Approved: 3/31/00
Date

MINUTES OF THE HOUSE TAXATION COMMITTEE.

The meeting was called to order by Chairperson Wagle at 9:00 a.m. on March 9, 2000, in Room 519-S of the Capitol.

All members were present except: Representative Tomlinson - excused
Representative Edmonds - excused

Committee staff present: Chris Courtwright, Legislative Research Department
April Holman, Legislative Research Department
Don Hayward, Revisor of Statutes
Shirley Sicilian, Department of Revenue
Ann Deitcher, Committee Secretary
Edith Beaty, Taxation Secretary

Conferees appearing before the committee: Gary Reed of Arkan Petroleum
Mark Shreve of Mull Drilling Co.
Bob Krehbiel of KIOGA

HB 2721 - Relating to oil and gas severance taxation.

The Chair introduced Gary Reed of Arkan Petroleum, a proponent who explained **HB 2721** to the Committee. (Attachment 1).

Bob Krehbiel, of KIOGA, explained the actual workings of the severance taxation.

Don Hayward of the Revisor's Office said that **HB 2721** was actually patterned after a bill that the state of Oklahoma passed three years ago. He said the bill was an attempt to remedy a defect in the definition of the basis for where you determine the severance tax doesn't apply, by taking care of those instances where a well doesn't necessarily decline in production but is basically leveled.

Next to appear before the Committee in support of **HB 2721** was Mark Shreve of Mull Drilling Co. (Attachment 2).

The hearing on **HR 2721** was concluded.

SB 502 - Oil lease property tax refunds.

Bob Krehbiel, representing KIOGA as a proponent for **SB 502**, explained the bill to the Committee. (Attachment 3).

The hearing on **SB 502** was concluded.

The Chair asked Don Haywood if **HR 2721** and **SB 502** could be combined as one bill. He said it would be possible.

The meeting was adjourned at 10:20. The next meeting is scheduled for Friday, March 10, 2000.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

ARKAN PETROLEUM, INC.

Gary L. Reed, President
PE., License #7168
SIPES #2428

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Wichita, Kansas 67230 * 316-733-4798
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BEFORE THE HOUSE COMMITTEE ON TAXATION

STATE OF KANSAS-HOUSE OF REPRESENTATIVES

MARCH 9, 2000

HEARING ON H. B. 2721

TESTIMONY OF GARY L. REED, PRESIDENT OF ARKAN PETROLEUM, INC.

TESTIMONY OF GARY L. REED, PRESIDENT OF ARKAN PETROLEUM, INC.

HEARING ON H. B. 2721

MARCH 9, 2000

Madam Chair and members of the Committee:

My name is Gary L. Reed, President of Arkan Petroleum, Inc., appearing in support of H.B. 2721.

Passage of what is commonly called the production enhancement severance tax exemption during the 1998 legislative session is strong evidence that the legislators of Kansas recognize the importance of prolonging the economic life of the producing oil and gas wells in our state by encouraging operators to initiate enhancement projects such as: workovers, recompletions, replacement and addition of production equipment including compression, and the use of new technology such as 3-D seismic and horizontal drilling. These efforts will ultimately maintain and increase the development of the oil and gas resources of Kansas for years to come.

As a registered professional petroleum engineer and a member of the board of directors of the Kansas Independent Oil and Gas Association, I served on the committee formed by the state corporation commission to adopt rules and regulations necessary to efficiently and properly administer the provisions of the original bill. The rules committee addressed many technical and operational questions which were brought up regarding the implementation of the bill. However, it became apparent that certain of the questions could only be clarified by legislative amendment. Proposed amendments could not be submitted to the

1999 legislature due to the timing of the rule making process . H.B. 2721 addresses two situations that have been identified as needing clarification beyond the scope of the original bill.

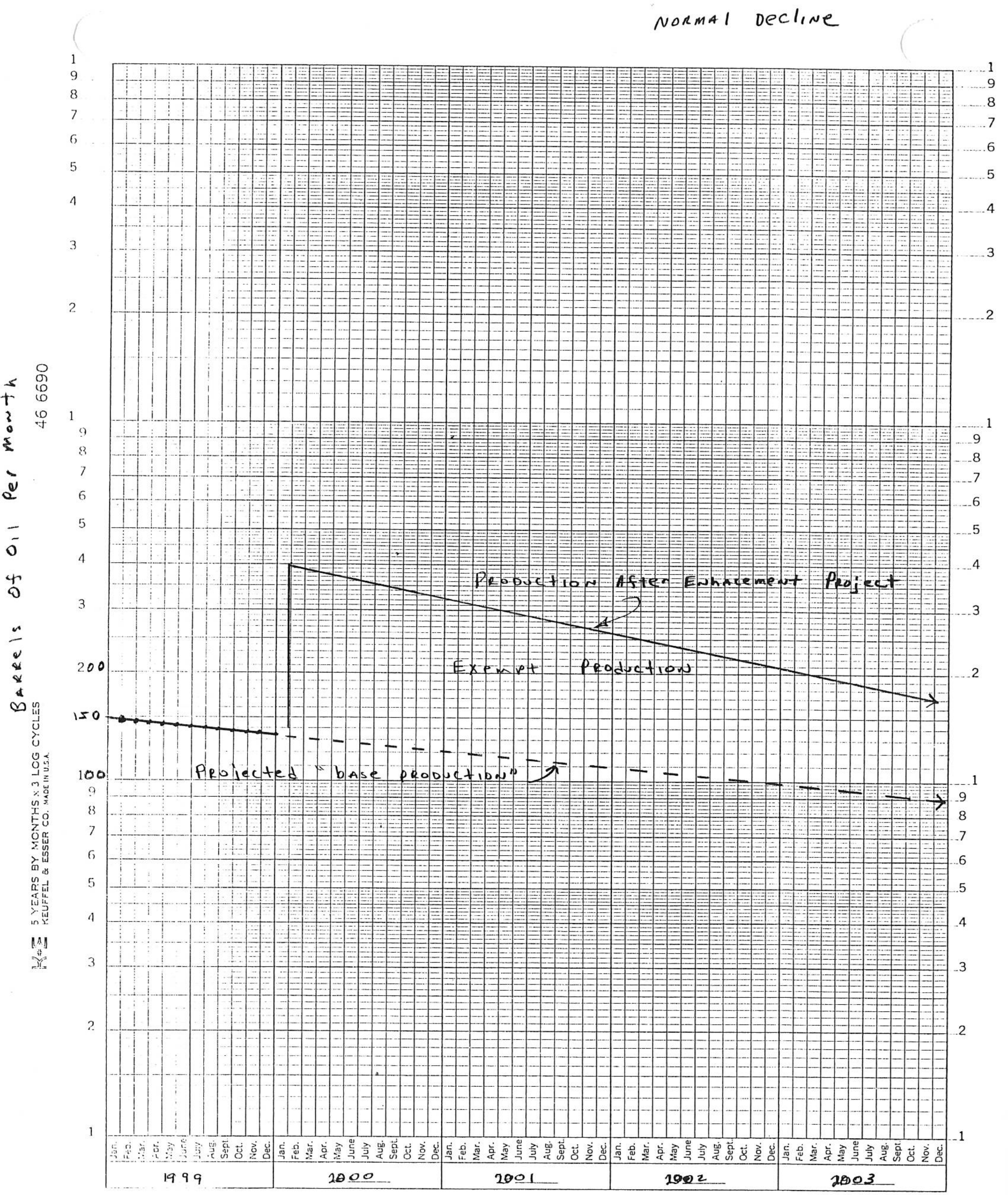
Paragraph 6(A)(2) of the bill addresses the definition and a calculation of the "base production" for a well immediately prior to the beginning date of a production enhancement project. The calculation of this base production is the initial step in identifying the amount of production from the well that will be granted relief from the mineral severance tax. Integral to the definition of base production is the concept that oil and gas production declines with time. The concept of production decline is so ingrained in the definition of base production that certain applications for the severance tax exemption have been denied because the well did not have a decline in its production. In other words, a well producing 5 barrels of oil per day each and every day for the 12 months preceding some type of production enhancement project would not be granted a severance tax exemption for any increased production resulting from the production enhancement project because technically a declining base production could not be calculated. It is my opinion that the intent of the original bill was not to deny such a well the severance tax exemption for increased production resulting from a qualified production enhancement project. Language added in H.B. 2721 addresses this problem by simply making the base production for a well with no decline or perhaps even an incline in its rate of production, the arithmetic average of the production for the 12 months preceding the date of an enhancement project.

Another problem occurs in the calculation of the base production for a well that has suffered some type of mechanical failure such as a casing leak. The original bill clearly defines the repair of a casing leak as a production enhancement project. Very often, this type of failure renders a well totally incapable of producing oil or gas. Depending on how long such a well is not producing, the calculated base production will be less and less until after twelve months of downtime, the base production would be zero. Language added in H.B. 2721 addresses this issue by establishing the base production rate of a well incapable of producing at the time of the production enhancement project to "zero" regardless of whether or not the well had production during the twelve month period immediately prior to the initiation of the production enhancement project.

I have included three graphical examples of the base production situations mentioned in my testimony.

It should be noted that in line 41 of page 4 of H.B. 2721 that the word "decline" has been inadvertently omitted from the phrase "....rate of production decline shall be equal to zero in the case.....".

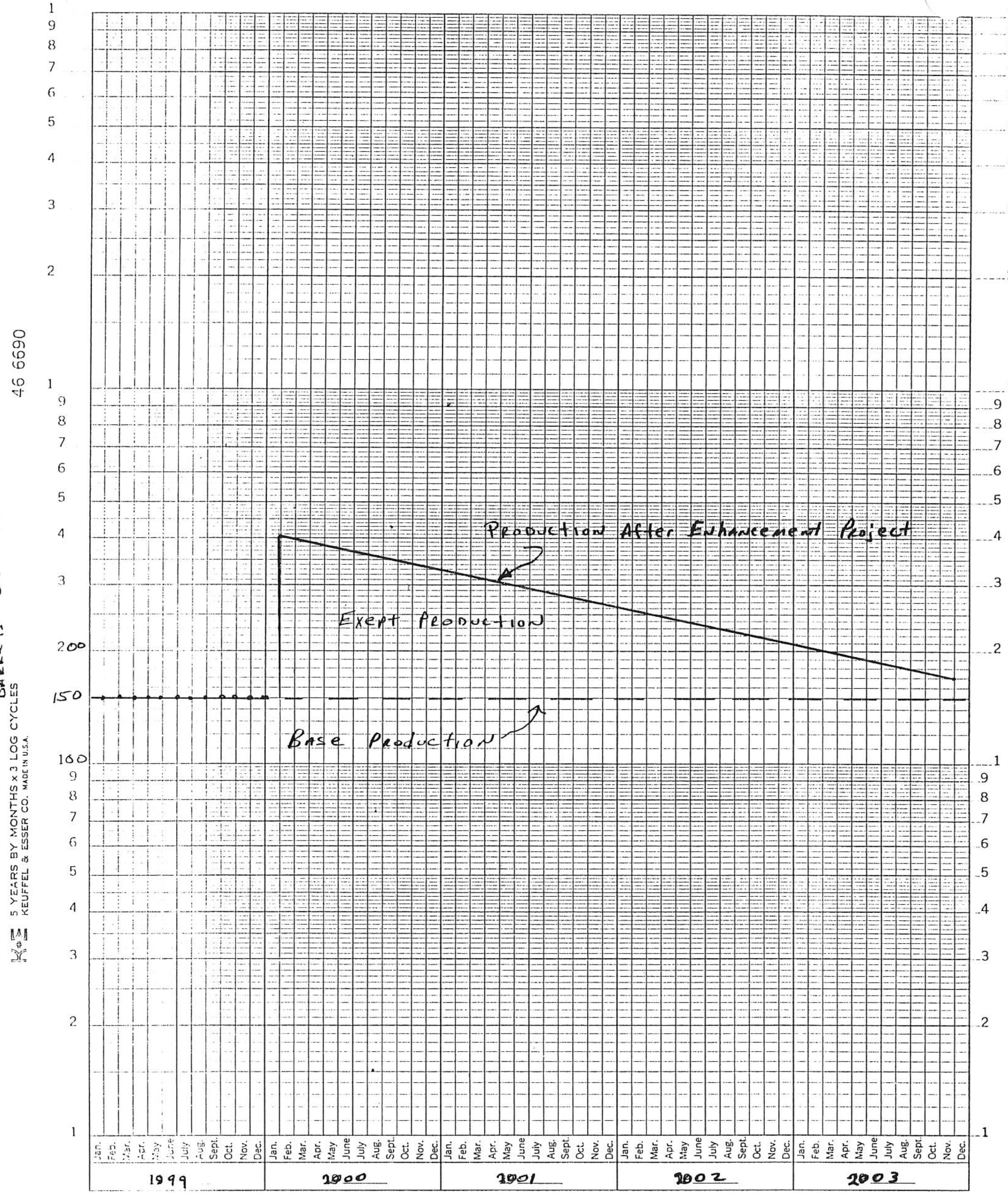
Thank you for allowing me to testify, and I will be glad to take any questions.



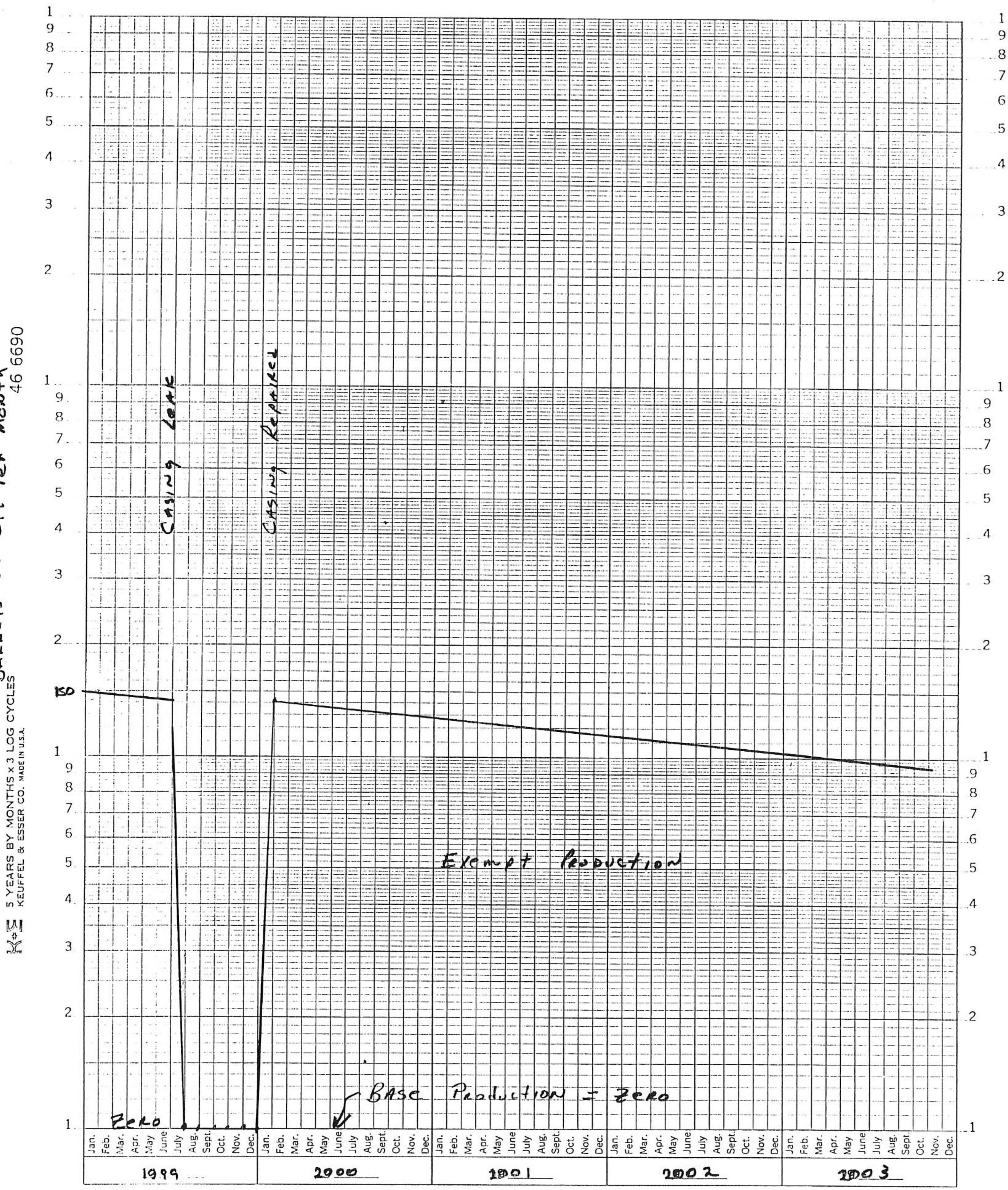
NORMAL DECLINE
Barrels of Oil Per Month
200
150
100
Production After Enhancement Project
Exempt Production
Projected "base production"
1999
2000
2001
2002
2003
5 YEARS BY MONTHS x 3 LOG CYCLES
KEUFFEL & ESSER CO. MADE IN U.S.A.
46 6690

1-5

Well Has No Decline



CASING LEAK



1-7

KANSAS INDEPENDENT OIL & GAS ASSOCIATION

KIOGA
105 S. BROADWAY • SUITE 500 • WICHITA, KANSAS 67202-4262
(316) 263-7297 • FAX (316) 263-3021

BEFORE THE HOUSE COMMITTEE ON TAXATION
STATE OF KANSAS-HOUSE OF REPRESENTATIVES
MARCH 9, 2000
HEARING ON H.B. 2721
TESTIMONY OF MARK A. SHREVE, PRESIDENT
KANSAS INDEPENDENT OIL AND GAS ASSOCIATION

Madam Chair and Members of the Committee:

My name is Mark A. Shreve and I am appearing on behalf of the Kansas Independent Oil and Gas Association in support of HB 2721.

Two years ago, a law was passed providing a seven-year severance tax exemption for incremental production resulting from enhanced recovery projects. This "production enhancement severance tax exemption" provides encouragement for Kansas oil and natural gas producers to prevent waste by more efficiently and completely developing our state's natural resources through production enhancement projects. HB 2721 is simply a clarification of the existing law. As noted in previous testimony by Mr. Reed, the law, as written, does not adequately cover situations in which pre-enhancement production is not declining nor does it adequately cover the situation where a well is incapable of production prior to the enhancement operation. HB 2721 clarifies these specific situations.

The production enhancement severance tax exemption passed in 1998 had no fiscal note attached to it because it does not affect severance tax on existing production. The only production exempt from severance tax is incremental production resulting from an enhancement project. This incremental production may not have been experienced without this law. Because HB 2721 is simply a clarification of existing law, it also should have no fiscal effect on the State of Kansas.

Although HB 2721 should have no fiscal effect on the State of Kansas, it should have a positive fiscal effect on the counties in which enhancement projects are located. By enhancing an existing well, Ad Valorem tax for the property will often increase due to the production increase experienced by the well. This will not only maintain the petroleum producing counties tax bases, but may actually expand these counties tax bases. Therefore, the existing law and the clarifications of this law outlined in HB 2721 are good for Kansas from a tax revenue standpoint.

House Taxation
Date: 3-9-00
Attachment # 2-1

Currently Kansas has approximately 42,000 wells considered marginal or stripper wells, those wells producing less than 15 barrels of oil per day or 90,000 standard cubic feet of gas per day. These stripper wells represent 75% of our oil and natural gas production. Over 6,000 Kansans are employed in oil and natural gas production. The production enhancement severance tax exemption is designed to reduce the costs associated with producing marginal oil and natural gas wells in Kansas. The exemption helps to prolong the life of these stripper wells, encourages enhancement to increase our Kansas oil and natural gas production and consequently, helps to maintain and potentially increase the number of jobs available in Kansas. This exemption does not apply when oil prices exceed $20.00 per barrel or when gas prices exceed $2.50 per thousand standard cubic feet (MCF) at the well head.

In summary, HB 2721 is simply a clarification of existing law which will help to prevent waste and encourage the efficient development of Kansas natural resources. I urge you to pass this bill. It is good for Kansas. Thank you.

KIOGA

KANSAS INDEPENDENT OIL & GAS ASSOCIATION

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TESTIMONY OF ROBERT E. KREHBIEL, EXECUTIVE VICE-PRESIDENT
OF THE KANSAS INDEPENDENT OIL AND GAS ASSOCIATION
ON SENATE BILL 502
BEFORE THE HOUSE COMMITTEE ON ASSESSMENT AND TAXATION
MARCH 9, 2000

Madame Chair 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 in support of S.B. 502.

Last year this Committee passed a bill which provided an income tax credit for property taxes paid on marginal oil wells making less than 15 barrels of oil per day when the price of crude oil is less than $16 per barrel. This legislation started out as Senate Bill 18 by Senators Lee and Corbin and was passed as part of Senate Bill 45.

This legislation represented excellent energy policy for the State of Kansas. It was designed to prevent the premature plugging of marginal wells when the price of crude oil falls below $16 per barrel, thus preventing the waste of Kansas' natural resources. This legislation has worked very well to achieve its intended purpose.

The implementation of the bill, however, required each working interest owner in a qualifying oil lease to claim the credit on their individual income tax returns. While this works, simply allowing the operator of the well to file for a property tax credit would save hundreds of man hours and hundreds of pieces of paper for both the industry and the Department of Revenue. That is the only purpose of SB 502, to simplify the procedure for claiming the credit. SB 502 will allow the operator to claim the credit for the property and eliminate the filing for credits by hundreds of non-operating interest owners.

The price of crude oil has recently moved above $16 so the credit will not be available for property tax year 2000. Nevertheless this is an important safety net for our industry when the OPEC nations drive prices down in their periodic attempts to drive U.S. oil from the markets. That time will recur again. Simplifying the procedure now for the future will be most helpful when that time comes.

Thank you very much for your consideration.

House Taxation
Date: 3/9/00
Attachment # 3-1

******* STATEMENT OF JOINT OPERATIONS *******

COMPANY BILLING SUMMARY

PICKRELL DRILLING COMPANY INC
100 S MAIN #505
WICHITA KS 672023738

WELL NUMBER: 601500
WELL NAME: RALL A
LOCATION: 17:KING-010/030S/008W
BILLING DATE: NOVEMBER 1999
PAGE: 1

REFERENCE	DESCRIPTION OF EXPENSE	SOURCE OF CHARGES		DETAIL AMOUNT	SUB TOTAL	GRAND TOTAL
[---- LEASE OPERATING EXPENSES ----]						
11-5	AD VALOREM TAXES	.	LOE	1,258.00		
22	FIXED OVERHEAD	RC:00120-1 WELL	LOE	317.00		
11-18	HAUL SALT WATER	TRUCKING	LOE	45.00		
490 11/2	MAINT ENGINE	691 JAYHAWK OILFIELD SUPPLY	LOE	156.77		
11-16	MAINT MISC LEASE EQUIPMENT	LABOR	LOE	120.00		
11-18	MAINT MISC LEASE EQUIPMENT	TRUCKING	LOE	288.00		
22	PUMPER EXPENSE	RC:00620-WAGES TAXES INS BEN MILEAGE	LOE	175.00		
30	SALT WATER DISPOSAL FEES	RC:01245-SWD PER CONTRACT	LOE	35.00		
---------	TOTAL OPERATING			------------	2,394.77	
=========	TOTAL LEASE OPERATING EXPENSES				============	2,394.77

* * * * TOTAL WELL CHARGES * * * * 2,394.77

NUMBER	OWNER NAME	INVOICE	[BEFORE CASING] PERCENT	AMOUNT	[AFTER CASING] PERCENT	AMOUNT	[WORKING INTEREST] PERCENT	AMOUNT	TOTAL CHARGES
BUR260	BURNSIDE INC	064163	.01562500		.01562500		.01562500	37.42	37.42
BUR304	BURTON O&G PROPERTIES	064164	.10546875		.10546875		.10546875	252.57	252.57
BUR305	BURTON O&G PROPERTIES L P	064165	.08789062		.08789062		.08789062	210.48	210.48
CUR200	EDGAR S CURRY	064166	.02343750		.02343750		.02343750	56.13	56.13
CUR275	WILLIAM F CURRY	064167	.00781250		.00781250		.00781250	18.71	18.71
DEA200	DEARCO	064168	.03125000		.03125000		.03125000	74.83	74.83
G&N200	G & N INVESTMENTS INC	064169	.03125000		.03125000		.03125000	74.84	74.84
JOH225	VIRGINIA M JOHNSON REVOCABLE	064170	.06250000		.06250000		.06250000	149.67	149.67
KLI200	DR JOHN R KLINE	064171	.01562500		.01562500		.01562500	37.42	37.42
LEH200	KATHERINE C LEHMAN	064172	.00781250		.00781250		.00781250	18.71	18.71
PAI199	PICKRELL ACQUISITIONS INC	064173	.29394532		.29394532		.29394532	703.93	703.93
PIC200	PATRICIA M & THOMAS R PICKRE	064174	.04394531		.04394531		.04394531	105.24	105.24
PIK200	GERALD W PIKE	064175	.02343750		.02343750		.02343750	56.13	56.13
RED200	BRENDA B REDFERN	064176	.03906250		.03906250		.03906250	93.54	93.54
SPT199	SEBITS PROPERTIES TRUST	064177	.07031250		.07031250		.07031250	168.39	168.39
STE725	JAMES E STEWART REVOCABLE TR	064178	.04687500		.04687500		.04687500	112.25	112.25
STE730	JAN LEE STEWART	064179	.03125000		.03125000		.03125000	74.84	74.84
STE745	KENTON S STEWART REVOCABLE T	064180	.06250000		.06250000		.06250000	149.67	149.67
	WELL OWNER TOTALS		1.00000000		1.00000000		1.00000000	2,394.77	2,394.77

	TOTAL SELECTIVE	TOTAL LEASEHOLD	TOTAL TANGIBLE	TOTAL INTANGIBLE	TOTAL OPERATING	TOTAL LEASE
EXPENSE TOTALS: RALL A	.00	.00	.00	.00	2,394.77	2,394.77

18 owners

3-2