natural gas resources were first discovered to exist in Kansas, Oklahoma, Texas, New Mexico, and Louisiana. The Hugoton Gas Field was the largest in 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

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.

SWKROA
SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION

Greeley
Hamilton
Kearny
Finney
Stanton
Grant
Haskell
Morton
Stevens
Seward

Phone (316) 544-4333
Fax (316) 544-2230

E-mail: SWKROA@pld.com
http://users.pld.com/swkroa

209 E. 6th St. / P.O. Box 250
Hugoton, Kansas 67951

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

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

RE: Senate Bill No. 571

March 13, 2000

To the Honorable Members of the Senate Energy and Natural Resources Committee.

Chairman Corbin and Members of the Committee:

REMARKS

My name is Erick E. Nordling of Hugoton, Kansas. I am Executive Secretary of the Southwest Kansas Royalty Owners Association (SWKROA). I would like to submit remarks for your consideration on behalf of members of our Association and on behalf of all Kansas royalty owners in support of Senate Bill 571.

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

There are tens of thousands of royalty owners who own minerals in Kansas, including someone in virtually every Kansas community. Although many are not members of the Association, the Association still represents their interests as well by advancing its goal of protecting the interests of royalty owners in the Hugoton Field. While most royalty owners in the Hugoton Field are people

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

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

The Association deeply appreciates the past support of the Kansas Legislature, including the passage of House Bill No. 2419 in 1998 that addressed this problem. At least to date, however, the Federal Energy Regulatory Commission has rebuffed this Legislature's attempts to deal with this obvious inequity, which was, in part, created by the Commission itself. On behalf of all Kansas royalty owners, the Association asks for your support of Senate Bill 571, which would relieve those royalty owners of the threats of payment of those unjust and ancient claimed debts associated with the discharge of the assessment of Kansas ad valorem taxes over a decade ago.

Respectfully submitted,

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

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Eric Nordling (5)

EXECUTIVE SUMMARY

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

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

Royalty owners should be granted relief from paying refunds and interest on taxes dating back to 1983-1988 for the following reasons:

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

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

RE: KANSAS AD VALOREM TAX REFUND

June 8, 1999

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

Chairman Barton and Members of the Committee:

INTRODUCTION

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

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

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

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

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

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

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

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

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

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

FLIP-FLOPS IN DECISIONS AT FERC.

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

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

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

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

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

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

through the pipeline companies to the consumers.

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

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

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

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

ROYALTY OWNERS HAD NO CONTROL.

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

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

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

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

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

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

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

THE INTEREST CALCULATIONS ON THE AMOUNT DUE MAKE IT PUNITIVE.

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

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

judicial determination that interest should be charged.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

FERC'S LACK OF JURISDICTION OVER ROYALTY OWNERS

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

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

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

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

STATUTE OF LIMITATIONS ARGUMENTS

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

On May 19, 1998, in order to determine whether FERC would honor the Kansas legislation by finding that such legislation would render recovery of royalty refunds uncollectible from the

royalty owners and thereby grant a waiver of those refunds, a number of producers filed a Motion in all of the pipeline dockets for a waiver of their royalty interest refunds or alternatively for a generic waiver as to all refunds attributable to royalty interests. Public Service Company of Colorado, et al., Dockets Nos. RP97-369, et al. This Motion attracted numerous interventions, answers, and comments, both in support and opposition. The Motion was vigorously opposed by the pipeline and gas distribution companies.

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

The Order of Denial concluded that "This order only addresses the issue of whether Kansas House Bill No. 2419 justifies waiver of ad valorem tax refunds. The Commission recognizes that there may be other Kansas statutes of limitation, such as the general contract statute of limitation in K.S.A. § 60-511, which might satisfy the Wylee uncollectibility statutes of limitation in this order, since they have not been raised by the parties."

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

> "Based on my discussions with my senate colleagues on the Ways and Means Committee, our intent in introducing SB 685 was to simplify, clarify and codify existing Kansas law, so that the public would have full knowledge that the five-year statute of limitations on bringing actions on contractual matters set forth in K.S.A. 60-511 applies to oil and gas refund matters. Thus, it would specifically apply to first sellers' attempts to collect ad valorem tax reimbursements from royalty owners, regarding ad valorem taxes paid from 1983 to 1988. SB 685 was not intended to create a new and different statute of limitations, and SB 685 does not do so.
>
> "I also explained this need for SB 685 at a hearing held on the bill before the Senate Energy and Natural Resources Committee on March 23, 1998. Based upon my discussions with my senate colleagues on the Energy and Natural Resources Committee after receiving testimony, both written and oral, the committee also believed that the

> existing five-year statute of limitations in K.S.A. 60-511 prohibits first sellers from bringing an action against royalty owners for all claims that are greater than five years old. I and my colleagues were concerned that royalty owners may not be aware of the relevant statute of limitations...A conference committee report on HB 2419 was adopted by the Senate on April 2, 1998 by a vote of 38 yeas and 0 nays, and by the House of Representatives on April 8, 1998 by a vote of 120 yeas and 0 nays. The governor signed the bill on April 20, 1998.
>
> "The purpose of simplifying, clarifying and codifying the existing five-year statute of limitations on actions in contractual matters, so that it specifically applies to first sellers' attempts to collect ad valorem tax reimbursements from royalty owners, was to prevent unnecessary litigation on such matters. Litigation by each royalty owner over claims which are barred by the statute of limitations would needlessly expend substantial resources of Kansas citizens and courts."

In spite of the clear indication of the intent of the legislation, on February 16, 1999, FERC denied rehearing on its November 2, 1998 opinion regarding the Kansas statute. FERC stated that, "nowhere in the motion (for rehearing) was there any reference to K.S.A. 60-511."

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

It is obvious that Congressional help is needed to abate

FERC's rulings.

AFTERMATH OF FERC DECISIONS

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

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

> "On or about March 9, 1998, producers had to pay over money attributable to unlawful ad valorem tax payments, including sums attributable to their royalty owners, to the pipeline companies or place the money into escrow if there was a dispute about the amount of money due pipeline companies from producers. Although the escrow procedures were intended only to be used when amounts actually were in controversy, many, if not most, producers, both large and small, used the escrow "loophole" to pay virtually all the money which the pipeline companies claimed they owed into escrow, because the producers wanted to preserve every possible defense. The FERC now has before it a multitude of issues from a multitude of producers that it must deal with in connection with the escrowed money. With only a couple of staff members working on the project, it could take months, if not years, to resolve all the disputes."
>
> "The only deadline which the producers are working against

> at the moment is March 9, 1999, the date that producers have to notify the FERC of any amounts that are not collectible from royalty owners. Even that date may not be considered firm by the FERC, if the producer can show some justifiable excuse for missing that date."

Taken to a more individual level, any potential refund obligation could possibly represent several years of current royalty payments, or with the compounding of interest and because of declining production could last the life of the well. Most of the money at issue is interest, which has been accruing at rates that royalty owners could not make from their own investments. Although SWKROA has membership of around 2,500, there are literally tens of thousands of royalty owners throughout the United States who are completely unaware of this potential financial bomb.

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

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

   - the change in FERC's decisions are unfair;

   - that collection benefits only pipeline companies who at the time already had a financial edge;

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

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

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

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

Respectfully submitted,

John Majeroni

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

on

Senate Bill 571

Before the Senate Committee on Energy

March 13, 2000

Senate Energy & Natural Resources

Attachment: 6

Date: 3-13-2000

A..GENT ENERGY, INC.

May 11, 1999

Congressman Jerry Moran
1519 Longworth
Washington, DC 20515

Re: Refunds of Kansas *ad valorem* tax reimbursements (Federal Energy Regulatory Commission Docket Nos. RP97-369-000, et al.)

Dear Congressman Moran:

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

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

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

By letters dated October 5, 1998, and October 12, 1998, FERC directed Kiwanda and its predecessor, Energy Exploration and Production, Inc. to make payments for stated amounts due for reimbursement of Kansas *ad valorem* taxes paid them during the period 1983 to 1988. Since both Kiwanda and its predecessor are now out of business, the letters were sent to those two entities at Argent's mailing address. By letter dated November 2, 1998, Argent informed the Commission that it was not affiliated with, and was not a mail drop for either Kiwanda or its predecessor. Further, Argent did not at that time own an interest in these properties, and indeed was not even in existence during the time of the alleged reimbursements, thus could not have received any such reimbursements.

110 SOUTH MAIN · SUITE 810 · WICHITA, KANSAS 67202 · 316-262-5111

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In spite of this reply, Argent received a letter from the FERC dated March 26, 1999, in which the Commission appears to have determined that Argent is indeed liable for these reimbursements as a successor to Kiwanda and its predecessor. The total of these alleged reimbursements plus interest is $855,147.60. I'm not sure but that we would have been better off had we thrown the first letters in the trash unopened. Argent has been forced to retain legal counsel to defend itself from being held responsible for an amount more than six times what it paid for these properties in 1993.

I still don't understand how a 1974 FPC ruling which allowed pass-through of Kansas *ad valorem* taxes (which was consistently upheld), could be reversed retroactively for fourteen years, have fourteen years of interest applied, then be assessed on natural gas producers who had complied with the law in effect at the time of these reimbursements. I just cannot comprehend such an action occurring in this country -- and I cannot believe that a regulatory body constituted in this country could hold Argent Energy, Inc. liable for repayment of reimbursements which it did not receive, on properties it did not own, during a time period before it existed, and having no possibility of recoupment from the now non-existent seller.

Congressman Moran, I join many Kansas gas producers in expressing my appreciation to you for your understanding and help. Your authoring of proposed legislation to remove the interest imposed on the repayment demanded on these reimbursements is indeed meaningful, both to Kansas royalty owners and to the producers. In the case of Argent Energy, however, the entire liability is inequitable. We have filed, through our attorneys, a reply to the FERC letter of March 26, 1999. I would hope that you will be able to monitor Argent's efforts to remove this liability. The filing is under Docket No. SA99-5-000. If there are further steps I should be taking, please let me know, and if I can furnish you with further documentation, I'll be happy to. Thank you for your consideration.

Sincerely,

James C. Remsberg

James C. Remsberg
President

COMMENTS OF JACK GLAVES IN BEHALF OF PANHANDLE EASTERN PIPE LINE COMPANY AND KINDER/MORGAN, INC. ON S.B. 571 BEFORE COMMITTEE ON ENERGY AND NATURAL RESOURCES

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. 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.

The state's taxing power would be invoked for the stated purpose in Section 8,

> "of granting refunds to Kansas natural gas producers, including working and royalty interest owners, to resolve claims by natural gas pipelines [as] their representatives in accordance with orders of the federal regulatory energy commission."

In fact, it is not the natural gas pipelines that have "claims" to resolve. The "claims" exist by virtue of Orders from the FERC that have been, and continue to be litigated and may ultimately end up in the United States Supreme Court. This

litigation has been ongoing in one form or another since 1974 when the Federal Power Commission issued its Opinion 699-D, which initially permitted producers to increase the rates received for natural gas to recover the Kansas ad valorem tax. The heavy litigation started in 1983, after the Kansas Legislature passed the severance tax, and we ended up with two contended "production taxes" to be paid by gas consumers in addition to the regulated price. The claim for refund of the ad valorem tax, included in the gas consumer's bill, is by the gas consumers that paid the tax. The 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 pipelines' customers, who are entitled to the money. How that qualifies pipelines to be inflicted with a "privilege tax" is difficult to understand. Section 2 states that a tax is imposed,.. "For the privilege of transporting natural gas from, within and through this state by pipeline..." Pipeline property is assessed at the 33% public utility ratio, resulting in 1999 ad valorem taxes of nearly $60 million dollars. 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. Under the present law, natural gas consumers are burdened with all legitimate costs associated with, among other things, the transportation of natural gas. See FPC v. United Gas Pipe Line co., 386 U.S. 237, 243 (1967), Cost of service normally includes proper allowance

for taxes and this allowance is obviously within the jurisdiction of FERC. Thus, the tax imposed by this Bill can result in taxes of millions of dollars on Kansas gas consumers. It is ironic that gas consumers paid the ad valorem tax obligation of the producers and royalty owners and would now pay a tax on their future gas consumption for repayment to the producers of taxes that have been determined that consumers should not have been required to pay in the first place. It becomes a dog chasing its own tail scenario, which leads me back to this Bill. It has three major constitutional obstacles:

1. The tax proposed to be levied is not for a public purpose. It's being 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 by virtue of the oil and gas leases, royalty owners, to the extent that their share of the taxes were paid for them by gas consumers.

The law that taxes can only be imposed for a public purpose is deeply embedded in Kansas. An 1874 case, Savings and Loan Association vs. Topeka, 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. 571 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. 571 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.

3. S.B. 571 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.

Given the fact that the apparent purpose of S.B. 571 is to subvert the FERC decision by requiring reimbursement of producers for their FERC ordered repayment obligation to consumers, by enacting a new "privilege tax" that ultimately will be borne by interstate gas consumers, it is clear that this Bill would be violative of the Supremacy Clause.

We believe that the total absence of a public purpose for S.B. 571, 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.

Additionally, the concept of S.B. 571 is simply unworkable. It provides for the issuance of revenue bonds in sufficient amount to reimburse producers and royalty owners for the entire ad valorem tax refund obligation, which currently totals over $360 million dollars. The bonds would be issued for terms up to 40 years with the revenue based upon the volume of gas coming into, flowing through and exiting the State of Kansas, both intrastate and interstate.

The first problem arises over how to calculate the gas volume that would be subject to the proposed tax. It is my understanding that KDOR's fiscal note utilized 1998 data, published by the Energy Information Administration, with respect

to interstate gas volumes. As reflected on attachment A, the total Kansas "supply", which presumably is one indicia of volume, reflects a declining trend from the 1,997,776 MMCF (2 bcf) for 1996, 1.9 bcf for 1997 and 1.58 bcf for 1998, a decline of 17% from 1997 to 1998. This declining trend is confirmed by production data as reflected by the attached graph B. Obviously, Kansas gas production peaked in 1995 at 725 BCF and is on a continuous decline with production for 1999 of only 544 BCF for a 25% decline in the four year period. The decline from 1998 to 1999 was over 55 BCF, or 9%. This decline will not abate without constraints on production or other dramatic changes in market forces or regulatory action. Bottom line, the revenue stream upon which the proposed tax would be imposed will continue to decline requiring on-going legislative action to increase the tax rate to satisfy bond payments. 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. Surely, no investment banker would deem the issuance of such bonds prudent or even feasible given the obvious threat of litigation and uncertainty of future tax requirements.

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. The tax burden that would be imposed for payment of the proposed bonds, at maturities of up to 40 years, would be borne, in the final analysis, by gas consumers, some 22.5% of whom are Kansas based. No one knows, at this point, what the total tax obligation, over the life of the bonds, would amount to. The required amount of the bonds is unknown. The level of tax required for an unascertained obligation is not known with any degree of certainty. Confusion abounds. K.S.A. 55-1624 (attached) enacted in 1998 bars collection of the refund obligation from the royalty owners. This statute will be asserted in defense of suits filed by Amoco and three other large producers pending in Stevens County for recovery of the royalty owner's portion of the tax debt. Offers of settlement reducing the small producer obligation are also pending with FERC.

However desirous you may be for legal or political relief for this whole unhappy scenario, S.B. 571 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.

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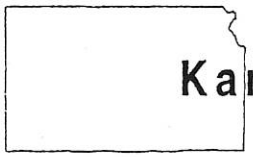

Kansas — Natural Gas 1998

	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**	**[R]1,903,939**	**1,582,927**

See footnotes at end of table.

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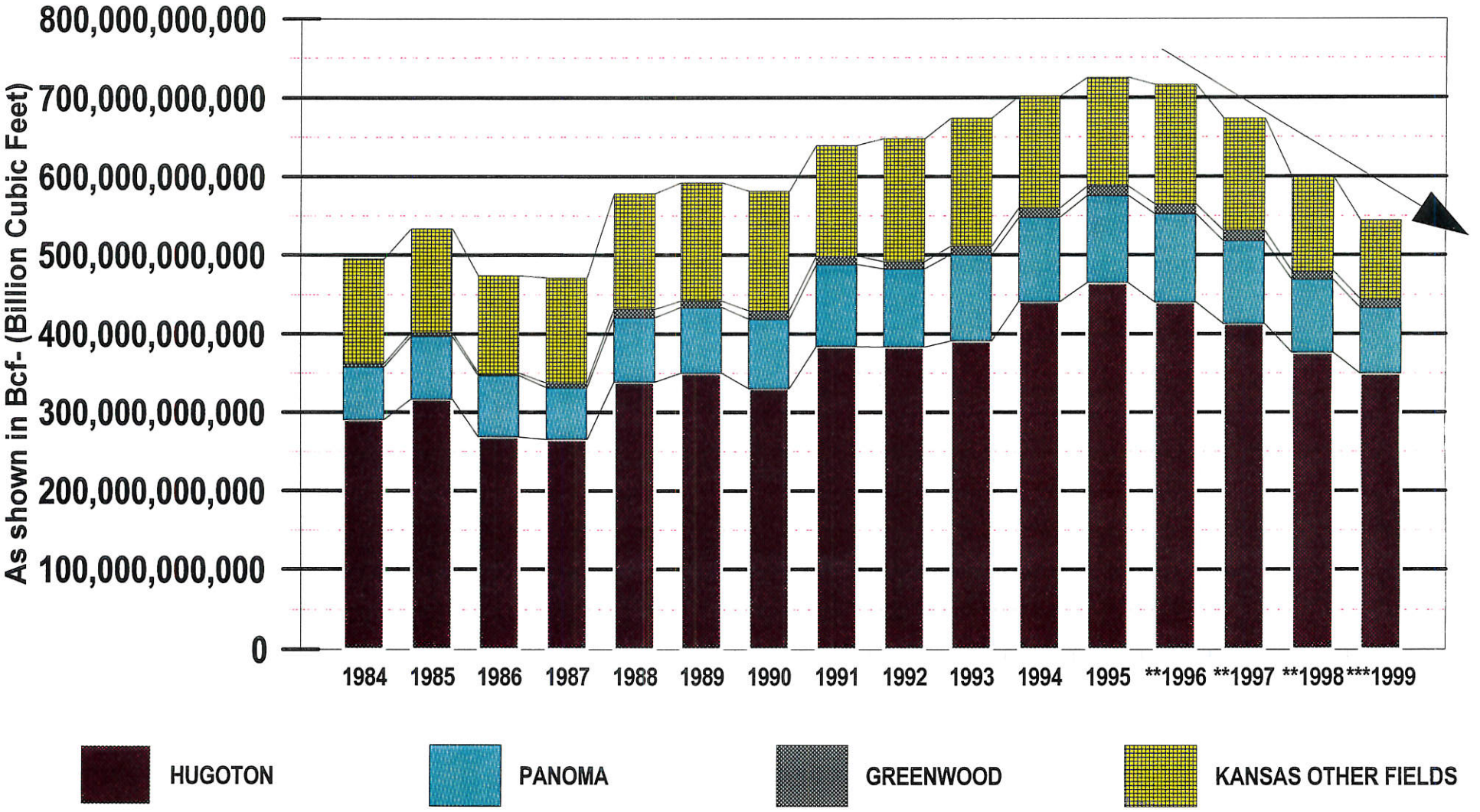
KANSAS GAS PRODUCT

BY MAJOR GAS FIELDS 1984-1999



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.

GARY W. BOYLE
Senior Counsel
GAS PIPELINE - Central
918/573-2359
918/573-4195 fax
gboyle@lgl.twc.com

One Williams Center, Suite 4100
Tulsa, Oklahoma 74172

March 13, 2000

The Honorable Senator David Corbin
Chairperson, Energy and Natural Resources Committee
Kansas State Senate
State Capitol
Topeka, KS 66612

RE: Senate Bill 571

Dear Senator Corbin:

Attached to this letter is the testimony of Williams Gas Pipelines Central, Inc. in opposition to Senate Bill 571. Williams appreciates this opportunity to provide your Committee with information concerning the proposed legislation. With your permission, I will briefly present the attached testimony at your hearing this morning and will be pleased to answer any questions from your Committee.

Thank you again for the opportunity to participate in important hearing.

Sincerely,

Gary W. Boyle

Attachment

Senate Energy & Natural Resources
Attachment: 8
Date: 3-13-2000 8-1

TESTIMONY OF WILLIAMS GAS PIPELINES CENTRAL, INC.
BEFORE THE ENERGY AND NATURAL RESOURCES COMMITTEE
IN OPPOSITION TO SENATE BILL 571

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 Senate Bill 571. 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, Senate Bill 571 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

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 Senate Bill 571 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. Senate Bill 571 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 Senate Bill 571.

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 Senate Bill 751 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 Senate Bill 751 at least until the legislation is struck down by the courts.

tax and would most certainly do the same with Senate Bill 751 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. Senate Bill 571 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

8-6

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.

Senate Bill 571 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. Senate Bill 571 Would Significantly Harm Kansas.

Even if a responsible member of the Kansas Legislature could reasonably reach the conclusion that Senate Bill 571 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 Senate Bill 751, 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 Senate Bill 751. 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 confident that the

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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.

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 Senate Bill 571 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 Senate Bill 571 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.

COMMITTEE ON ENERGY AND NATURAL RESOURCES
HEARING ON SENATE BILL 571
March 13, 2000

Testimony of Richard G. Smead
Senior Vice President
Colorado Interstate Gas Company and
ANR Pipeline Company

Good Morning, Mr. Chairman and members of the Committee. I am Richard G. Smead. I am Senior Vice President, Regulatory Affairs, for Colorado Interstate Gas Company, or CIG, and for ANR Pipeline Company. Both of our companies are strongly opposed to SB571, as I will explain further.

SB571 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, who is here today as well. ANR Pipeline has been only a minor participant, but–as I'll explain later–stands to be the "poster child" of the accidental victims of SB571.

The refunds ordered by FERC and the court are for overcharges in producers' gas prices from the 1983-1988 period when those producers were still Federally regulated. The refunds are substantial, something around $360 million statewide. Producers who owe refunds to CIG represent a little over 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 pay the money back to our customers, such as Public Service Company of Colorado who is here today, who will

in turn pay the money to the 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 receives 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.

In the case of other pipelines, such as Williams or Panhandle, it is consumers in other states. In fact, of the $360 million or so ordered to be paid, as much as $60 to $80 million will go to consumers right here in Kansas.

SB571 seeks to take this refund and turn it into a 40-year future problem for CIG, CIG's customers, and the consumers they serve. SB571 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. SB571 would then tax 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, through the rates of the utilities that serve them. One must not forget that a large share of that four-decade burden on consumers, as much as twenty percent or more of it, will 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 one hundred million dollars of the proposed tax. That is simply not fair. It can certainly 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 are wrapped up in years of legal

challenges don't really sell very well. Will they be 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 SB571–that's for the lawyers to do, and I'm sure they'll do a lot of it. I'm here to talk about the reason I understand the bill was proposed in the first place. That was 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. 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 SB571.

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, negotiating with our customers and with the representatives of the consumers in Colorado and Wyoming–our primary markets. We reached agreement on a proposal which 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.

Last week, 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 still 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 we 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 we've faced getting the information. I want it to be very clear, however, that our complaint against the operators only has one primary goal: To get the data we need 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 our consumers.

Other settlement proposals were filed on 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, we think our 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 our 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 we've 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 purpose of which is merely to bail out some big investor-owned companies.

As I said at the outset, CIG is in the middle. We want 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 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 conference to be held later this morning. This is a chance for us all 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 our offer last week at the FERC shows that CIG and PSCo are very serious in our commitment to get it worked out as to our ten percent of the total refund.

In considering SB571, 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 SB571 is simply 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. SB571 will not succeed legally, but even if it did, it would impose an unwarranted burden on consumers for the next forty years. This must not happen. Thus, we strongly recommend that you vote "No" on SB571, and that you encourage the efforts underway in the industry to work out the refund issues once and for all. Thank you.

Rick Smead - Costal Corp

STATE OF COLORADO

PUBLIC UTILITIES COMMISSION

Raymond L. Gifford, Chairman
Robert J. Hix, Commissioner
Polly Page, Commissioner
Bruce N. Smith, Director

Department of Regulatory Agencies

M. Michael Cooke
Executive Director

Bill Owens
Governor

March 10, 2000

Richard Smead, Esq.
Colorado Interstate Gas Company
P. O. Box 1087
Colorado Springs, CO 80944

James Albright, Esq.
Public Service Company of Colorado
1225 – 17th Street, Suite 600
Denver, CO 80202-5533

Dear Messrs. Smead and Albright:

Re: Kansas Ad Valorem Tax Offer of Settlement

The Colorado Public Utilities Commission (CPUC) supports the Offer of Settlement currently proposed to be filed with the Federal Energy Regulatory Commission (FERC) in Docket Number RP98-54-__, the Kansas Ad Valorem Tax case (KAVT).

The CPUC regards the KAVT Offer of Settlement favorably for at least two important reasons. First, if it is accepted by FERC, the settlement will finally bring to a close a long and expensive dispute. Colorado and other states' consumers have been owed a significant refund for several years (so long, in fact, that the interest owed is in excess of 160 percent of the principal), and the settlement will effect that refund in short order.

Second, the settlement strikes an appropriate balance between the interests of companies that are owed a refund (such as Colorado Interstate Gas) and the producers who must pay it. There has been a concern that small producers and individuals, including their royalty owners, may have difficulty paying the refund obligation. In response to that concern, the settlement forgives 12.5 percent of the gross refund liability of consenting owners, and then in most cases applies a further credit of $10,000 to the obligation. This forgiveness will eliminate the obligation of 400 working interest production owners who owe less than $10,000 (including interest), and it will obviate a substantial amount of collection and administrative expenses.

It is the CPUC's understanding that the amount forgiven is but a small percentage of the total amount due to CIG, allowing it to collect the overwhelming majority of the refund, and then pass it through to Colorado utilities and, ultimately, Colorado ratepayers. Therefore, we support the proposed settlement and hope FERC will approve it.

Very truly yours,

Bruce N. Smith
Director

STATE OF COLORADO

OFFICE OF CONSUMER COUNSEL
Department of Regulatory Agencies

1580 Logan St., Suite 740
Denver, CO 80203
Phone: (303) 894-2121
FAX (303) 894-2117

Kenneth V. Reif
Director

Bill Owens
Governor

M. Michael Cooke
Executive Director

March 9, 2000

John McNish
Advisory Counsel
Kansas Corporation Commission
1500 S.W. Arrowhead Road
Topeka, Kansas 66604-4027

RE: Kansas *Ad Valorem* Tax Refund Cases Settlement Conference

Dear Mr. McNish:

The Colorado Office of Consumer Counsel (OCC) fully supports the Offer of Settlement filed yesterday with the Federal Energy Regulatory Commission by Colorado Interstate Gas Company, Public Service Company of Colorado, Cheyenne Light, Fuel and Power Company, and Colorado Springs Utilities in the Kansas *Ad Valorem* Tax Refund docket. My office is a party to the FERC proceeding in this matter, but we are unable to attend the settlement conference on March 13. We applaud your efforts to reach a settlement and hope there will be support among the parties for this Offer of Settlement.

This Offer of Settlement presents a fair resolution of the issues and promises to bring to closure years of protracted and expensive litigation. The offer balances the interests of the small producers and individuals, including their royalty owners, for whom the payment of refunds could be a hardship, with the interests of the millions of consumers who paid this tax and are entitled to reimbursement. Under this settlement offer, each consenting working interest owner's refund liability would be reduced by 12.5% and a $10,000 credit, which should result in eliminating the refund obligation of nearly all working interest owners for whom making a refund would be a hardship.

My office represents 1,500,000 residential, small business and agricultural gas consumers in Colorado who stand to benefit from this refund of about $20 to $25 million through reduced gas costs and funding for low-income energy assistance programs. Colorado law requires that up to 90 percent of any unclaimed electric or gas refunds be paid to the Colorado Energy Assistance Foundation to help low-income consumers pay their utility bills. Because the refund dates back to 1983-1988, the unclaimed portion of the refund will be substantial.

It is in the public interest to resolve this matter in a way that ends the litigation, removes concerns about potential hardship for small producers, and reimburses the millions of small consumers, particularly low-income consumers, the dollars owed them.

Thank you for your consideration.

Sincerely,

Ken Reif
Director

cc: Honorable Carla Stovall
John Wine
William F. Demarest, Jr.
Public Service Company of Colorado
Colorado Interstate Gas Company
Colorado Springs Utilities
Colorado Public Utilities Commission
Colorado Energy Assistance Foundation
Colorado Congressional Delegation

Colorado Energy Assistance Foundation
Keeping Coloradans Warm

March 10, 2000

Mr. John McNish, Advisory Counsel
Kansas Corporation Commission
1500 S. W. Arrowhead Road
Topeka, Kansas 66604-4027

Dear Mr. McNish:

The Colorado Energy Assistance Foundation (CEAF) is writing you as a party to the Kansas *ad valorem* proceedings. CEAF appreciates the opportunity you have afforded to the parties concerning settlement discussions on March 13, 2000, in Topeka. Unfortunately, CEAF will not be able to attend. Yet, since our interest in this matter is substantial and long-standing, we are communicating our thoughts and position via this letter.

CEAF is a nonprofit fuel fund assisting low-income energy consumers throughout Colorado. As such, we represent the interests of the tens of thousands of low-income households who incurred financial harm due to the natural gas overcharges. A substantial share of the refunds in question are due to these consumers, either directly through utility refunds or remittance of unclaimed refunds to CEAF, as set forth in Colorado state statute.

As a party to this matter, CEAF is aware of the settlement offer being put forth by Colorado Interstate Gas Company (CIG). Please be advised that CEAF supports this approach to resolution. It mitigates any potential hardship on the smaller owners and producers while returning funds long overdue to consumers.

We commend the efforts of CIG to initiate a fair and reasonable settlement of this matter. We encourage all parties to lend their support to this proposal.

Sincerely,

Karen M. Brown

Karen M. Brown
Executive Director

cc: Attorney General, State of Kansas
Colorado Interstate Gas Company
Public Service Co. of Colorado
Colorado Springs Utilities
Colorado Public Utilities Commission
Colorado Office of Consumer Counsel
Colorado Congressional Delegation

THE STATE OF WYOMING

JIM GERINGER
GOVERNOR

Public Service Commission

HANSEN BUILDING, SUITE 300 2515WARREN AVENUE CHEYENNE, WYOMING 82002
(307) 777-7427 FAX (307) 777-5700 TTY (307) 777-7427 http://psc.state.wy.us

STEVE ELLENBECKER
CHAIRMAN
STEVE FURTNEY
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KRISTIN H. LEE
COMMISSIONER

STEPHEN G. OXLEY
SECRETARY AND CHIEF
COUNSEL
DAVID M. MOSIER
ADMINISTRATOR

March 8, 2000

President Richard L. Kaysen
Cheyenne Light, Fuel & Power Company
P. O. Box 1409
Cheyenne, Wyoming 82003

Re: Colorado Interstate Gas Company
Federal Energy Regulatory Commission Docket No. RP-98-54

Dear Mr. Kaysen:

Cheyenne Light, Fuel & Power Company, Colorado Interstate Gas Company, Public Service Company of Colorado and Colorado Springs Utilities have made an offer of settlement in the referenced proceeding. The Wyoming Public Service Commission has reviewed the settlement proposal in its current form and strongly supports it.

We believe that the proposed settlement strikes an acceptable balance among the interests of royalty owners, producers and consumers. The settlement would greatly simplify the existing federal administrative proceeding and, most importantly, would preserve substantial monies which would provide more timely refunds to utility customers.

Sincerely,

STEVE ELLENBECKER
Chairman

KRISTIN H. LEE
Commissioner

xc: Colorado Interstate Gas Company
Public Service Company of Colorado
Colorado Springs Utilities

BEFORE THE SENATE ENERGY AND NATURAL RESOURCES COMMITTEE

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

S.B. 571

Senate Bill 571 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 S.B. 571 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

are entitled to $60,466,040.

The Kansas Legislature has traditionally avoided entering into areas which involve the effects of litigation. Yet, S. B. 571 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.

S.B. 571 would prolong litigation and would effectively increase the liability of the producers as the interest component of the FERC orders continues

to grow. S.B. 571 raises a number of legal issues. First, S.B. 571 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. S.B. 571 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, S.B. 571 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. S.B. 571 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, S.B. 571 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 S.B. 571 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.

S.B. 571 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 S.B. 571 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 isssued.

Given the debate that S.B. 571 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 S.B. 571 and to protect the interest of consumers. S.B. 571 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.

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

Hearing on SB 571
Energy and Natural Resources Committee
Kansas Legislature
February 2000

Chairman Corbin, members of the Energy and Natural Resources committee.

Good morning,

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

I commend Senator Morris and this committee for holding this hearing on SB 571. The Kansas Ad Valorem tax reimbursement issue is clearly an important and complicated issue before the FERC and the state of Kansas.

Let me first give a brief overview of the history of the Kansas Ad Valorem tax refund issue. I believe this brief overview will not only put SB 571 into an important historical context, but will also help explain the pipelines' perceived concerns with the proposed legislation. In 1983, following the passage of the

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

Since these initial orders and appeals, all of the interested parties, including the producers, pipelines, and consumers, have participated in numerous dockets before FERC on various issues, and these dockets are awaiting final orders. In addition, legislation to resolve the Kansas Ad Valorem tax obligation issue is in discussion at the federal level before Congress. In the meantime, certain producers have refunded millions of dollars to the pipelines who in turn have

passed the refunds on to their customers, a number of producers have escrowed their money due, and others have not done anything.

At this point in the process, NNG like others in the pipeline industry, remain skeptical that SB 571 contributes to the resolution of this issue. The large tax increase proposed to be levied upon the pipeline industry and ultimately the consumers, constitutional questions, and the marketability of revenue bonds issued for the purpose of generating refunds to Kansas gas producers, certainly provide justification for such skepticism.

SB 571 imposes an estimated annual tax increase that could be as high as $5-6 MM on NNG service. Since tax payments are included in the pipeline cost of service and therefore pipeline rates, consumers ultimately will bear the burden of the increase. The tax increase proposed in SB 571 sets in motion a regressive tax with trend lines all too clear; residential customers will end up paying more. They will pay more on their individual energy bills and more when local businesses, hospitals and schools pass on their share of the tax increase to the consumer as well. The tax increase contained in SB 571 is an unfair and flawed attempt to resolve the Kansas Ad Valorem refund issue. New taxes and increased energy costs for all Kansans is not the solution to alleviating refund obligations for one group; the producers.

SB 571 also invites a litigious relationship to develop between Kansas and other parties to the Ad Valorem refund process. As indicated above, the Kansas Ad Valorem tax refund issue remains actively litigated at the FERC level. Adoption of SB 571 could interfere with settlements that have been proposed by interested parties at the FERC level, and could be inconsistent with the intent of federal legislation that is currently under consideration. NNG believes SB 571 invites prolonged and very controversial litigation regarding the constitutionality of this bill under the Commerce and Supremacy Clauses of the United States Constitution, which is more likely to complicate the refund process rather than assist it.

Consequently, NNG suggests these uncertainties create a cloud of litigation around this funding scheme, to tax all Kansans and relieve producers of any Kansas Ad Valorem refund obligations, which ultimately jeopardizes the marketability of the revenue bonds.

NNG respectfully requests the committee defer to other methods or existing processes to address this issue. Later this morning, Senator Morris will convene a forum for open discussion and dialogue among interested parties, in an effort to craft a Kansas settlement offer that could be presented to the FERC. NNG supports this effort and will participate in such an effort. We firmly believe that mutual agreement of some form of resolution is the only timely way this complex issue can be resolved.

Kansas
Ad Valorem Tax Reimbursement
Fact Sheet

Background

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

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

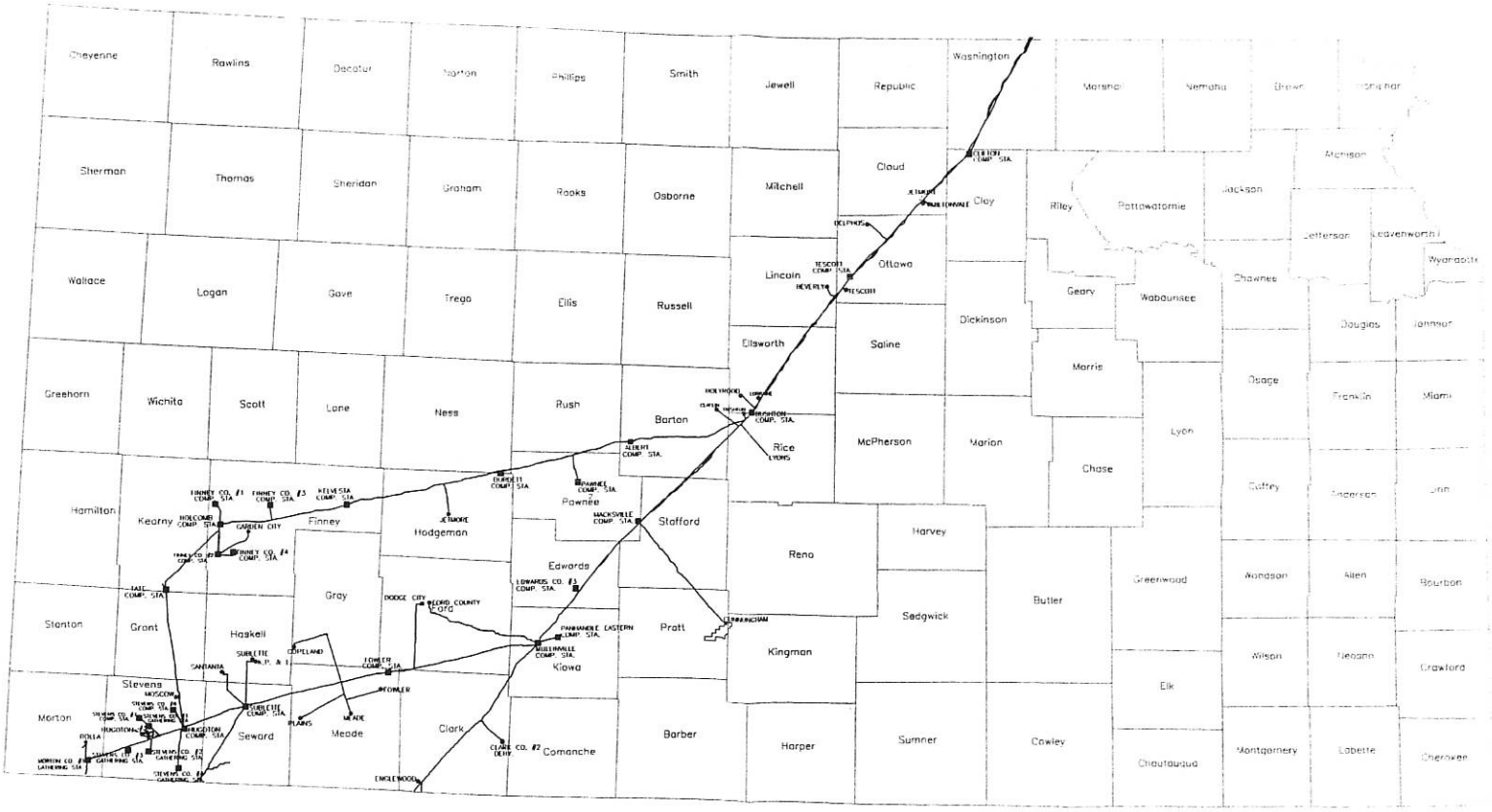
Who Pays	Producers
Who Collects/Disperses Payment	Pipelines
Who Receives Payment	Local Distribution Companies Ultimate Consumer
Estimated Payment Amount	$ 360MM $ 60MM Kansas Consumers
Federal Activity Congressional	HR 1117 (Moran); S 636 (Roberts); prohibit the collection and refunding of interest accrued and/or exempting small producers from tax refund obligations.
FERC	Missouri PUC filed a settlement proposal providing a $50,000 credit to first sellers towards their tax refund liability KCC filed comments regarding the Missouri settlement proposal requesting the FERC appoint a settlement judge and convene a settlement conference to address a possible resolution to this issue. The FERC has established a procedure to assist producers who would be faced with financial difficulty.

Kansas Legislature

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

KANSAS

Enron Transportation & Storage Facilities



ENRON

BEFORE THE
KANSAS SENATE COMMITTEE ON
ENERGY AND NATURAL RESOURCES

PREPARED TESTIMONY OF
JAMES W. BARTLING
MANAGER PUBLIC AFFAIRS

ON BEHALF OF
GREELEY GAS COMPANY
AND
ATMOS ENERGY CORPORATION

TESTIMONY IN OPPOSITION TO
SENATE BILL NO. 571

MARCH 20, 2000

TESTIMONY ON BEHALF OF ATMOS ENERGY CORPORATION
AND
GREELEY GAS COMPANY IN OPPOSITION TO
SENATE BILL NO. 571

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

Greeley Gas Company is a local distribution company (LDC) that serves approximately 113,000 customers in the state of Kansas with approximately 70,000 of these customers in the northeast counties of Douglas, Leavenworth, Johnson, and Wyandotte where we serve parts of the cities of Olathe, Lenexa, Overland Park, Bonner Springs, Lawrence, and Kansas City. We serve a little less than 5,000 customers in the southwest counties of Grant, Hamilton, Kearny, Morton, and Stanton where we serve the cities of Johnson City, Syracuse, and Ulysses. In the southeast section of Kansas we serve over 13,000 customers in Montgomery County, including the cities of Independence and Coffeyville.

But we also serve the "little" towns of Kansas including Fall River, Jarbalo, Linwood, Stark, Tyro, Havana, Hickock, Manter, Ness City, Lincolnville, Wilsey, and many others. When I say "little" I don't mean little in importance because Greeley Gas Company and the other five Business Units of Atmos Energy Corporation serve hundreds of towns with several hundred or less customers. It is these customers in these "little" towns, as well as us "fat cats" living in Johnson County, that will ultimately be paying this tax as proposed in Senate Bill No. 571.

Most of the gas that Greeley Gas Company sells to our customers is transported to our cities' respective city gate delivery points by the various

pipelines serving Kansas, both interstate and intrastate, and would be subject to this tax. We, as a utility, would ultimately pass this tax on to our 113,000 Kansas customers who would no doubt tell you as one that they feel that their gas cost is already too high.

Once approval has been obtained from the Kansas Corporation Commission to pass along these increased costs, whether through the purchased gas adjustment (PGA) mechanism or as the result of increased costs identified within a rate case, these increased costs will be passed on to our customers as an increase to each hundred cubic foot (Ccf) that they use. This will result in the larger annual gas users paying more on an annual basis than the smaller gas users. With the highest percentage of our larger residential gas users living in Johnson County we would expect that county's residents to pay a disproportionately higher percentage of the annual cost of this tax. While many people might say, "What's wrong with that," over sixty percent of our customers would take issue with that idea.

While it appears that the stated intent of this bill is that it "shall not apply to the local distribution of natural gas," the fact that LDC's must transport most of their gas will result in them incurring this tax as well. Their only recourse is to pass this tax along as an added cost to their customers. By virtue of this added cost, and others like it, we can expect

that some businesses may desire to switch to an alternate fuel because the price of natural gas has become less competitive. We strongly believe that competition is good for the economy but cannot support this added cost to our customers.

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

amendments to bill

Kansas Development Finance Authority
Discussion Points Concerning Senate Bill 571
March 13, 2000
Presented by Linda Wood, Chief Financial Analyst

Issues:

- How will data on gas transported be gathered to assess the tax?
- Is tax of "$.01 per million cubic feet " enough to pay debt service on bonds issued? Kansas Development Finance Authority ("KDFA") is unable to determine this, because we do not have information on all the variables: revenues generated by the tax; amount of bonds to be issued; length of amortization for the bonds.
- Legislation does not specify amount of bonds to be issued to provide proceeds for refund payments. Would KDFA be issuing the entire $362 million due to all consumers, or only the $60 million owed to Kansas consumers?
- KDFA has been told the revenue stream is decreasing, because the natural gas resource is depleting. It would be extremely difficult to market and sell a bond issue predicated on a declining revenue stream.
- KDFA has questions about the legality of a tax which has interstate commerce ramifications.
- The reference in Section 3 of the bill to the Interstate Commerce Commission should be deleted; this commission no longer exists.
- Section 10 of the bill authorizes the Kansas Water Office to refund bonds, but that entity is not an authorized issuer of these bonds. KDFA serves as the State's issuer, and KDFA statutes provide authority for KDFA to refund any KDFA issued debt.
- Section 8 ties the interest rate on the bonds to the index prescribed in K.S.A. 10-1009. KDFA is not typically subject to that index, and so is provided greater flexibility in structuring debt issued by KDFA, generally resulting in lower interest costs to the State.
- KDFA would require first lien on any revenues generated to pay debt service on bonds issued. Section 6 provides that revenues collected go first to the "mineral tax production refund fund" and then to the payment of bonds. That would not be acceptable to the market.
- Language in Sections 8 (b) through 11 is probably unnecessary, since KDFA's statutes and the bond documents typically approved by KDFA's Board of Directors cover these elements of structuring a bond issue.
- The language in Sections 6 and 13 conflicts about where bond proceeds will be deposited and how they will be used.
- "ALL" bond proceeds cannot be used to pay natural gas producers, because a portion of bond proceeds will be needed to fund a debt service reserve, and additional proceeds will be used to pay the costs of issuance of the bonds.
- There are three separate funds referenced in the bill, and there appears to be some conflict about from where each derives revenues and for what each is used: 1) Mineral tax production refund fund, 2) Natural gas producers ad valorem tax refund and bond retirement fund, and 3) Natural gas producers privilege tax refund fund.

TESTIMONY OF BILL DIRKS

AARP KANSAS STATE LEGISLATIVE COMMITTEE

ON SENATE BILL 571

MARCH 13, 2000

My name is Bill Dirks and I am a member of AARP's Kansas State Legislative Committee (SLC). In Kansas, AARP represents more than 350,000 residents age 50 and over before the legislature and before the Kansas Corporation Commission. 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 that 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 SB 571 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 get to 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.

ROBERTS
KANSAS

302 HART SENATE OFFICE BUILDING
WASHINGTON, DC 20510-1605
202-224-4774

COMMITTEES:
ARMED SERVICES
AGRICULTURE
INTELLIGENCE
ETHICS

United States Senate

WASHINGTON, DC 20510-1605

March 9, 2000

Senator David Corbin
Chairman
Senate Energy and Natural Resources Committee
Room 120S
State Capitol
Topeka, KS 66612

Dear Senator Corbin:

I appreciate your committee's work regarding the unfairness of FERC decisions that severely penalize our Kansas natural gas producers. This has been a well-coordinated effort by the Legislature, Governor Bill Graves and Congress.

For almost two decades FERC allowed gas producers to obtain reimbursement for payment of the Kansas ad valorem tax. However, the agency reversed 19 years of precedent and ruled that the ad valorem tax was ineligible for reimbursement. Kansas natural gas producers are grossly penalized for following FERC's repeated interpretation of federal law. In response, the Kansas Congressional delegation initiated efforts in Congress to provide partial relief for Kansas producers under the FERC rulings and subsequent court decisions. Unfortunately, our legislation is strongly opposed by other states that stand to reap large windfalls--at Kansas' expense--because of the FERC rulings.

With time growing short for congressional action, it certainly is appropriate at this point to seek solutions to this injustice at the state level. Senator Steve Morris has a proposal before the committee that merits serious study. The legislation provides a comprehensive and feasible approach that gives producers needed assistance in meeting the unfair FERC interest and principal payments while avoiding a new tax burden on Kansas citizens.

I encourage your careful review of this legislation and look forward to continuing working with you on this important issue.

With every best wish,

Sincerely,

Pat Roberts

PR:ad

Senate Energy & Natural Resources
Attachment: 15
Date: 3-13-2000

15-1

April 9, 1999

To: Doug Benevento
Office of Senator Wayne Allard

From: Jon Whitney
Colorado Interstate Gas Company

Subject: Robert's Amendment No. 101 to Supplemental Appropriations Bill

I am writing to urge Senator Allard to voice his opposition to the Robert's Amendment No. 101 in Section 2316 of the Senate Supplemental Appropriations bill. Specifically, this amendment would prohibit the Federal Energy Regulatory Commission (FERC) from requiring interest to accompany producer refunds of earlier paid reimbursements of the Kansas ad valorem tax. As you may know, the FERC and the U.S. Court of Appeals have ruled that natural gas producers must refund to pipelines monies illegally collected as ad valorem taxes from the early 80s to the early 90s. Once refunded, most of these dollars will be returned to local distribution companies, who in turn will refund them to ratepayers. CIG and other pipelines serving Colorado stand to collect more than $30 million for ultimate distribution to natural gas consumers in the state; the total amount nationwide is $350 million.

Some of the producers have already refunded the overcharges with interest, and it would be unfair (and possibly illegal) not to charge those who have yet to pay. Further, producers have been on notice since 1983 that these funds were at risk, and they have had the benefit of holding these dollars since that time.

We encourage Senator Allard and his staff to contact Colorado Congresswoman Diana DeGette and encourage her to ask Michigan Senator John Dingell to assert the Commerce Committee's jurisdiction over this matter.

Thank you for your consideration. If you have any questions, please do not hesitate to call.

MARY LOU MAKEPEACE
MAYOR

CITY OF COLORADO SPRINGS 99 APR -9 AM 2:14

April 6, 1999

UIP

Honorable Wayne Allard
U.S. Senate
513 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Allard:

The Senate recently added an amendment, offered by Senator Roberts, to the 1999 Supplemental Appropriations Bill (H.R. 1141, section 2316) that would prohibit the Federal Energy Regulatory Commission (FERC) from ordering refunds to consumers of interest accrued on Kansas ad valorem taxes collected between the years of 1983 and 1988. The House version of the bill does not contain such a prohibition. I urge you to oppose inclusion of the "Roberts amendment" in the conference report.

In 1998, FERC made a final determination ordering the refund of the ad valorem taxes with interest. The Commission's finding came after numerous FERC hearings on the matter and a final decision by the United States Court of Appeals, D.C. Circuit which found that this Kansas state tax was unlawfully collected by producers under federal law.

Because numerous interstate pipelines purchased gas in Kansas during the period in question, and transported it elsewhere, consumers in 23 different states are entitled to refunds. Consumers in 12 states should receive refunds of at least $5 million. The states expected to receive the largest refunds include: Kansas, Missouri, Minnesota, Colorado, Illinois, Indiana, Michigan, Wisconsin, Ohio and California.

Congress should not be swayed by arguments that such refunds will cause undue hardship on small gas producers in Kansas. The fact is, the overwhelming majority of the refunds will be paid by national and international, publicly-traded oil and gas companies which received ample notice of the liability for refunding the tax. FERC has shown sympathy for small producers by providing a process for reducing their payments if they can demonstrate hardship. To date, about 155 individual producers have made use of this option by filing claims.

Senator Roberts' amendment would prohibit Colorado Springs Utilities from collecting approximately $1.9 million dollars (calculated on a $1.1 million dollar overcharge plus interest) it is owed through the refund. It is CSU's position that the full refund, interest included, should go back to the purchasers. Purchasers can in turn utilize the money to defray the cost of providing service to their own customers. I strongly urge you to oppose the Roberts' amendment in conference.

Sincerely,

Mary Lou Makepeace

Mary Lou Makepeace
Mayor

30 S. Nevada Ave., Suite 401 • TEL 719-385-5900 FAX 719-578-6601
Mailing Address: Post Office Box 1575, Mail Code 410 • Colorado Springs, Colorado 80901-1575

United States Senate

WASHINGTON, DC 20510

April 21, 1999

The Honorable Ted Stevens
Chairman, Senate Appropriations
Committee
S128
Washington, D.C. 20510

The Honorable Robert Byrd
Ranking Member, Senate
Appropriations Committee
S128
Washington, D.C. 20510

Dear Senators Stevens & Byrd;

It is our understanding that yesterday you received a letter from Senator Allard and others with respect to an amendment added to the Emergency Supplemental by Senator Pat Roberts. We would like to add our names to that letter.

If accepted the Roberts Amendment would prohibit the Federal Energy Regulatory Commission (FERC) from collecting and refunding to consumers interest accrued on Kansas ad valorem taxes improperly passed along to consumers between the years 1983 and 1988. We hope at conference that the Senate will recede on this item.

Should you have any further questions, please feel free to contact either of us.

Sincerely,

Senator Craig Thomas

Senator Chuck Hagel

W[illegible]NE ALLARD
[illegible]LORADO
HA[illegible]NATE OFFICE BUILDING, SUITE 513
PHONE (202) 224-5941
FAX (202) 224-8471

ARMED S[illegible]
BANKING, HOU[illegible]G, AND URBAN AFFAIRS
SELECT COMMITTEE ON INTELLIGENCE

United States Senate

WASHINGTON, DC 20510-0606

April 20, 1999

The Honorable Ted Stevens
Chairman, Senate Appropriations Committee
S128
Washington, D.C. 20510

The Honorable Robert Byrd
Ranking Member, Senate
Appropriations Committee
S128
Washington, D.C. 20510

Dear Senators Stevens & Byrd;

During floor consideration of S. 544, the Emergency Supplemental Appropriations Bill, an amendment was attached by Senator Roberts that would prohibit the Federal Energy Regulatory Commission from collecting and refunding to consumers interest accrued on Kansas ad valorem taxes improperly passed along to consumers between the years 1983 through 1988. We urge you to recede to the House of Representatives, which has no comparable provision, with respect to this item at conference.

On August 2nd, 1996 the United States Court of Appeals for the D.C. Circuit ruled in Public Service Company of Colorado v. Federal Energy Commission that Kansas natural gas producers violated the Natural Gas Policy Act of 1978 (NGPA) when they passed on to consumers Kansas' ad valorem taxes. Under the NGPA, a natural gas producer is allowed to pass on the cost of a state severance tax. A severance tax under NGPA is a tax, "... attributable to the production of such natural gas ...". The D.C. Court of Appeals ruled that Kansas' tax was not a tax on production and was improperly passed along.

The result of this ruling is that 23 states are owed a refund of the principal and accrued interest of the tax passed along during this time. With principal and interest included, the total amounts to over $334 million. The Roberts amendment would deny repayment to consumers in 23 states of $207 million in accrued interest. The proponents of this amendment argue that it is unfair to charge the Kansas producers the interest because they relied upon the word of FERC in passing along the cost of these taxes. However, litigation on this issue began in 1983 and many of the parties who are now arguing surprise, were in fact engaged in that litigation.

While we understand the concern of the proponents of the amendment that having to repay large amounts of interest could put smaller producers in financial difficulty, this amendment does not distinguish between larger producers, who were or should have been aware of

7340 EAST CALEY
SUITE 215
ENGLEWOOD, CO 80111
PHONE: 303-220-7414
FAX: 303-220-8128

3400 16TH STREET
SUITE 3Q
GREELEY, CO 80631
PHONE: 970-351-7582
FAX: 970-351-7585

228 NORTH CASCADE AVENUE
SUITE 106
COLORADO SPRINGS, CO 80903
PHONE: 719-634-6071
FAX: 719-636-2590

411 THATCHER BLDG.
5TH AND MAIN STREET
PUEBLO, CO 81003
PHONE: 719-545-9751
FAX: 719-545-3832

215 FEDERAL BLDG.
400 ROOD AVENUE
GRAND JUNCTION, CO 81501
PHONE: 970-245-9553
FAX: 970-245-9523

15-5

potential repayment, and smaller producers. While we may be amenable to hardship relief for smaller producers, that is not an issue that can be resolved in conference of the Emergency Supplemental. Further, prior to agreeing to hardship relief we would want to know why FERC's already established procedures to assist producers who would face financial difficulty because of repayment are inadequate. Therefore, we would respectfully request the Senate recede from this provision so that the interested parties can attempt to resolve this matter in an equitable fashion.

Attached is a list of states whose consumers are owed a refund from Kansas producers for your information.

Thank you for your attention to this matter. If you have any questions, please feel free to contact us.

Sincerely,

Senator Wayne Allard

Senator Evan Bayh

Senator George Voinovich

Senator Robert Kerrey

Senator Herb Kohl

Senator Rod Grams

Senator Richard Durbin

Senator Charles Grassley

GIL GUTKNECHT
1ST DISTRICT, MINNESOTA

Congress of the United States
House of Representatives
Washington, DC 20515–2301

April 21, 1999

The Honorable C.W. Bill Young
Chairman
Committee on Appropriations
H-218 Capitol
Washington, D.C. 20515

Dear Bill:

I respectfully request you strike Senator Pat Roberts' Amendment that was included in the Senate Supplemental Appropriations Bill.

As you may know, the Federal Energy Regulatory Commission (FERC) ordered Kansas producers to refund unlawfully collected *ad valorem* taxes during from 1983-1988. Because numerous interstate pipelines purchased gas in Kansas and transported it elsewhere, consumers in 23 states are entitled to refunds on this unlawfully collected tax. Consumers in my state alone are expected to receive over $44 million in refunds.

The history is simple, FERC first ruled the taxes were unlawful and ordered a refund. Then, the D.C. Circuit agreed with the FERC and also held the companies liable for additional taxes beginning in 1983. After petition, FERC established procedures for the payment of full refunds plus interest to the affected companies, who in turn would reimburse the affected customers. If necessary, small produces facing hardships in paying the refunds may petition FERC for relief.

In summary, please reject the Roberts Amendment which validates the unlawful collection of taxes.

With best regards.

Sincerely,

Gil Gutknecht
Member of Congress

WASHINGTON OFFICE:
425 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–2301
(202) 225–2472

HOME OFFICE:
MIDWAY OFFICE PLAZA

15-7

This money is owed to consumers based on the FERC's decisions. The United States Court of Appeals for the D.C. Circuit has affirmed these orders. *Public Service Company of Colorado v. FERC*, 91 F.3d 1478 (D.C. Cir. 1996), *certiorai* denied, 117 S. Ct. 1723 (May 12, 1997). Public Service Company of Colorado was instrumental in initiating the action that brought about these decisions, which are favorable to your constituents.

The estimated maximum amount of principal and accrued interest potentially due to Colorado consumers is in the range of $22 to $24 million. Up to two-thirds of that amount is interest. If Amendment 101 is included in the Conference Committee's Emergency FY 1999 Appropriations Bill, then this money could be lost to Colorado consumers.

Moreover, the Colorado Energy Assistance Foundation ("CEAF") would be adversely affected. Pursuant to § 40-8-101(2), of the Colorado Revised Statutes, CEAF could receive up to 90 percent of the undistributed balance of the refund to help low income customers in their energy bills.

Therefore, we urge you to support our position and vote against Amendment 101 to S. 544 and any similar amendments and proposals.

Thank you very much in advance for your consideration of this matter.

Very truly yours,

Robert J. Hix
Chairman

Vincent Majkowski
Commissioner

Raymond L. Gifford
Commissioner

Enclosure

APR 19 1999

STATE OF COLORADO

PUBLIC UTILITIES COMMISSION

Robert J. Hix, Chairman
Vincent Majkowski, Commissioner
Raymond L. Gifford, Commissioner
Bruce N. Smith, Director

Department of Regulatory Agencies

M. Michael Cooke
Executive Director

Bill Owens
Governor

April 12, 1999

Congressman Thomas G. Tancredo
1123 Longworth House Office Building
Washington, DC 20515

Dear Congressman Tancredo:

RE: Amendment 101 to Senate Emergency FY 1999 Supplemental Appropriations Bill (S. 544) and House Emergency FY 1999 Supplemental Appropriations Bill (H.R. 1141)

The Colorado Public Utilities Commission would like to share our position on the adverse financial effect of Amendment 101 to Senate Emergency FY 1999 Supplemental Appropriations (S. 544) in the Conference Committee's Emergency FY 1999 Supplemental Appropriations Bill ("Amendment 101"). The bill would gravely harm your constituents, the ratepayers, and consumers of Colorado.

Amendment 101 would alter the Natural Gas Policy Act of 1978 (15 U.S.C. § 3301 *et seq.*) to eliminate retroactively the liability of certain natural gas producers to pay interest associated with a refund. Specifically, Amendment 101 to S. 544 proposes to waive approximately $200 million of accrued interest on Kansas *ad valorem* refunds. This money is owed to natural gas consumers in 23 states, including Colorado. The Kansas *ad volorem* tax was imposed by the State of Kansas beginning in 1978. The tax is a severance tax based on production, found as such by the Federal Energy Regulatory Commission ("FERC"). If the tax were a property tax, it would have qualified as an add-on to the maximum lawful price.

1580 Logan Street, Office Level 2, Denver, Colorado 80203, 303-894-2000

www.dora.state.co.us/puc
Permit and Insurance (Outside Denver) 1-800-888-0170
TTY Users 1-800-659-2656 (Relay Colorado)
Consumer Affairs 303-894-2070

Consumer Affairs (Outside Denver) 1-800-456-0858
Hearing Information 303-894-2025
Transportation Fax 303-894-2071
Fax 303-894-2065

$207 million in accrued interest. In addition to Colorado, the states of Kansas, Missouri, Minnesota, Nebraska, Illinois, Iowa, Indiana, Michigan, Wisconsin, Ohio, California, Oklahoma, Texas, South Dakota, and Wyoming are each owed refunds in amounts ranging from $2.9 to $75.5 million. The remaining states are owed less than $1 million each.

The FERC ordered Kansas gas producers to make these refunds based on a final decision of the United States Court of Appeals for the D.C. Circuit. The court found that the Natural Gas Policy Act prohibited the inclusion of these taxes in the price for natural gas. Public Service Company of Colorado, Colorado Springs Utilities, and Colorado Interstate Gas Company have led efforts to pursue the litigation that resulted in the FERC refund orders.

The large gas producers have been on notice about this refund since 1983. These large companies have contested the refund at the FERC and in the courts, using every legal maneuver available to avoid refunding this money to consumers. The FERC denied the producers' request to reconsider its order to require interest on the improperly collected taxes. The producers' appeal of the FERC's decision is pending in the D.C. Circuit Court of Appeals. Amendment 101 to S.544 is an attempt to reverse the FERC's decision before the appellate court can rule on the issue.

The Colorado Interstate Gas Company, Public Service Company of Colorado, Colorado Springs Utilities, the Colorado Energy Assistance Foundation, the Colorado Public Utilities Commission and the Colorado Office of Consumer Counsel are united in our efforts to ensure Colorado consumers receive the refund to which they are entitled. We urge you to support our efforts.

Very truly yours,

Ken Reif
Director

15-10

APR 19 1999

STATE OF COLORADO

OFFICE OF CONSUMER COUNSEL
Department of Regulatory Agencies

1580 Logan St., Suite 740
Denver, CO 80203
Phone: (303) 894-2121
FAX: (303) 894-2117

Kenneth V. Reif
Director

Bill Owens
Governor

M. Michael Cooke
Executive Director

April 12, 1999

The Honorable Tom Tancredo
House of Representatives
1123 Longworth House Office Building
Washington, DC 20515

RE: Amendment 101 to S.544, Senate Emergency FY 1999 Supplemental Appropriations Bill and H.R. 1141, House Emergency FY 1999 Supplemental Appropriations Bill.

Dear Representative Tancredo:

The Colorado Office of Consumer Counsel urges you to vote against Amendment 101 to S.544, and any similar amendments and proposals that deny Colorado consumers almost $20 million in interest on a $30 million refund of the Kansas *ad valorem* tax on natural gas sales. If Amendment 101 passes, the amount owed to Colorado consumers will be reduced from $30 million to about $10 million. This refund with interest was ordered by the Federal Energy Regulatory Commission (FERC) for taxes collected illegally between 1983 and 1988 by Kansas natural gas producers. Amendment 101 to S.544 (the Roberts amendment, which is Section 2316) would prohibit the FERC from requiring interest on refunds of state *ad valorem* taxes on natural gas sales that were collected before 1989. The interest on the refund is about two-thirds of the total.

Colorado's low-income consumers in particular will be adversely affected if the Roberts amendment passes. Colorado law requires that up to 90 percent of any unclaimed electric or gas refunds be paid to the Colorado Energy Assistance Foundation (CEAF) to help low-income consumers pay their utility bills. Because the Kansas *ad valorem* tax refund dates back to 1983-1988, the unclaimed portion will be substantial. If Congress removes the interest and reduces the amount of the refund, CEAF will have less to distribute to low-income consumers.

Millions of natural gas consumers in 23 states are entitled to refunds of the Kansas *ad valorem* taxes. Nationwide, the refund totals about $335 million with about

15-11

DISTRICT, COLORADO

COMMITTEE ON EDUCATION AND THE WORKFORCE

COMMITTEE ON RESOURCES

COMMITTEE ON INTERNATIONAL RELATIONS

Congress of the United States
House of Representatives
Washington, DC 20515–0606

April 16, 1999

The Honorable C.W. Bill Young
Chairman, House Appropriations Committee
United States House of Representatives
2407 Rayburn H.O.B.
Washington. DC 20515

Dear Chairman Young:

As you may know, Senator Pat Roberts recently added an amendment to the Fiscal 1999 Supplemental Appropriations Bill (S. 544) that would prohibit the Federal Energy Regulatory Commission (FERC) from collecting and refunding to consumers interest accrued on Kansas ad valorem taxes collected between the years of 1983-1988. The House version of the bill (H.R. 1141) does not contain such a prohibition. In your effort to reconcile the vast differences between the two supplemental appropriations bills. I urge you oppose inclusion of the "Roberts Amendment" in the conference report.

At stake is approximately $335 million in tax refunds. Before Congress prohibits these refunds. it is important that this matter is debated separately on the House floor. Few Members of the House are yet aware of this important issue. At least twelve states would benefit by over $5 million in refunds per state. However. 1999 is a difficult year for oil producers. many of whom would be responsible to pay for the refunds. It is important to hear their views on this issue as well.

The Kansas ad-valorem tax refund was recently upheld by a Washington, D.C. Federal Circuit Court. I urge the members of the Conference committee to withhold inclusion of the Roberts Amendment in the conference report, and allow the stakeholders an opportunity to discuss the refund in the House of Representatives.

If you need further information on this issue, please do not hesitate to contact me or Matt Knoedler of my staff at 225-7882.

Sincerely,

Tom Tancredo

Tom Tancredo
Member of Congress

15-12

April 16, 1999

Also +.
Dyrd
Young
Obey

The Honorable Ted Stevens
Chairman
Committee on Appropriations
S-128 Capitol Building
Washington, DC 20510

Dear Mr. Chairman:

We are writing to express our opposition to Section 2316 of the Emergency Supplemental Appropriations Act of 1999 (H.R. 1141) as passed by the Senate. The provision would reverse a Federal Court decision requiring natural gas producers in Kansas to refund approximately $360 million in overcharges, including penalties and interest, for natural gas sales made to consumers during the period of 1983 through 1988. Additionally, this provision, which has not received any hearing or debate in Congress, would retroactively amend the Natural Gas Policy Act of 1978 in a manner that unfairly favors one segment of the natural gas industry above all others. The amendment clearly represents legislating on an appropriations bill, and should be rejected pending hearings.

By way of introduction, the Interstate Natural Gas Association of America (INGAA) represents the natural gas pipelines in North America, and the American Gas Association (A.G.A.) represents the nation's local natural gas utilities. Together we transport and deliver over 90 percent of all the natural gas consumed in the United States.

Section 2316 of the Senate bill would partially overturn a decision by the U.S. Court of Appeals for the D.C. Circuit, which was upheld by the U.S. Supreme Court and implemented by the Federal Energy Regulatory Commission (FERC). The estimated $360 million in overcharges were the result of a state *ad valorum* tax collected by natural gas producers, which was subsequently found to be in violation of federal policy for interstate natural gas sales. The Senate amendment would waive reimbursements for interest and penalties (approximately $200 million of the total refund), even though the courts and the FERC have specifically required them in this case, and in past overcharge cases.

The vast majority of these interest and penalty refunds, approximately 90 to 95 percent, would be refunded to consumers who purchased natural gas from Kansas that was subject to the state tax during the period in question. The remainder would go to pipelines and local gas distribution companies to reimburse them for over-priced gas that they purchased for their own accounts. Allegations that the pipelines and/or local distribution

companies would receive most of these refunds are simply false. It is consumers who lose if this amendment is approved.

Some individuals also have argued that small gas producers will be driven from business unless they obtain relief from these penalties and interest. In fact, the FERC already has a process in place to waive these refunds for hardship cases involving small producers, and to date, several producers have been granted a waiver. Make no mistake, it is large, financially capable producers who would really benefit from this amendment.

A.G.A. and INGAA urge the conferees on H.R. 1141 to reject this provision. If this amendment is enacted, natural gas consumers in a number of states, including Missouri, Kansas, Illinois, Colorado, Michigan, Minnesota and Wisconsin, would not receive legitimate refunds. This matter deserves Congressional hearings before any action is taken to upset several legal and regulatory decisions. Please let us know if you have any questions.

Respectfully,

Jerald V. Halvorsen
President
Interstate Natural Gas Association of America

David Parker
President and CEO
American Gas Association

JERRY MORAN
FIRST DISTRICT
KANSAS

COMMITTEE ON
AGRICULTURE

COMMITTEE ON
TRANSPORTATION AND
INFRASTRUCTURE

COMMITTEE ON
VETERANS' AFFAIRS

1519 LONGWORTH HOUSE OFFICE BUILDI
WASHINGTON, DC 20515-1601
(202) 225-2715

DISTRICT OFFICES:
1200 MAIN STREET
SUITE 402
P.O. BOX 249
HAYS, KS 67601-0249
(785) 628-6401

20 WEST 2ND
SUITE 205
P.O. BOX 1128
HUTCHINSON, KS 67504-1128
(316) 665-6138

Congress of the United States
House of Representatives
Washington, DC

Statement of Congressman Jerry Moran

Kansas Ad Valorem Tax

March 13, 2000

Chairman Corbin, Ranking Member Biggs, and members of the Senate Energy and Natural Resources Committee, I appreciate your willingness to hold this hearing on Senate Bill 571, and to allow me to submit testimony.

On November 7, 1997 I introduced legislation to waive the interest penalty ordered by the Federal Energy Regulatory Commission (FERC) for refunds ordered on Kansas Ad Valorem taxes. Following the introduction of the bill, two hearings were conducted by the House Commerce Committee's Subcommittee on Energy and Power, where several important facts about this case were covered in detail. In considering whether a legislative remedy at either the state or federal level is appropriate, the following facts, as outlined from Congressional hearings on June 8, 1999 and July 29, 1999, are important to highlight:

1.) The court-ordered refunds are not going to the consumers who were inappropriately ordered to pay Kansas Ad Valorem taxes. According to the pipelines, there is no way to identify the individual consumers from 1983-1988; however, those same records are required in determining which royalty owner or producer must now pay, based on the same 1983-1988 time frame. (Commerce Committee Report 106-38, p. 128)

2.) The five-year delay by the Federal Energy Regulatory Commission accounts for one-third of the time, and well over one third of the cost, of the penalty. For five years, FERC's inaction on the issue simply added cost to this retroactive liability. When questioned, FERC representatives were unable to explain the five-year delay.

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3.) Producers followed the natural gas laws and all FERC orders the entire time. At no time was there an attempt to do anything other than follow the rules and live under FERC's regulations.

4.) For the consumer, the amount of refund is minimal. Estimates from the last hearing indicate a refund of around $15 per household. If the refund is offered as a billing reduction, spread out over a year on utility bills, this amounts to $1.25 per month. On the other hand, the damage to the producer is devastating. For farmers and royalty owners, a bill of $10,000 or more is common. For a retired individual, this amount is well over what they would receive for an entire year from Social Security.

As time pressures continue to mount on this issue, it is appropriate to consider all possible remedies from both a state and federal level. It is important to find ways to assist producers and royalty owners, as resolution of this issue is in the best interest of all parties concerned.

Again, I thank you for your time and for considering this bill. I look forward to continuing to work with you on this important issue.

HEIN AND WEIR, CHARTERED
Attorneys at Law
5845 S.W. 29th Street, Topeka, KS 66614-2462
Telephone: (785) 273-1441
Telefax: (785) 273-9243

Ronald R. Hein
Email: rhein@hwchtd.com

Stephen P. Weir*
Email: sweir@hwchtd.com
*Admitted in Kansas & Texas

Testimony re: SB 571
Senate Energy and Natural Resources Committee
Presented by Ronald R. Hein
on behalf of
Pioneer Natural Resources U.S.A., Inc.
March 13, 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 SB 571. This bill is an effort to correct a manifest injustice that resulted from a retroactive decision that was made by the Federal Energy Regulatory Commission (FERC) which reversed an earlier opinion of the Federal Power Commission (FPC) which was the predecessor to FERC. In the 1970s, FPC had ruled that the property tax in Kansas was, in essence, a severance tax. As you have heard from other conferees, FERC reversed this position in the 1990s, and made their decision retroactive. Therefore, those natural gas producers that had relied upon the earlier FPC ruling (which passed the cost of the property tax paid in Kansas to the consumer) were required to repay retroactively the amount of the tax that was passed on, plus interest and penalties. Ultimately, this injustice has been, to date, upheld by the courts.

I was in the legislature at the time the FPC made its earlier ruling, and was very actively involved in the legislative process when the state enacted a severance tax as an add on to, what everybody thought at that time, was the existing severance tax on gas and oil. Since the ad valorem or property tax was assessed pursuant to a formula that looked at the production from the well, it was always perceived to be a production based tax rather than a "classic" type of property tax.

SB 571 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 SB 571 for passage. Thank you very much for permitting me to provide this written testimony.

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KANSAS SENATE BILL 571
NATURAL GAS TAX

COMMITTEE ON ENERGY & NATURAL RESOURCES
KANSAS SENATE

MARCH 13, 2000

Kansas City Power and Light opposes SB 571, which would impose a tax of $.01 per million cubic feet to fund a natural gas pipeline producer ad valorem tax refund and bond retirement fund, for the following reasons:

- It appears that under SB 571 the refunds ordered by FERC plus interest and administrative costs of the fund would ultimately be paid by those who were deemed entitled to the refunds.

- There is no limit in the bill on the total amount of tax that can be collected, or the term of the taxing period.

- At a rate of $.01/mcf, the cost to KCPL for natural gas for generation needs is estimated to be an additional $25,000 to $75,000 per year.

Kansas City Power & Light Company is the second largest investor-owned electric utility in the state of Kansas, serving a population of over 1 million people in portions of 23 counties in northeastern Kansas, northwestern Missouri, and across the Kansas City metropolitan area. One of the nation's first electric utilities, KCPL has been providing reliable and economical energy to its customers for more than a century. Today, KCPL is the leading provider of energy and related products and services in the Kansas City metropolitan area and nationwide.

KANSAS CITY POWER & LIGH
1201 WALNUT • P.O. BOX 418679 • KANSAS CITY, MO 64141-9679 • 8