Approved April 1, 1986
Date

MINUTES OF THE Senate COMMITTEE ON Assessment and Taxation.

The meeting was called to order by Senator Dan Thiessen at
Vice- Chairperson

11:00 a.m./~~p.m.~~ on Thursday, March 27, 1986 in room 519-S of the Capitol.

All members were present except:
Senator Fred A. Kerr (Excused)

Committee staff present:
Tom Severn, Research Department
Melinda Hanson, Research Department
Don Hayward, Revisor's Office
LaVonne Mumert, Secretary to the Committee

Conferees appearing before the committee:
Donald P. Schnacke, Kansas Independent Oil and Gas Association
Spencer L. Depew, Kansas Independent Oil and Gas Association
John Jordison, Peoples Natural Gas Company
Bill Bryson, Kansas Corporation Commission

Senator Allen moved that the minutes of the March 26, 1986 meeting be approved. Senator Mulich seconded the motion, and the motion carried. Senator Hayden moved that the minutes of the March 26, 1986 meeting be approved. Senator Mulich seconded the motion, and the motion carried.

H.B. 2643 - Natural gas; contract provisions disallowing production tax pass-through prohibited. Re Proposal No. 8

Donald P. Schnacke testified in support of the bill (Attachment 1). He briefly described the history of regulation of natural gas in Kansas. He explained that the Federal Energy Regulatory Commission permits the pass-through of the ad valorem tax and the severance tax on interstate gas. Mr. Schnacke said that this bill would establish as public policy that intrastate gas be treated the same as interstate gas. In answer to Senator Salisbury's question, Mr. Schnacke said the net result of the bill will be to stimulate interest in drilling for intrastate natural gas. In response to Senator Hayden's question, Mr. Schnacke said there is no relationship between H.B. 2643 and infill drilling.

Staff advised that they know of no fiscal note on the bill.

Senator Hayden declared a conflict of interest.

Responding to questions from Senator Salisbury, Mr. Schnacke said the consumers ultimately pay the pass-through taxes. He noted that the bill does not provide for mandatory pass-through but provides that this be a negotiable item. He feels that it is a "state of mind type of statute" and says the expression of the Legislature is that it is the public policy to treat the intrastate market in the same way as the interstate market.

Spencer L. Depew spoke in favor of the bill (Attachment 2). He said the bill would encourage Kansas producers to explore for new intrastate gas. Mr. Depew stated that H.B. 2643 would allow intrastate gas to be competitive with interstate gas. He noted that the bill would only apply to contracts entered into after July 1, 1986 and does not apply to users of natural gas for irrigation purposes.

John Jordison said that he had opposed the bill in the interim committee and in the House committee. Their concern was that the bill might be an attempt to increase the price of intrastate gas which would decrease its marketability. In addition, they felt the bill was unnecessary legislation. Mr. Jordison said they have determined that the bill would not alter the way they negotiate with producers, so they neither support nor oppose the bill.

13 B12

CONTINUATION SHEET

MINUTES OF THE Senate COMMITTEE ON Assessment and Taxation,

room 519-S, Statehouse, at 11:00 a.m./~~p.m.~~ on March 27, 1986

H.B. 3069 - Combined filing and payment of severance tax and conservation fees

Donald P. Schnacke said they support the bill without the House floor amendments (Attachment 3). He expressed concern about the surplus in the conservation fee fund because there is some interest by other agencies in using the funds for purposes other than what it is intended for.

Bill Bryson spoke in favor of H.B. 3069 without the House floor amendments. He said the Commission wants to lower the levy. The Commission feels the fund should be about $1 million, $500,000 for plugging costs and $500,000 to cover other expenses. Mr. Bryson said the Commission would like to continue the assessment by rule and regulation so they can make evaluations on an ongoing basis.

Senator Salisbury moved that the bill be amended by removing the House floor amendments. Senator Mulich seconded the motion, and the motion carried. Senator Karr moved that H.B. 3069, as amended, be recommended favorably for passage. Senator Mulich seconded the motion, and the motion carried.

H.B. 2643 - Natural gas; contract provisions disallowing production tax pass-through prohibited. Re Proposal No. 8

Senator Mulich moved that the bill be recommended favorably for passage. Senator Allen seconded the motion, and the motion carried.

Meeting adjourned.

ASSESSMENT AND TAXATION

OBSERVERS
(PLEASE PRINT)

DATE	NAME	ADDRESS	REPRESENTING
3/27/86	Jack Montgomery	Topeka	Governor - Policy
	Dana Ferrell	"	Budget
	Chip Wheelen	Topeka	KLPG
	Robert A. [illegible]	[illegible]	[illegible]
	T. Fred Kalb	Broomfield Co	Union Pacific Corp
	SPENCER L. DEPEW	WICHITA	KIOGA
	Bob Clelland	Topeka	Dept. of Revenue
	Jim Bread	Topeka	KCC
	Bill Bryson	Topeka	KCC
	WALTER DUNN	✓	EKOGA
	Ken PETERSON	TopekA	KPC
	TREVA POTTER	TOPEKA	NORTHERN NAT. GAS
	John Jordison	Topeka	Peoples Natural Gas
	Diana Cole	Topeka	Northern Nat. Gas
	GERALD QUICK	Council Bluffs Iowa	PEOPLES NATURAL GAS
	Rick Kready	Topeka	KPL Gas Service
	JIM McBride	Topeka	observer

KIOGA
KANSAS INDEPENDENT OIL & GAS ASSOCIATION
500 BROADWAY PLAZA • WICHITA, KANSAS 67202 • (316) 263-7297

March 27, 1986

TO: Senate Committee on Assessment & Taxation

RE: HB 2643

HB 2643 arose out of 1985 Interim Proposal No. 8. The bill reflects what the Interim Committee members believed - that intra-state and inter-state natural gas producers should be uniform in the treatment of production taxes.

We believe that HB 2643 is in the spirit of encouraging a basic industry in Kansas.

Natural gas production in Kansas has been in a serious decline since 1970. A sharp decline in 1979 continued until 1982. A slight increase in 1983 brought production to only 48.3% of the peak production of 1970 (see chart).

Before the Congress passed the NGPA in 1978, intra-state gas in Kansas was competing with inter-state gas production. There were good supplies and the price was outside of controls. Producers were busy trying to find more intra-state gas.

When Congress passed the NGPA in 1978, intra-state gas purposely was made available to the inter-state markets. Ninety percent of the gas production in Kansas is classed as inter-state. The old Federal Power Commission, now FERC, since 1975 recognizes the Kansas ad valorem tax to be passed through as though it was a severance tax.

When Kansas passed the severance tax, it imposed a 7% tax on natural gas production. That brought the total production tax on natural gas to the highest level in the nation - 17% to 22% depending on the ad valorem tax involved. Inter-state producers can pass both taxes through as a public policy established by the FERC, but not so for the intra-state producers.

When an intra-state producer has a contract that permits the pass-through of the severance tax, it does pass through.

In effect, Kansas, by enacting its severance tax on natural gas moved away from what is federal public policy for inter-state gas. The result is that most intra-state gas producers in Kansas are not looking for natural gas today. The severance tax on the intra-state gas produced is estimated to be $3-4 million, out of $101 million collected and about $4 million of $131 million ad valorem taxes collected.

We think we have a long enough history of this discrimination against intra-state gas producers to merit bringing this problem to your attention. The present policy encourages producers to hook-up and sell only to inter-state pipelines. We think HB 2643 is a solution to assure that intra-state produced gas is treated the same as inter-state gas in Kansas. We think this would stimulate competition and it would be good for the consumers and the industry, as well as the counties and the State of Kansas.

Attachment 1
Senate Tax Comm. - 3/27/86

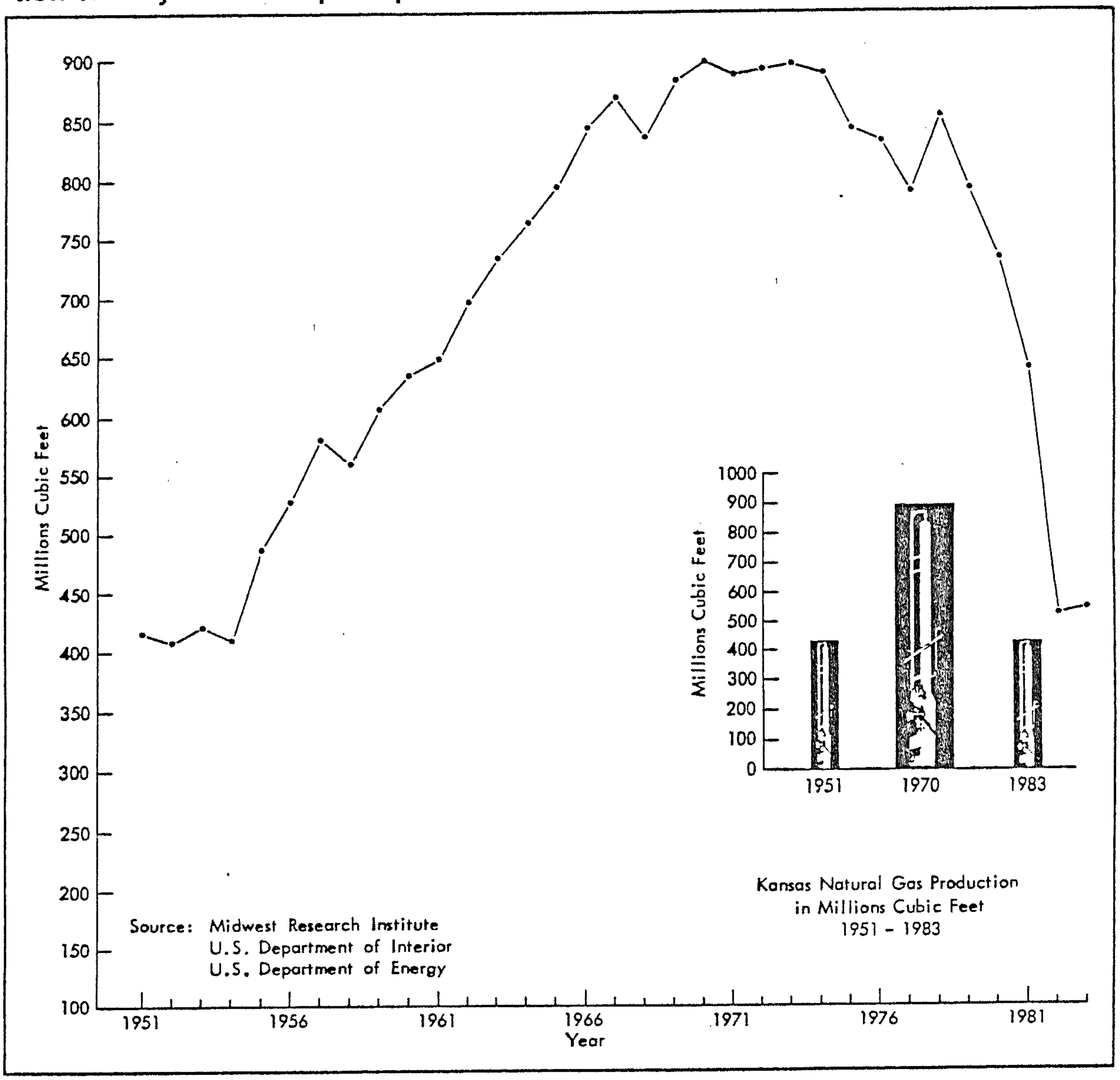
We believe HB 2643 addresses this problem by establishing as public policy, that all gas under the jurisdiction of the State of Kansas be treated the same as inter-state produced natural gas, as recognized by FERC, by recognizing the right of producers to pass along the applicable Kansas production taxes on Kansas produced natural gas. This equal treatment for inter-state and intra-state natural gas would allow competition on an equal footing; would stimulate drilling and production; and will be healthy for the industry involved and stimulate increased tax revenues for the counties and the State Kansas.

In summary, this proposal does not abrogate existing contracts. It is an incentive for negotiation in the future. It would tend to move Kansas producers back into the intra-state market. Kansas is known to have some of the cheapest gas in America. This would help Kansas consumers who would not have to depend on more expensive, deeper wells from out of state in the interstate market. If enacted, it will increase Kansas gas reserves.

Donald P. Schnacke

DPS:pp

Kansas natural gas production reached an all time high in 1970. A sharp decline in 1979 continued until 1982. A slight increase in 1983 brought production to only 48.3% of peak production in 1970.



SENATE ASSESSMENT AND TAXATION COMMITTEE
March 27, 1986

TESTIMONY OF SPENCER L. DEPEW
Wichita, Kansas

My name is Spencer L. Depew. I am a practicing attorney at law residing in Wichita. Historically a large part of my law practice is consisted of representing various independent oil and gas operators producing in the State of Kansas. In view of recent developments relating to prices or oil and gas produced in Kansas, I am not sure that I still have any clients.

I am presently a member of the Board of Directors of the Kansas Independent Oil & Gas Association and I am serving as the Chairman of the KIOGO Natural Gas Committee.

The Kansas independent oil and gas operator has long prided himself upon his ability to survive the most adverse circumstances. Hopefully some independent operators are still surviving. These operators include producers of natural gas in the State of Kansas who have lived through the enactment of the Natural Gas Policy Act adopted by Congress in 1977, which for the very first time found the Federal Government regulating the price of Kansas natural gas sold to intrastate pipelines for consumption within the State of Kansas, the enactment of the Kansas Natural Gas Price Protection Act, which further regulated the price of certain Kansas intrastate gas, the adverse decisions of the Kansas Supreme Court and the United States Supreme Court

Attachment 2
Senate Tax Comm. - 3/27/86

which upheld the validity of the Kansas Natural Gas Price Protection Act, the enactment of the Kansas Natural Gas Price Control Act, which further regulated the price of certain Kansas intrastate gas, the adoption of the Kansas Severance Tax, plummeting natural gas prices and finally the drying up and disappearance of a large part of the Kansas intrastate gas market. The purchasers of natural gas in the Kansas intrastate market have been sympathetic, but there is very little that they have been able to do to help the Kansas producers. It is most unusual for the Kansas independent oil and gas producers to turn to the Kansas Legislature for help, but that is what we are now doing. We have nowhere else to turn and any assistance that the Kansas Legislature can provide to the Kansas oil and gas industry is vitally needed and I assure you will be truly appreciated.

In many ways this appearance before your Committee represents a new experience for the Kansas independent oil and gas operator. Until now he has always felt that he could compete with anyone in the market place, but now that he finds he is the most heavily taxed segment of a national energy industry, which industry is in shambles. The Kansas independent gas producer has no alternative other than to ask for your help.

The Kansas Supreme Court and the United States Supreme Court both found that the contractual price to be paid to the intrastate gas producer is subject to regulation under the "police power" of the state and that it is reasonable and appropriate for his gas contract to be rewritten by the Legislature if the

Legislature finds that the same is in the best interest of the citizens.

What is the solution for the Kansas independent gas producer? I feel that the answer is to allow the Kansas independent gas producer, who sells his gas into the Kansas intrastate market, to receive a price comparable to the price that he would receive if he sold the gas into the interstate market. Such an incentive will allow and encourage the Kansas producer to explore Kansas for new gas reserves in areas of the state where the only existing markets are pipelines tied into the intrastate markets. At the present time the exploration for such new gas reserves in the State of Kansas seems to be almost non-existent. As you know, those Kansas producers who do find new reserves of natural gas immediately seek out the interstate gas markets.

The interstate gas market, under the control of the Federal Energy Regulatory Commission, has long recognized and continues to recognize today the concept of reselling natural gas at a "just and reasonable" rate, and in defining the "just and reasonable" rate the Federal Energy Regulatory Commission recognizes, pursuant to Congressional mandate, that production taxes, such as the Kansas ad valorem tax and the Kansas severance tax, are necessary costs of production, to be included in the price to be paid for interstate natural gas, and accordingly the Federal Energy Regulatory Commission allows such taxes to be passed through to the ratepayers by the purchaser of the interstate gas from the producer.

I propose today that the Kansas legislature take the lead and establish a new policy of encouraging the search for new Kansas gas reserves for the Kansas intrastate gas market by enacting innovative legislation that will find that the producers of Kansas natural gas that is sold for consumption within the State of Kansas, and the purchasers of such gas from the producers, be entitled to receive a "just and reasonable" rate for such gas. Such legislation will allow Kansas gas sold for consumption by Kansans to be competitive with Kansas gas sold by Kansas producers into the interstate market, and the result will be the potential discovery of new Kansas gas reserves which hopefully will be available to serve future Kansas generations for many years to come. In essence, such legislation would find that the producers of such gas are entitled to receive from the purchasers of such gas reimbursement of the ad valorem tax and the severance tax paid upon the gas production, and which would then allow the purchasers of the gas to flow the Kansas taxes through to the ratepayers; if in the future there is no more intrastate gas available to the Kansas consumers, the distributors of natural gas will be required to go into the interstate natural gas market to purchase gas and the price to be paid by the ratepayers for such gas will include these very same taxes, even if the gas originated in the State of Kansas.

House Bill 2643 does not automatically require production taxes to be included in the purchase price for natural gas. Such a provision is allowed, however, to be considered as one of the negotiable terms for a new contract. Such provisions would not be retroactive and would only apply to contracts entered into after the effective date of this Act which presumably will be July 1, 1986. Also, specific provision has been made that this Act shall not apply to users of natural gas for irrigation purposes with in the State of Kansas.

I am not asking for any unfair advantage for the Kansas gas producer in the market place today; all I am asking for is a recognition and acknowledgment of the handicaps under which the Kansas independent oil and gas producers have been operating and that such producers be given the opportunity to have a fair and equal treatment under the law and be given the opportunity to receive a "just and reasonable" rate for Kansas natural gas sold to Kansas ratepayers.

KIOGA

KANSAS INDEPENDENT OIL & GAS ASSOCIATION

500 BROADWAY PLAZA • WICHITA, KANSAS 67202 • (316) 263-7297

March 27, 1986

TO: Senate Committee on Assessment & Taxation

RE: HB 3069

We have no objection to HB 3069. As a matter of fact, we wanted this included in the severance tax passed in 1983, if for no other reason than to indicate that a minor severance tax had been in place for years, that amounts to nearly $4 million annually and that there is extensive regulation of the industry. That money is being used to regulate our industry in Kansas.

We also believe HB 3069 will put into procedure a discipline in collecting the severance tax designated for the KCC and KDH&E. Up to now, these agencies have only hoped the assessments would come in, and, if they don't, they just merely raise the levy. It is possible, through an increase in collections, the levy by the two agencies could be reduced.

We would hope that passage of HB 3069 would not prejudice the passage of HB 3078 which is recommended by the Organizational Sub-committee of the "Blue Ribbon" Committee appointed by KCC Chairman Lennen and KDH&E Secretary Sabol, which would transfer the entire oil and gas regulatory program that now lies in KDH&E (about a $500,000 effort) to the KCC which has the vast majority of the oil and gas regulatory program (about a $3.5 million effort).

We do not support the House floor amendments which greatly reduce the KCC Conservation Fee Fund. We do not support the assessments being made by statutory authority. We support the continuation of doing it by rule making. KCC agreed yesterday to a plan that would reduce the fund significantly and we think that is the proper procedure. We strongly recommend that you reject the House floor amendment.

Donald P. Schnacke

DPS:pp

Attachment 3
Senate Tax Comm. - 3/27/86