Approved February 22, 1984
Date

MINUTES OF THE Senate COMMITTEE ON Energy and Natural Resources.

The meeting was called to order by Senator Charlie L. Angell, Chairperson, at

8:00 a.m./~~p.m.~~ on Tuesday, February 21, 1984 in room 123-S of the Capitol.

All members were present except:

Senator Francis Gordon (Excused)
Senator Paul Hess
Senator Tom Rehorn

Committee staff present:

Ramon Powers, Research Department
Wayne Morris, Research Department
Don Hayward, Revisor's Office
LaVonne Mumert, Secretary to the Committee

Conferees appearing before the committee:

Jack Byrd, Interstate Oil Compact Commission

Vice-Chairman Kerr moved that the minutes of the February 14 and 17 meetings be approved. Senator Gordon seconded the motion, and the motion carried.

Copies of a letter from Representative Dan Glickman to Governor John Carlin concerning legislation ratifying low-level radioactive waste compacts were distributed to the Committee (Attachment 1).

Jack Byrd discussed the jurisdiction of the states and the federal government in relationship to minimum prices for gas produced. He said that prior to the Natural Gas Act, states frequently used minimum prices to accomplish conservation and to prevent waste. He cited how the State Corporation Commission set minimum prices before the Natural Gas Act (NGA) was passed. Under the NGA, the states' right to set minimum prices was preempted, and the states were left only with jurisdiction over intrastate gas. The Federal Power Commission, in the late 1960's, fixed a minimum price of 18¢. When the Natural Gas Policy Act (NGPA) was passed, the Federal Power Commission became the Federal Energy Regulatory Commission (FERC). They took the 18¢ minimum price and added an escalation rate just as the maximum lawful prices are allowed to escalate. That minimum rate for this month is 29.3¢ per mcf exclusive of state severance tax. Mr. Byrd explained the reason why there is gas selling in Kansas below that minimum rate. At the time the minimum rate was established, the Federal Power Commission had jurisdiction only on interstate gas; but under the NGPA, the FERC has jurisdiction over both interstate and intrastate gas. The NGPA reserved to the states the authority to fix a maximum lawful rate for gas produced provided that rate is not in excess of the maximum lawful rate established by the NGPA. But the NGPA is silent on the states authority to establish a minimum rate. Mr. Byrd said his personal opinion is that a state can fix a minimum rate equal to the minimum rate that was fixed by FERC under the NGPA. As to a state's authority to fix a minimum rate in excess of that, he does not believe it could be above the maximum lawful rate fixed by Congress.

Mr. Byrd talked about take-or-pay clauses. He noted that they are not peculiar to the oil and gas industry. He explained that the sum paid for gas not taken goes into an account 191, which is a rate base account. The company is allowed to earn whatever their rate of return is on that rate base. When the gas is taken, that sum is taken out of the rate base and is moved into the gas purchased cost account. Mr. Byrd does not feel the solution is to legislate against take-or-pay clauses because that would punish the wrong party. He feels the problem should be handled at the regulatory level so that costs for imprudent investments are excluded from the rate base. He told the Committee that other states have taken actions to cancel underages to curb the problem of cheap gas being shut in.

Chairman Angell asked why producers might not want to infill drill. Mr. Byrd said that there may be a feeling that Congress may deregulate gas, thereby raising the price without infill drilling. He also said it is possible it might not pay out because there is speculation as to the amount of additional recovery from infill drilling. He stressed the importance of the timing and said that he feels if infill drilling is not accomplished in the near future, it will never be done. Mr. Byrd told the Committee, in his opinion, the field should never have been developed on a 640-acre spacing. He talked about the permeability of the lower horizons. Senator Feleciano asked the position of the Interstate Oil Compact Commission concerning infill drilling. Mr. Byrd said that they have recommended that all states review both their spacing and proration orders to determine if additional volumes could be recovered by infill drilling. Responding to questions from

MINUTES OF THE Senate COMMITTEE ON Energy and Natural Resources,

room 123-S, Statehouse, at 8:00 a.m.XXXX on Tuesday, February 21, 1984

Senator Feleciano, Mr. Byrd said that he does represent Mesa Petroleum and that Mesa would benefit from infill drilling. However, they are precluded from initiating infill drilling by their contract with Kansas Power and Light Company.

Staff reviewed a memorandum concerning the estimated impact of deregulation of natural gas on state and local tax collections. They explained how the price and production figures were determined and reviewed the estimated increased severance, property, income and sales taxes. The low estimate is 60 million dollars and the high estimate is 162 million dollars.

The meeting was adjourned at 9:01 a.m. by the Chairman. The next meeting of the Committee will be at 8:00 a.m. on February 22, 1984.

Senate Energy & Natural Resources
Feb. 21, 1984

Name	Organization
Patti Gorham	KCC
Jack Glaves	Panhandle Eastern
Don Schnacke	KIOGA
Lon Stanton	Northern Natural Gas
D.S. Black	KPL/Gas Service
Dick Compton	Midwest Energy
Ed Reinert	KS League of Voters
Ed Peterson	KCC
Shirley Domer	KU Energy Research
Chip Wheelen	KLPG
Bill Rinehart	Gulf Oil Corp.
David W Nickel	KCC
Penny Plamann	KIOGA
Rick Kready	KPL / Gas Service Co.
Bill Perdue	" "
Walter Dunn	EKOGA
Joe Hodges	Cities Service Oil & Gas
Robert C. Anderson	Mid Cont Oil & Gas
George Adams	Mobil

Attachment 1

copy: Governor
Gary
B. Watson

AN GLICKMAN
..TH DISTRICT—KANSAS

COMMITTEES:
AGRICULTURE
JUDICIARY
SCIENCE AND TECHNOLOGY

CHAIRMAN: SUBCOMMITTEE ON
TRANSPORTATION, AVIATION AND MATERIALS

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ADMINISTRATIVE ASSISTANT

SCOTT FLEMING
LEGISLATIVE DIRECTOR

PATRICK GARCIA
DISTRICT ADMINISTRATOR

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OFFICE OF THE GOVERNOR

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515

February 9, 1984

Honorable John Carlin
Governor
State of Kansas
State House
Topeka, Kansas

Dear John:

I wanted to give you an update on where things stand here in Congress relative to legislation ratifying low-level radioactive waste compacts.

As you know, hearings were held in both the House and Senate last fall, and more hearings are scheduled in the House Interior Subcommittee on Energy and the Environment on February 23 and 24. I understand that these hearings will include witnesses from the Environmental Protection Agency and the Nuclear Regulatory Commission, as well as a represenative from each of the Compact Commissions.

Any chance for movement on compact bills such as the Central Interstate Compact depends, I am told, on whether or not the states "get their act together" and either approve the remaining compacts or come up with a contingency plan for the post-1985 deadline which is fair to both the states which have formed compacts as well as those that haven't. To this end, you may want to use your influence as Chairman-elect of the National Governors Association to put pressure on states to make this issue a priority.

My staff and I are in frequent contact with the Central Interstate Compact Commission Staff Director and Counsel, Ray Peery; however, if there is ever any information or strategy you feel might be helpful in moving things here in the House, please let me know. Should there be a change here in Subcommittee intentions, I'll make sure you're aware of it.

With best regards,

Dan

Dan Glickman
MEMBER OF CONGRESS

DG:sm
cc: Terry Smith

Atch. 1

Attachment 2

KANSAS LEGISLATIVE RESEARCH DEPARTMENT

Room 545-N - State House

Phone 296-3181

Date February 15, 1984

TO: SENATOR CHARLIE ANGELL Office No. 355-E

RE: IMPACT OF NATURAL GAS PRICE DEREGULATION ON STATE AND LOCAL TAXES

This memorandum is in response to your request for initial estimates as to the impact of the deregulation of natural gas prices on state and local tax collections in Kansas.

Based on the data, assumptions, and methodologies presented below, it is estimated that the deregulation of natural gas prices, if effective July 1, 1984, might increase severance, property, income, and sales tax collections in Kansas by some $60 million to $162 million. It should be understood, however, that these estimates are preliminary and are most useful in illustrating the ways in which deregulation would impact tax collections.

The price and production estimates used are presented first, and then the impact on each of the above four taxes is estimated separately.

Price. The consensus estimate for the severance tax as to the average price of natural gas in Kansas in FY 1985 is $1.35 per m.c.f. You have stated that other experts in the energy field are estimating that, if deregulated, natural gas prices in Kansas could increase to between $2.40 and $2.60 per m.c.f. At your request, I have prepared estimates using each of the two new estimated prices. These prices would be an increase of between $1.05 and $1.25 per m.c.f. over the current estimated price.

Production. The consensus estimate as to natural gas production volume in FY 1985 is 420,000,000 m.c.f. I will therefore use that production figure for one set of estimates. In addition, however, it is a general principle of economics that, other things being equal, an increase in the price of an item will lead to more production of that item. Thus, it should be expected that an increase in the price of natural gas from $1.35 to either $2.40 or $2.60 per m.c.f. would lead to an increase in the production of natural gas. Furthermore, the impact on production might be expected to be felt most strongly in the Hugoton field because that area is one of the oldest producing fields in the state and has some of the lowest-priced gas in the state and nation. To estimate the impact of price deregulation on Hugoton production, I have calculated the capacity of Hugoton by taking its highest production in the past seven years (1978) and reducing it by the percentage decline in Hugoton field pressures; this methodology should approximate maximum production unaffected by price restraints. This result is almost 500,000,000 m.c.f., an increase of about 250,000,000 m.c.f. from the current estimate of Hugoton production. Thus, this estimated increased production would result in potential total state production of 670,000,000 m.c.f. (if deregulation were accompanied with infill drilling, production might be higher).

Atch. 2

Increased Income. By multiplying the most conservative price increase above with the current FY 1985 estimate of production, one may develop a conservative estimate as to the impact of price deregulation in Kansas, as follows:

420,000,000	m.c.f.
$x 1.05	m.c.f.
$441,000,000	

Likewise, by multiplying the higher estimated price increase with the increased estimate of production, one may develop an upper limit estimate as to the impact of price deregulation in Kansas, as follows:

250,000,000	m.c.f. (added production)	420,000,000	m.c.f. (current estimate)
$x 2.60	m.c.f.	$x 1.25	m.c.f.
$650,000,000		$525,000,000	

$ 650,000,000
525,000,000
$1,175,000,000

Thus, it is estimated that price deregulation in Kansas could result in an increase in gross receipts for producers of between $441 million and $1.175 billion.

Severance Tax. The net severance tax rate on natural gas of 7 percent (8 percent minus 1 percent credit for property taxes) is applied against the wellhead price. Therefore, the estimated increase in gross receipts will have a direct impact on severance tax receipts, as estimated below:

$441,000,000		$1,175,000,000
x 94.5%	(percent taxable)	x 94.5%
$416,745,000		$1,110,375,000
x 7%	tax rate	x 7%
$ 29,172,150		$ 77,726,250

Property Tax. Higher production prices would, other things being equal, increase property taxes on natural gas properties because the calculation of a lease's gross reserves is the most important step in valuing the gas lease. That value is calculated by multiplying the total annualized production for the previous year times a net price figure times a present worth factor. The last three years the estimated property taxes on gas leases have averaged approximately 6 percent of the value of production from the preceding year. Thus, using that percentage against the increased production values, property taxes might increase as follows:

$441,000,000		$1,175,000,000
-29,172,150	severance tax	-77,726,250
$411,827,850		$1,097,273,750
x 6%	average property tax as percentage of prior year's value	x 6%
$ 24,709,671		$ 65,836,425

However, the higher property tax estimate presented above would apply only after any increase in production had worked through the valuation process. If production in the Hugoton field increased as a result of deregulation in (for example) 1985, then the valuations for 1986 levies would increase substantially because the decline factors would be distorted. In subsequent years the decline factors presumably would return to normal.

Income Tax. Increased production receipts could be expected to increase individual and corporation income tax collections in Kansas. Royalty owners are assumed to be individuals, and their shares are not subject to expenses, but are subject to severance and property taxes. Assuming all royalty owners are Kansans and that all hold one-eighth interests, individual income tax collections might be expected to increase as follows:

$387,118,179	total net increase (after severance and property taxes)	$1,031,437,325
x 12.5%		x 12.5%
$ 48,389,772	increased state individual income	$ 128,929,666
x 4.5%	assumed marginal tax rate	x 4.5%
$ 2,177,540		$ 5,801,835

Working interest owners are assumed to be corporations, and approximately 80 percent of Kansas natural gas production is from out-of-state producers. The amount of increased income taxes from corporations under deregulation might be as follows: 87.5 percent x 20 percent (Kansas corporations) ÷ 2 (to account for some additional expenses and the fact that Kansas-owned gas is already somewhat higher priced than the average price of gas in Kansas) = 8.75 percent of total additional income subject to tax in Kansas.

$387,188,179	total net increase (after severance and property taxes)	$1,031,437,325
x 8.75%		x 8.75%
$ 33,872,841	increased state corporate income	$ 90,250,766
x 6.75%	corporate tax rate	x 6.75%
$ 2,286,417		$ 6,091,927

Income from out-of-state corporations owning Kansas production rights would also be subject to Kansas income taxes, but it is assumed that total, nationwide production values would not increase under deregulation — that higher priced gas in other states would fall to the estimated prices listed above.

Sales Taxes. Based on the above figures the additional amount of income retained in the state by individual Kansans and Kansas corporations after severance, property, and income taxes might be \$78-\$207 million. Assuming that all such additional net income is spent in taxable sales but not taking into account a multiplier or "ripple" effect, state sales tax collections might conservatively be expected to increase as follows:

\$78,000,000	\$207,000,000
x 3%	x 3%
\$ 2,340,000	\$ 6,210,000

Summary. The above tax estimates are summarized below:

Low Estimate (in millions)	Source	High Estimate (in millions)
\$ 29	Severance Tax	\$ 78
25	Property Tax	66
4	Income Taxes	12
2	Sales Tax	6
\$ 60		\$ 162

I hope this information is useful to you. Please contact me if I may be of further assistance to you.

Wayne D. Morris
Principal Analyst

WDM/pb