Approved: March 25, 3009
Date

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Chairman Richard Carlson at 9:00 a.m. on March 18, 2009, in Room 535-N of the Capitol.

All members were present.

Committee staff present:
Gordon Self, Office of the Revisor of Statutes
Scott Wells, Office of the Revisor of Statutes
Chris Courtwright, Kansas Legislative Research Department
Kathy Beavers, Committee Assistant

Conferees appearing before the Committee:
Representative Jeff King
Joan Wagnon, Secretary, Kansas Department of Revenue
Bill Waters, Kansas Property Valuation Department
Dudley Feuerborn, Commissioner, Anderson County Board of Commissioners
Bob Bouldin, Commission, Morton County Board of Commissioners
Tony Fowler, Commissioner, Montgomery County Board of Commissioners
Mark Low, Meade County Appraiser
Gordon Stull, Pratt County Counselor
Ron DeGarmo, Morton County Board of Commissioners and President, Kansas Legislative Policy Group (Written only)
Ron Gaches, Southern Star Central Gas Pipeline, and El Paso
Larry Garrett, Colorado Interstate Gas Company

Others attending:
See attached list.

HB 2378 - Public utility defined for property tax purposes related to natural gas inventories.

The Chairman opened the hearing on **HB 2378**.

Gordon Self, Office of the Revisor of Statutes, briefed the committee on **HB 2378**. He stood for questions.

Representative Jeff King testified in support of **HB 2378** (Attachment 1). Representative King stated that the intent of **HB 2378** is to restore a tax on out-of-state businesses. He stated there are three broad factors in favor of passage of **HB 2378**. They are:

- It has been voted for by the people of the state of Kansas
- Embodies the will of the Kansas voters
- Would return equity to our tax system

Joan Wagnon, Secretary, Kansas Department of Revenue, testified in support of **HB 2378** (Attachment 2). Secretary Wagnon introduced Bill Waters and Tony Folsom. She stated that Kansas Department of Revenue fully supports this bill. **HB 2378** treats in-state and out-of state companies the same, rather that favoring the out-of-state companies and making the in-state companies pay the tax alone.

Bill Waters, Kansas Property Valuation Department, testified in support of **HB 2378** (Attachment 3). **HB 2378** will correct a flaw in the legislation passed in 2004 and implement the intent of Kansas voters that stored natural gas held for resale underground formations in the state should be subject to property taxation.

Dudley Feuerborn, Commissioner, Anderson County Board of Commissioners, testified in support of **HB 2378** (Attachment 4). He stated that in 2004 Missouri Gas Energy filed an application for tax exemption. The exemption caused Anderson County to lose $486, 884 of the projected budget for 2005 and the school districts in Garnett and Colony lost $649,000. The mill levy had to be increased to cover the shortfall.

Minutes of the House Taxation Committee at 9:00 a.m. on March 18 2009, in Room 535-N of the Capitol.

Bob Bouldin, Commissioner, Morton County Board of Commissioners, testified in support of **HB 2378** (Attachment 5). He stated that Morton County had lost approximately $500,000 a year in tax revenue. The loss of that much revenue takes away from small counties like Morton County.

Tony Fowler, Commissioner, Montgomery County Board of Commissioners, testified in support of **HB 2378** (Attachment 6). Montgomery County lost more than $260,000 a year in tax revenue that would have broadened the county tax base. That is lost revenue that would have helped the cemeteries, hospitals and increased the tax burden for the county. **HB 2378** will help close the gap

Mark Low, Meade County Appraiser, testified in support of **HB 2378** (Attachment 7). He stated that Meade County lost $2 million a year, every year, in revenue since 2005. This amount is significant in Meade County. The tax burden on in-state utilities is because of the loophole that exempts those out-of-state entities that store the same natural gas in Kansas. **HB 2378** will close the loophole in the current statute.

Gordon Stull, Pratt County Counselor, testified in support of **HB 2378** (Attachment 8). The storage fields can trespass on other persons property. He stated the problems that the leaking of gas is a big impact on the communities.

The Chairman called attention to written testimony from Ron DeGarmo, Morton County Board of Commissioners and President, Kansas Legislative Policy Group in support of **HB 2378** (Attachment 9).

Ron Gaches, Southern Star Central Gas Pipeline, and El Paso, testified in opposition to **HB 2378** (Attachment 10). He stated that he did not think state gas owners would store their gas in Kansas if they had to pay property taxes.

Larry Garrett, Colorado Interstate Gas Company, testified in opposition to **HB 2378** on the grounds that it exceeds permissible state authority under the United States Constitution (Attachment 11). Mr. Garrett cited legal cases having to do with two constitutional infirmities in **HB 2378**. He explained the infirmities and stated that, if **HB 2378** passed, he would not recommend to his clients that they store gas in Kansas.

The Chairman closed the hearing on **HB 2378**.

The next meeting is scheduled for March 19, 2009.

The meeting was adjourned at 10:20 a.m.

HOUSE TAXATION COMMITTEE

SIGN IN SHEET

DATE: MARCH 18, 2009

LON STANTON	NORTHERN NATURAL GAS CO
Ron Gaches	Southern Star / El Paso
Catrina Garrett	Colorado Interstate Gas Co
Josh Berlin	Pinkerton - Smith
Bob Boaldin	Morton County Commissioner
Mick Urban	ONEOK
TONY FOWLER	MONT. Co. Comm.
Mark Low	Meade Co App
DUDLEY R. FEUERBORN	ANDERSON CO.
Gordon B. Stull	Pratt County Counselor
D J McMorris	Pratt Co Appraiser
Michelle Butler	Capitol Strategies
John D. Pinegar	Natural Gas County Coalition
Jodi Slaven	PFA - DCP

STATE OF KANSAS

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TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
VICE CHAIR: TAXATION
MEMBER: TRANSPORTATION
JUDICIARY

Testimony in Favor of HB 2378

Representative Jeff King

March 18, 2009

Chairman Carlson & Members of the House Taxation Committee;

Thank you for this opportunity to testify in favor of House Bill 2378. This statute does not seek to impose a new tax. Instead, it restores a tax on out-of-state business that was approved both by Kansas voters and the 2004 Kansas Legislature.

Other conferees will testify on the specifics of this proposed legislation. My purpose is only to emphasize three broad factors in favor of its passage. First, HB 2378 embodies the will of the Kansas voters. This statement is not mere hyperbole. In 1992, Kansas voters amended the Kansas Constitution expressly to permit the taxation of natural gas inventories stored in underground foundations. HB 2378 corrects statutory ambiguities that thwarted the clearly expressed will of Kansans to tax stored natural gas.

Second, HB 2378 reflects the will of the Kansas Legislature. Following the 1992 constitutional amendment, Kansas taxed stored natural gas for almost a decade. Around 2002, federal law changed to prohibit pipeline or storage facility owners from actually possessing the stored natural gas. As a result, the Kansas Supreme Court ruled that counties could not tax the new owners of stored natural gas because (as out-of-state utility companies) they fell outside the jurisdiction of the Kansas Corporation Commission.

The 2004 Kansas Legislature voted virtually unanimously to remedy this problem and reauthorize the taxation. The Kansas Supreme Court struck down the 2004 statute as ambiguous. HB 2378 would promote the original intent of the 2004 legislation (and the 1992 constitutional amendment) by correcting this ambiguity and including out-of-state utility companies in the definition of a public utility.

Third, HB 2378 would return equity (and a much needed source of local government revenue) to our tax system. Prior to 2002, when the stored natural gas was owned by Kansas-based pipeline and storage companies, Kansas entities paid this tax. Now that out-of-state utility companies own the stored natural gas, they avoid the tax based on

their non-Kansas status. This change has cost Kansas counties approximately $10 million in annual revenue. HB 2378 would restore equity to our tax system and return long-standing county by holding out-of-state utility companies to the same standard as Kansas ones.

Thank you for your consideration of my testimony and this important legislation.

KANSAS
DEPARTMENT OF REVENUE

Kathleen Sebelius, Governor
Joan Wagnon, Secretary

www.ksrevenue.org

Testimony to the House Taxation Committee

Joan Wagnon

March 18, 2009

- HB 2378 fixes a flaw in the statute amended in 2004 to tax natural gas held for resale in underground formations in this state.
- The voters and the legislature have consistently supported the taxation of natural gas stored for resale.
- The taxation of natural gas held for resale was not challenged for the 10 year period from 1993 to 2002 when title to the natural gas was in the pipelines.
- The Federal Energy Regulatory Commission (FERC) by 2002 had prohibited the pipelines from selling natural gas; thus resulting in its ownership being transferred to companies that do not meet the present statutory definition of a public utility.
- Unless fixed, Kansas tax policy regarding the taxation of stored natural gas is subject to whatever regulatory changes may come out of the Federal Energy Regulatory Commission (FERC).
- Unless fixed, the stored natural gas of Kansas based public utilities will continue to be taxed while the stored natural gas of out-of-state public utilities will not be taxed.
- This resolution does not increase the taxes of any storage company or natural gas pipeline.
- This legislation treats in-state and out-of-state companies the same, rather than favoring the out-of-state companies and making the in-state companies pay the tax alone

KANSAS
DEPARTMENT OF REVENUE

Kathleen Sebelius, Governor
Joan Wagnon, Secretary

www.ksrevenue.org

Testimony on Taxation of Stored Natural Gas
to
House Taxation Committee
by Bill Waters
Attorney
Division of Property Valuation-Kansas Department of Revenue

HOUSE BILL 2378

Chairman Carlson, members of the committee, I appear today in support of HB 2378. This legislation is designed to implement what is clearly the intent of Kansas voters that stored natural gas held for resale in underground formations in this state should be subject to property taxation. Perhaps a brief history of this issue would be helpful in explaining how we arrived at this point and why the legislation is necessary. (See attachment 1.)

HB 2378 corrects what the Court deemed to be a flaw in the legislation passed in 2004. The Court held that the *storage companies* "controlled" the natural gas and, for that reason, the companies that owned and sold the natural gas did not meet all three parts of the statutory requirements – "own," "control" and "hold for resale

HB 2378 has been carefully drafted to avoid any kind of discrimination. It taxes only natural gas *held for resale*. Any industry, whether it is a Kansas industry or a non-Kansas industry, is not taxed on any natural gas they store for their own use in a manufacturing process. Also, HB 2378, in and of itself, creates no distinction between Kansas municipalities and non-Kansas municipalities. The property of Kansas municipalities is exempt under art. 11, § 1 of the Kansas Constitution. Many years ago, our Supreme Court addressed the taxation of non-Kansas municipalities in *The State v. Holcomb*, 85 Kan. 178 (1911) and held that our state's constitutional provision exempting municipalities from property taxation applies only to Kansas municipalities.

HB 2378 does not impose any new taxes on pipelines or underground storage companies. All the while the pipelines and storage companies owned the natural gas; they paid the taxes without challenge. This began in 1992 when the voters passed the constitutional amendment and continued for 10 years until the FERC changed the rules on us. This bill merely ensures that the new owners of the stored natural gas pay the taxes that were once paid by the pipelines and storage companies.

You are, of course, aware that a resolution was also introduced to amend the constitution to again tax stored natural gas held for resale. Whether the constitution is amended or HB 2378 is approved, the result will be challenged. The initial thought behind amending the constitution was to attempt to eliminate the argument that the definition of a public utility is somehow locked in time. However, our re-reading of *In re Tax Exemption Application of Central Illinois Public Service Co.*, 276 Kan. 612 (2003), shows that the Kansas Supreme Court specifically stated that the legislature has the authority to define what constitutes public utility property, as long as the definition conforms to the commonly understood meaning of the term. 276 Kan. at 619. We believe that HB 2378 is carefully drafted to define a public utility as the term is commonly understood.

ATTACHMENT 1

HISTORY (STORED NATURAL GAS TAXATION IN KANSAS)

- Merchants' and manufacturers' inventories became exempt from property taxation in Kansas on January 1, 1989.

- The Kansas Supreme Court in *Colorado Interstate Gas Co. v. Board of Morton County Comm'rs,* 247 Kan. 654 (1990) (*"Morton County"*), held that natural gas held for resale by a public utility was merchants' and manufactures' inventory and, therefore, exempt from property taxation.

- In 1992, the legislature, in response to the *Morton County* case, submitted a constitutional amendment to the voters to exclude public utilities from the inventory exemption.

- The voters approved the constitutional amendment in November, 1992, and commencing in 1993, stored natural gas held for resale in underground formations in this state was again taxed.

- Throughout the rest of the 1990s, the taxation of stored natural gas held for resale in underground formations in this state was not challenged because it was owned by the pipelines and storage companies, who were public utilities pursuant to K.S.A. 79-5a01.

- K.S.A. 79-5a01 then and now defines businesses transporting or distributing to, from, through or in this state natural gas in pipes or pipelines, or engaging primarily in the business of storing natural gas in underground formations as public utilities.

- Because public utility inventories are not exempt from property taxation, the stored natural gas held for resale was taxable as long as the pipelines and storage companies owned it.

- In the late 1990s, the Federal Energy Regulatory Commission (FERC) implemented FERC Order 636, which prohibited the pipeline and storage companies from owning and marketing natural gas.

- Upon the implementation of FERC Order 636, title to the stored natural gas was transferred from the pipelines and storage companies to various marketing companies, municipalities and out-of-state utilities.

- The marketing companies, municipalities and out-of-state utilities did not meet the statutory definition of a public utility; therefore, once title was passed to them, the state lost its authority to tax their stored natural gas.

- In 2002, several counties attempted to tax the stored natural gas now owned by these marketing companies, municipalities and out-of-state utilities.

- Several of these marketing companies, municipalities and out-of-state utilities appealed the counties decision to tax the stored natural.

- The Kansas Supreme Court in *In re Tax Exemption Application of Central Illinois Public Service Co.*, 276 Kan. 612 (2003), held that the marketing companies, municipalities and out-of-state utilities did not meet the statutory definition of a public utility; therefore, their stored natural gas was held to be exempt inventory.

- In 2004, the legislature, in response to the *Illinois* Central case, amended K.S.A. 79-5a01 to provide that companies owning, controlling and holding for resale natural gas in underground formations in this state are public utilities and, therefore, subject to taxation on their inventories.

- Again, several taxpayers appealed and again the Kansas Supreme Court, in *In re Appeal of Director of Property Valuation,* 284 Kan. 592 (2007), held that the stored natural gas was exempt inventory. The Court's decision turned on the words used in the 2004 amendment to K.S.A. 79-5a01. It held that the *storage companies* "controlled" the natural gas and, for that reason, the companies that owned and sold the natural gas did not meet all three parts of the statutory requirements – "own," "control" and "hold for resale."

ANDERSON COUNTY COMMISSION

100 E. 4th Ave.
Garnett, KS 66032

Dudley Feuerborn, Chairman
Eugene Highberger, Member
Dean Register, Member

Testimony of
Commissioner Dudley Feuerborn
Anderson County Board of Commissioners

HB 2378

Before the House Committee on Taxation

March 18, 2009

Chairman Carlson and Members of the Committee:

My name is Dudley Feuerborn, I am a County Commissioner for Anderson County. I am here in my capacity as county commissioner and as a representative of the **County Natural Gas Coalition**. I have enclosed a list of the affected counties and members of the Coalition with my testimony.

Thank you for the opportunity to appear before the committee to provide testimony in support of House Bill 2378. I want to share with the committee the effects of the loss of revenue as a result of the Supreme Court's 2003 decision in Central Illinois Public Service Company v. Meade County.

On December 2, 2004, Missouri Gas Energy, in Anderson County, filed an application for tax exemption for the allocated natural gas inventory with the Director of the Property Valuation Division pursuant to K.S.A. 79-213. The exemption caused Anderson County to lose $486,884.93 or almost 8% of the projected budget for 2005. More important was the hit experienced by our local school districts. Unified School District #365 in Garnett suffered a budget loss of $215,860 while Unified School District #479 in Colony had a budget shortfall of $61,434.78. In all, the taxing subdivisions in Anderson County lost tax revenue totaling over $1 million, a significant amount of money for a county with a population of just over 8,000 people and only 4,231 tax payers. As a result, we had to increase our mill levy 12 mills to make up for some of the lost revenue. **In all, storage counties have lost a total of nearly $9 million per year since the Court's decision.**

The Anderson County Commission supports the passage of HB 2378. We believe the change is necessary to close the unintended loophole in the state's valuation of stored natural gas so that all companies that store natural gas in underground formations in Kansas share equally the responsibilities of funding county services.

Thank you for this opportunity. I will be glad to stand for questions at the appropriate time.

Kansas Counties with Stored Natural Gas *

Allen

Anderson

Chautauqua

Elk

Jefferson

Kingman

Kiowa

Leavenworth

Meade

McPherson

Montgomery

Morton

Pratt

Reno

Rice

Wilson

Woodson

* Natural gas held for resale by out-of-state entities.

MORTON COUNTY COMMISSIONERS

1ST DISTRICT	2ND DISTRICT	3RD DISTRICT
RON DEGARMO	**BOB BOALDIN**	**TERESA *HARDER***
Rolla, Kansas 67954	Elkhart, Kansas 67950	Elkhart, Kansas 67950
(620) 593-4455	(620) 697-2286	(620) 697-2099

Testimony of
Commissioner Bob Boaldin
Morton County Board of County Commissioner

House Bill 2378

House Committee on Taxation

March 18, 2009

Chairman Carlson and members of the Committee:

Thank you for allowing me to present testimony in support of House Bill 2378. I am Bob Boaldin, from Elkhart, Kansas. I have served as a member of the Morton County Board of Commissioners for over 20 years.

Morton County is located in the southwest corner of Kansas. Like many small rural Kansas communities, the population of our county is declining and we are challenged to address the basic needs of our citizens through a declining tax base. The majority of our counties' tax base is derived from farming, agricultural related business and the oil and natural gas industry.

For many decades, Morton County and other members of the **County Natural Gas Coalition** were permitted, by law, to assess and collect ad valorem property tax on natural gas held in storage by both resident and non-resident companies. Through a combination of a change in federal regulations and the Kansas courts, a loophole was created that exempted out-of-state utilities from taxation on their stored natural gas.

Our estimates show that Morton County has lost about $500,000 a year in tax revenue as the valuation of stored natural gas in our county dropped more than $6 million between 2004 and 2007 as most of our stored natural gas was taken off the tax rolls. $500,000 a year is real money for a county with 3,500 residents.

Morton County Board of County Commissioners supports the broadening of our tax base whenever possible. We support passage of HB 2378 in order to reinstate the unintentional exemption of a unique type of property.

Thank you for your attention to this matter.

COUNTY COMMISSIONERS

Montgomery County
217 East Myrtle
Independence, Kansas 67301

Phone (620) 330-1111 Fax (620) 330-1202

Tony Fowler
District No. 1

Larry McManus
District No. 2

Fred Brown
District No. 3

Testimony of
Commissioner Tony Fowler
Montgomery County Board of County Commissioners

House Bill 2378

Before the House Committee on Taxation

March 18, 2009

Chairman Carlson and Members of the Committee:

My name is Tony Fowler, I am a County Commissioner for Montgomery County. Thank you for the opportunity to appear before the committee to provide testimony in support of HB 2378.

Montgomery County was not hit as hard as some of the other counties by the loss of revenue as a result of the Kansas Supreme Court ruling that natural gas held by out-of-state entities was not considered a public utility for ad valorem property tax purposes. Montgomery County was fortunate enough to experience an expansion of the Coffeyville Resources oil refinery and nitrogen fertilizer plant. The expansion and reappraisal of the plant increased property valuation in Montgomery County by $807 million, offsetting lost revenue that resulted from the Supreme Court's decision on natural gas.

However, it is estimated that Montgomery County lost more than $250,000 a year in tax revenue, revenue that would have broadened our tax base. In 2004, Montgomery County collected $281,354 in ad valorem property taxes on a stored natural gas assessed value of $2.1 million. In 2007, that number had dropped to $18,415, on an assessed valuation of only $146,021, a substantial loss.

That is a lost revenue source to Montgomery County schools, its cemeteries, and its hospitals and an increased tax burden for Montgomery County citizens and businesses, like Coffeyville Resources, that employ hundreds of Kansans. *Why should Kansas companies have to step-in for out-of-state utilities taking advantage of the state's storage capacity?*

Passage of House Bill 2378 will broaden our tax base and reduce the tax burden on Montgomery County businesses and citizens. I urge the passage of HB 2378 and will stand for any questions.

Meade County Appraiser

Meade County Courthouse • P.O. Box 278 • Meade, KS 67864
620/873-8710 • Fax: 620/873-8713

Testimony of
Mark Low
Meade County Appraiser

House Bill 2378

Before the House Committee on Taxation

March 18, 2009

Chairman Carlson and Members of the Committee:

My Name is Mark Low, County Appraiser for Meade County. Thank you for the opportunity to appear before the committee to provide testimony in support of House Bill 2387. I wanted to provide a brief history of our efforts to close this loophole.

In 2004, the assessed value of stored natural gas in Meade County was estimated at $23 million. After the Kansas Supreme Court's decision in Central Illinois Public Service Company v. Meade County, the assessed value dropped significantly, dropping by nearly $20 million. I, along with the Property Valuation Division of the Kansas Department of Revenue, and attorneys for Meade County, sought to amend K.S.A. 79-5a01 as it defines public utility to include all companies located in-state or out-of-state, that own, control, and hold natural gas.

House Bill 2897 passed the House 101-23. The bill was not heard in the Senate but was added to a House Substitute for Senate Bill 147 during a conference committee on a range of tax issues. House Substitute for Senate Bill 147 was later approved by the Senate 40-0 and in the House 109-11. Ultimately, as provided earlier, the change to K.S.A. 79-5a01 did not meet the approval of the court. Meade County and other members of the County Natural Gas Coalition are before you now with different language we believe will meet the court's approval. It is our intention to include all companies that store natural gas for resale regardless of domicile or regulation by the Kansas Corporation Commission.

We estimate that the Meade District Hospital, Unified School District No. 226, and Meade County together lost $2 million in tax revenue a year, every year, since 2005. $2 million is significant in a county with a population of less than 5,000 people and a county budget of only $6 million. In addition, broadening the tax base will alleviate some of the burden on Meade County businesses and residents. Currently, 45% of the county tax base is made up of in-state public utilities. As the law now stands, the tax burden on our in-state utilities is higher because of the loophole that exempts those out-of-state entities that store the same natural gas in Kansas. Passage of HB 2378 will end the inequality that exists for these resident utilities and return millions to the Meade County tax rolls.

Thank you for your time, I will be glad to stand for questions.

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Testimony of
Gordon B. Stull
County Counselor, Pratt County, Kansas

House Bill 2378

House Committee on Taxation

March 18, 2009

Mr. Chairman and Members of the Committee:

I am Gordon B. Stull, an attorney from Pratt, Kansas, and I have served as the Pratt County Counselor for twenty-five years. I appreciate the opportunity to provide this testimony to you today. I am here representing Pratt County in its capacity as a member of the County Natural Gas Coalition.

Pratt County supports the County Natural Gas Coalition position with respect to this proposed legislation. My comments will not deal directly with the legislation but, instead, will focus on some of the unintended consequences to counties that host underground storage fields. Because my comments could be construed as being anti-oil and gas, or anti-storage field, I want to say at the outset that Pratt County is a strong supporter of the oil and gas industry, including underground gas storage fields. Pratt County's economy has been boosted for many years by oil and gas production and pipeline transmission lines which crisscross our county providing jobs, ancillary businesses, and payment of bonus rentals and royalties to many landowners. Pratt County would do nothing to discourage use of its native oil and gas resources for economic development, if done in a responsible and reasonable way.

I have been involved with the oil and gas industry for many years. Oil and gas plays a significant portion of my law practice and I have been an investor in and operator of oil and gas wells and, at one time, was the President of a drilling company that operated four drilling rigs and five completion units. I was an owner and President of another company that owned and operated a drilling rig. Currently, I represent numerous oil and gas producing and operating companies. My comments should not be considered a reflection on the industry as a whole, but on a situation which has had, and continues to have, negative and bothersome impacts to Pratt County. Under the right circumstances, the same things could happen to other counties that have storage fields.

My comments are directed principally in response to the assertions of Ron Gaches, representing Southern Star Central Gas Pipeline, and Lawrence E. Garrett, representing Colorado Interstate Gas Company. The testimony of Mr. Gaches would suggest to you that underground gas storage fields are benign operations which impose "remarkably few demands on local units of government and its neighbors". Mr. Garrett would lead you to believe that transporting natural gas into the State of Kansas for storage underground in our counties is just like someone hauling freight across the state and, therefore, there is no nexus between the owners of the gas and the State of Kansas. I believe what they were describing is a situation which may be desired and even intended but, in actuality, may not be attained in a given set of circumstances. Pratt County has three storage fields, two of which have been operated successfully without any material negative impact. The third, the Cunningham Storage Field, operated by Northern Natural Gas Company, has been and is a different matter. Let me describe for you Pratt County's experience with Northern Natural Gas and the Cunningham Storage Field.

The Cunningham Storage Field was certified in 1978 and being one of the largest in Kansas encompasses approximately 26,240 acres covering portions of Pratt and Kingman Counties. The storage facility has 81 wells, including 52 injection/withdrawal wells, 28 observation wells, and a water disposal well, together with many miles of interconnecting pipelines and compression facilities. When originally developed, the storage field was supposed to be comprised of the Viola and Kinderhook formations. After several years of operation, it became apparent to Northern that their field was leaking vertically and they had invaded the Simpson formation under a significant portion of the property covered by the storage field. *This posed two issues.* The *first* was that they had invaded space of Pratt County property owners that did not belong to Northern. *Second*, Northern had placed storage gas under pressure in a formation which had not been prepared for those purposes, in accordance with the standard procedures used by storage companies to maximize the possibilities for containment. As a result of Northern's actions, litigation by landowners was started to secure compensation from Northern for their property loss. After this litigation was resolved, Northern certificated the storage field to additionally cover the Simpson formation. The field then covered not only the Viola and Kinderhook formations, but also the Simpson and Arbuckle formations. This was completed in the mid 1990's.

Northern continued to operate the Cunningham Storage Field but, in the late 1990's, apparently began to suspect that they were still leaking. They began to question adjoining oil and gas operators about their wells and suggested that the gas being produced from them belonged to Northern. Northern began to question one operator which had two wells within one mile of the boundaries of the Cunningham Storage Field and also began to question an operator that had a well **more than four miles away**. Northern began to strongly assert ownership of the gas being produced from those wells relying upon the 1993 legislation which permitted storage field owners to reclaim migrating storage gas. However, Northern offered little, if any, satisfactory proof to the operators that, indeed, it was Northern's gas. This ultimately led to litigation against the operator closest to the storage field which was tried in U.S. Federal District Court. The owners of the well were found by a Federal Court jury to not be producing Northern's gas. On appeal to the Tenth Circuit Court of Appeals, this finding was upheld. In addition, Northern also sued the operator of the well four miles north of the storage field. The suit was thrown out by the Federal District Court and was upheld on appeal to the Tenth Circuit Court.

An interesting side note to all of this is that while Northern was pursuing litigation against these operators, Northern was also making filings with the Kansas Corporation Commission to the effect that Northern was containing its storage gas within the boundaries of its storage field so the storage field could get re-certified.

Unwilling to accept rulings of the Federal District Court, Northern, on March 16, 2007, filed an application with the Federal Energy Regulatory Commission ("FERC") seeking to extend the northern boundaries of the Storage Field by an additional 4,800 acres, asking for certification for the Viola and Simpson formations. Within its application, Northern asserted that the 4,800 acres were the minimum acreage necessary to effectively implement a containment plan for migrated gas. In October 2008, FERC issued its ruling allowing Northern to increase its certificated area by only 1,760 acres, increasing the size of the storage to approximately 28,000 acres. This extension incorporated the area on which the two closest wells were located. FERC made a finding that Northern's evidence **did not** support expanding the boundaries of the storage field further north and closer to the well four miles away that Northern claimed was producing its gas.

Undeterred, Northern has filed an application for reconsideration by FERC of the findings denying the additional extension. In addition, Northern has filed litigation against the operator of the well involved in the previous litigation and against other operators, claiming all of those operators of approximately 20 wells are producing Northern's migrated storage gas. Some of those **wells are almost eight miles from the north boundary of Northern's Cunningham Storage Field**, affecting many thousands more acres and numerous property owners.

If you take Northern's claims as true, Northern's operation of the Cunningham Storage Field has created storage gas leaks over thousands of acres of Pratt County land. Northern claims it has trespassed into and under the property of numerous owners and, in the process, made use of their property without payment or the owner's knowledge or permission. The operators which have been sued by Northern contest these claims. It will probably take many years to resolve the disputes. Many local owners and oil companies will have to spend large sums of money defending against these claims to protect their property rights.

It does not matter if the Cunningham Storage Field is leaking because of the result of poor engineering, operational practices, or negligent or reckless conduct. Intent doesn't matter. The effect has been the same on many residents and other businesses within Pratt County, Kansas. The County is powerless to intervene or do anything about this as operation of the Storage Fields is controlled by the Kansas Corporation Commission and FERC. The County cares about this because if Northern has leaked over thousands of acres, it has contaminated any native gas under those properties with storage gas.

Pertinent to House Bill 2378, as a result of the taking of the two wells closest to the storage field, Pratt County may have to refund **$93,000.00**, in paid ad valorem taxes on the valued wells. In addition, going forward the County estimates it will lose approximately **$90,000.00** per year of ad valorem tax which had been attributable to the working interest and royalty portion of those wells. If Northern has, in fact, ruined 20 some wells more than 4 to 8 miles north of its storage field, the Pratt County Appraiser has estimated the ad valorem tax loss to the County will be somewhere between **$500,000.00 and $1,000,000.00 per year**. This does not take into consideration additional wells which, perhaps, would have or could have been drilled but for Northern's actions. In addition, Pratt County royalty owners and oil and gas operators

will lose millions of dollars in revenue, much of which would have or could have been expended in Pratt County. The value of the owner's land will forever be diminished.

One further effect of operational problems with Northern's Cunningham Storage Field is that they have essentially created a "dead zone" within and around the storage area and any area where Northern is claiming gas has migrated. Oil companies will not drill in or around the Storage Field for fear of being sucked into litigation with Northern if they would happen to obtain a successful gas well. A company that recently leased approximately 10 square miles north and west of the Storage Field for purposes of seismic exploration has declined to conduct any seismic or other exploration activity on leases that are in the vicinity of the Northern Storage Field because of this very problem. Therefore, Pratt County and its property owners have lost significant potential economic opportunity because of the location of a Storage Field within the county.

The problems with the Cunningham Storage Field may be considered an aberration but it starkly represents the negative impact a storage field can have on a county that hosts it. ***Pratt County hopes that it does not get into a situation like Hutchinson, several years ago, when a leaking storage field caused a major disaster in that town, including the loss of life.*** Even though Northern Natural has claimed and litigated in many venues, it has never once contacted the Pratt County Commission to discuss with the Commission these leaking problems. Nor have they offered assistance to the County to prepare for emergencies which may or could arise when storage gas reaches an area that no longer confines it. The area Northern is now claiming has leaked storage gas has two small cities within just a couple of miles.

For those who would suggest that storage gas creates no nexus with the hosting governmental entity, they should visit with the oil operators and property owners in and around the Cunningham Storage Field.

Thank you. I will be happy to try to answer any questions.

KANSAS LEGISLATIVE POLICY GROUP

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Testimony of
Commissioner Ron DeGarmo
Morton County Commissioner
President, Kansas Legislative Policy Group

Written Remarks on
House Bill 2378

House Committee on Taxation

March 18, 2009

Chairman Carlson and Members of the Committee:

The Kansas Legislative Policy Group (KLPG) is pleased to provide written testimony in support of House Bill 2387. KLPG is a bipartisan, non-profit organization of elected commissioners from 30 western Kansas counties. We appreciate the opportunity to submit remarks on this issue, which is of great importance to our member counties.

HB 2378 will correct an unintentional loophole created by a combination of changes in federal regulation and decisions by Kansas courts that exempted from ad valorem taxation natural gas held in storage by out-of-state entities. Closing this loophole will provide the 17 affected counties increased annual tax revenue of almost $9 million. The Kansas Legislative Policy Group supports every opportunity to broaden our tax base. Broadening the base reduces the tax burden on everyone and enables our counties to provide necessary public services to their citizens.

We encourage the Committee to favorably consider House Bill 2378.

Thank you for your consideration and the opportunity to present these written remarks.

GACHES, BRADEN & ASSOCIATES
Government Relations & Association Management

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Testimony of Southern Star Central Gas Pipeline and El Paso In Opposition to HB 2378 – Increasing Taxes on Interstate Gas Inventories Submitted to House Tax Committee Presented by Ron Gaches Wednesday, March 18, 2009

Thank you Mr. Chairman and members of the committee for this opportunity to speak about the proposed property tax on interstate natural gas inventories. My name is Ron Gaches and I represent Southern Star Central Gas Pipeline and El Paso Energy.

Southern Star and El Paso are among the small number of interstate pipeline companies that operate natural gas underground storage facilities in the state of Kansas. The others include Northern Natural Gas and Panhandle Eastern.

These storage fields are typically in what we call porosity fields – underground geological formations that previously produced natural gas.

The companies that store interstate natural gas are regulated by the federal government. Also, in Kansas, the Oil and Gas Conservation Division of the Kansas Corporation Commission has promulgated rules and regs to establish guidance on the safe operation of these facilities.

Interstate storage operations are typically part of the operations of an interstate pipeline company. Gas purchasers buy gas throughout the year and store it for later use. Many large purchasers of gas (typically large industrial users, utilities, municipalities and even gas producers) will purchase natural gas during the warm months for their use during the cold winter months. They use the gas to heat homes, or commercial and industrial facilities, or to generate electricity in natural gas turbines. Other natural gas is used to make a variety of products for use in agriculture and industry.

There are nearly 20 underground storage fields operating in Kansas and most of them store gas owned by out-of-state companies.

House Bill 2378 is the latest installment in a dispute over the taxation of natural gas that began in 1986. That's the year Kansas adopted the constitutional amendment that explicitly exempted merchants and manufacturers inventories from application of the property tax.

The core question this bill tries to address is whether or not natural gas owned by out-of-state entities and stored temporarily in Kansas is exempt from property tax because it is an inventory, or subject to tax because it is public utility property.

Let's be very clear from the beginning about who owns storage gas. It is not owned by the storage companies or interstate pipeline companies.

Some of the gas is owned by Kansas utilities and other Kansas companies. The gas owned by Kansas investor-owned utilities is treated as public utility property and is valued and taxed as part of the utility. The gas owned by other Kansas municipal utilities and coops, Kansas businesses (large industries, gas producers and other firms) is exempt from property tax under current law.

The rest of the gas is owned by a variety of out-of-state purchasers and users of gas. Some are public utilities in other states; some are municipalities from other states; some are major industries in other states; some are out-of-state energy companies; and some are gas producers who have their gas in storage waiting for a buyer.

The interstate natural gas storage companies contend all out-of-state storage gas should be regarded as an inventory and exempt from property tax. The counties testifying before you today contend all gas should be subject to property taxes.

This debate has been ongoing for more than two decades with occasional decisions by the courts and the legislature that highlight the nature of the controversy.

In 1992 the legislature approved a constitutional amendment that attempted to exclude public utility property from the inventory exemption.

In 2003 the Kansas Supreme Court ruled that interstate pipeline customers were not public utilities and therefore the gas they own was not subject to the property tax.

In 2004 the legislature statutory language attempted to redefine public utility property in a way to capture interstate storage gas for property taxes.

In 2007 the Kansas Supreme Court again ruled that the interstate gas owners were not subject to the property tax.

Obviously, a pattern has emerged. The legislature has ceded to the efforts of the counties where storage is located and tried to find a way to define public utility property to capture interstate natural gas in storage; while the Kansas Supreme Court has consistently found that those efforts fall short and the gas is not subject to the tax.

In a few minutes Larry Garrett of El Paso/Colorado Interstate Gas will provide an overview of the legal arguments that the gas storage industry is convinced will prevail in the next court consideration of this issue, if this proposed language is passed into law. But first I'd like to comment on the public policy objectives of the proposed bill.

We believe Kansas tax policy should encourage storage of gas in Kansas facilities. It promotes the value of the entire natural gas production, processing, pipeline and storage industries in Kansas.

What is the possible public policy purpose of imposing the property tax on interstate gas?

Does the underground storage of gas impose a burden on local units of government? No. In fact, underground storage facilities impose almost no demand at all on local government services.

Does the transport of the gas through Kansas impose a burden on local units of government? No. In fact, the storage industry is invisible to most Kansans and imposes remarkably few demands on local units of government and its neighbors.

Are storage companies and interstate pipelines escaping their property tax liabilities? Absolutely not!

In fact they pay significant property taxes. The storage facilities themselves and the gas they have in the ground required to properly operate the storage field are considered public utilities and assessed at 33% of their fair market value, the highest tax burden on any class of property in the state.

Consider the property tax contribution of one storage operator to Meade County – one of the counties asking for interstate storage gas to be taxed.

Last year, Panhandle's Borchers Field storage facility (one of the larger storage facilities in Kansas) paid $2.2 million in property taxes to Meade County. That's $2.2 million in property taxes on the value of the storage facility and the "working gas." Working gas is the gas owned by the storage company and necessary to maintain for the efficient operation of the field. The tax on working gas is not in dispute.

In addition, Panhandle paid $1.25 million in property taxes on their pipeline and transportation facilities in Meade County. That's a total $3.45 million in property taxes in one year.

Panhandle is not disputing the validity or legality of these property taxes. It is the additional tax the counties want to levy on the gas owned by out of state firms that is stored in the Borchers Field that is in dispute.

Similarly, Southern Star paid more than $8.5 million in property taxes in 67 Kansas counties last year. The largest amounts, including more than $900,000 in Anderson County and nearly $770,000 in Montgomery County, were in the counties where they have storage facilities.

Isn't that enough? I don't think the argument can seriously be made that storage companies and interstate pipelines aren't paying their fair share of Kansas property taxes.

The taxation of stored gas is attractive simply because it is a way for a small number of counties to raise revenue from out of state taxpayers.

If we re-impose the property tax do you think we will have any out of state gas owners that would knowingly allow their gas to be stored in Kansas? Of course not.

If the legislature is going to redefine "public utility" so that natural gas is no longer eligible for the merchants and manufacturers property tax exemption, why stop there? Why not redefine public utility to recapture the tax on wheat, or corn, or milo?

What do you suppose would happen to the Kansas grain elevator business if the legislature redefined "public utility" to insure that grain owned by out of state firms but held in Kansas elevators were subject to the property tax?

Suppose we redefine "public utility" so that it captures the inventories carried by the railroads and motor carriers and held temporarily at the new intermodal transportation facility being constructed south of Olathe.

Consider the impact on our manufacturing centers in Kansas City and Wichita if we reimposed the property tax on General Motors or Cessna. What would happen to those businesses if we re-imposed the property tax on the products they produce and held in temporary storage?

The answer to all of these questions is simple. Imposing the property tax on these inventories would drive business out of Kansas.

Counties that are home to gas storage fields are simply trying to impose taxation without representation. The gas can't vote. The owners of out-of-state gas are all out-of-state and can't vote.

From the counties' perspective, this is the perfect tax. They can impose a tax on a group of taxpayers who can't vote to throw them out.

That's called taxation without representation. We're all pretty familiar with the concept.

It didn't prove popular with American taxpayers in 1776, and it isn't popular today.

We believe the counties have it wrong. You shouldn't be considering a bill to increase taxes on interstate storage gas. Instead you should be considering an amendment that makes it clear ALL storage gas is exempt from property tax.

Kansas utility consumers ... your constituents ... need and deserve a break. The state has slipped into recession. Kansas employers are hemorrhaging jobs faster than anyone can remember, and energy prices are as volatile as they've ever been.

The local property taxes on natural gas owned by Kansas investor-owned utilities are passed on 100% to Kansas utility consumers.

The gas is already subject to the state severance tax when it is produced and the consumers' energy bills are already subject to a variety of local and state taxes and fees. The property tax on natural gas is a third tax on the same molecule of gas.

The dirty little secret about taxes on natural gas owned by Kansas utilities is that they are entirely hidden taxes. The Kansas consumer pays the taxes but never sees the tax bill. It's all just rolled into their utility bill. And, most of the consumers that pay the tax bill live in communities outside of where the storage facilities are located, so they don't even receive the benefit of the hidden tax revenue generated on their utility bills.

It has become standard tax policy in Kansas that we tax a product at the point of retail sale or consumer use, and not impose taxes on the inputs required to produce the product or service. Except with natural gas where we impose a triple tax on Kansas consumers.

Instead of asking your constituents if they think Kansas should impose a tax on interstate storage gas, ask them if they support elimination of the hidden natural gas taxes buried in their utility bills.

Ask them if they believe they deserve relief from the triple taxation of natural gas. I'm guessing that if your constituents understood what was going on they would probably tell you they have had enough of hidden taxes.

This is a dispute that has gone on for more than twenty years. Kansas counties have known for years the fragile legal status of this revenue source; as a result of the 2007 court decision the tax has been refunded for several prior years and not collected the last two years. The Kansas Supreme Court has consistently decided in favor of the taxpayer.

Continuing the effort to impose this tax will only result in more legal expenses for the state and counties and more frustration for a storage industry that has been proud to call Kansas home, but is questioning the state's commitment to its success.

We ask this committee to consider all of the implications of the policy represented by HB 2378 and reject it. You wouldn't do this to Kansas agribusiness, interstate motor carriers or railroads, or Kansas auto or aviation manufacturers. You shouldn't do it to our natural gas storage industry.

Thank you for your consideration and I'll respond to any questions.

Testimony of Colorado Interstate Gas Company
In Opposition to HB 2378 - Increasing Taxes on Interstate Gas Inventories
Submitted to House Tax Committee
Presented by Laurence E. Garrett
Wednesday, March 18, 2009

Thank you, Chairman Carlson and members of the committee, for the opportunity to address the proposed property tax on interstate gas inventories. My name is Laurence E. Garrett and I am an attorney for Colorado Interstate Gas Company ("CIG"), located in Colorado Springs, Colorado.

The purpose of my testimony is to oppose HB 2378 on the grounds that it exceeds permissible state authority under the United States Constitution. The proposed legislation contains two constitutional infirmities. First, it does not satisfy the "minimum contacts" requirement under the Due Process Clause of the United States Constitution. Second, it does not pass muster under the Commerce Clause of the United States Constitution because it fails the "substantial nexus" test that the courts have adopted in Commerce Clause jurisprudence.

HB 2378 clearly fails to satisfy the "minimum contacts" requirement under the Due Process Clause of the United States Constitution. Under that test, no state can reach beyond its borders to tax a non-resident where doing so offends "traditional notions of fair play and substantial justice," a principle which has long been established by *International Shoe Co. v. Washington,* 326 U.S. 310 (1945) and its progeny. Although physical presence is not necessarily required, an out-of-state taxpayer must purposefully direct its efforts toward state residents and must purposefully avail itself of the benefits and protections of the economic market in the state in order for state taxation to pass Due Process muster. See, *Quill Corp. v. North Dakota,* 504 U.S. 298, 307-308 (1992).

The minimum contacts requirement assures that a company "[has] fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign." *Id., quoting Shaffer v. Heitner*, 433 U.S. 186, 218 (1885). As noted by the Fourth Circuit Court of Appeals, in exploring the due process limits on the legislative power of a state, the Supreme Court has employed language similar to that used in personal jurisdiction matters, explaining that "there must be at least some minimal contact between a State and the regulated subject before it can, consistently with the requirements of due process, exercise legislative jurisdiction." *Adventure Communications, Inc. v. Kentucky Registry of Election Finance,* 191 F.3d 429, 436 (4th Cir. 1999). The Supreme Court has also held that third party actions cannot provide the necessary nexus, stating "The unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum state." *Hanson v. Denckla,* 357 U.S. 235 (1958).

The proposed legislation would unlawfully tax out-of-state taxpayers who have never purposefully directed their activities toward residents of the state of Kansas and have never purposefully availed themselves of any benefits or protections of the

economic market in the state of Kansas. There is simply not sufficient "minimum contact" between the state of Kansas and the out-of-state taxpayers to satisfy the requirements of the Due Process Clause. Additionally, the mere fact that CIG – a third party – has temporary custody of the taxpayers' property at CIG's in-state storage facilities cannot serve to support Kansas taxation on the out-of-state taxpayers since they have absolutely no control (actual or constructive) over the ingress and egress of natural gas to and from the Kansas storage facilities operated by CIG. The Due Process Clause forbids imputation of such independent, third-party actions to the purported out-of-state object of state legislation for purposes of establishing constitutionally sufficient minimum contacts.

Furthermore, HB 2378 does not pass muster under the Commerce Clause of the United States Constitution because the activity which is proposed to be taxed lacks any "substantial nexus" to Kansas. The United States Supreme Court has adopted and consistently applied a four-part test for determining whether a state tax on an interstate business is valid under the Commerce Clause. A tax passes muster against a Commerce Clause challenge so long as the "tax [1] is applied to an activity with a substantial nexus with the taxing state, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the state." *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279 (1977).

The first part of the test requires a substantial nexus between the taxpayer and the state to ensure that interstate commerce is not unduly burdened. It poses an even higher hurdle than the minimum contacts necessary to satisfy the Due Process Clause test: "[A] corporation may have the 'minimum contact' with a taxing state as required by the Due Process Clause, and yet lack the 'substantial nexus' with that state as required by the Commerce Clause." *Quill Corp. v. North Dakota,* 504 U.S. 298, 313 (1992). This principle was affirmed by the Supreme Court of Kansas in *In re Appeal of Intercard, Inc.,* 270 Kan. 346, 14 P.3d 1111, 1115 (2000). There, the Kansas Supreme Court held that "[i]t is well settled that under the Commerce Clause a state may not subject a business to tax unless the business has a substantial nexus within the state."

The definition of what constitutes a "substantial nexus" has been the subject of a long line of United States Supreme Court and state court decisions. Although the specific boundaries of the "substantial nexus" requirement have not been defined with great specificity, there is a "bright line" test which was established by the United States Supreme Court in *National Bellas Hess, Inc. v. Department of revenue of Ill.,* 386 U.S. 753 (1967) and which was reaffirmed in the *Quill Corp.* case. In those cases, the Supreme Court held that taxpayers "whose only connection with customers in the [taxing] state is by common carrier" do not maintain a substantial nexus with a state that permits the state to impose taxes. CIG, a federally regulated, open-access transporter of natural gas in interstate commerce is the functional equivalent of a common carrier. It can no more serve as the proxy or vehicle for taxation by Kansas on an out-of-state taxpayer than could the common carrier as issue in *National Bellas Hess* serve as the proxy or vehicle for taxation by Illinois on an out-of-state taxpayer. Therefore, the proposed constitutional amendment violates the Due Process Clause by attempting to

sweep within the taxing jurisdiction of the state of Kansas virtually any entity without regard to whether the entity has a substantial nexus with Kansas.

Thank you for allowing me to present this testimony. I respectfully urge you to reject HB 2378 on the grounds that it violates the United States Constitution. I would be happy to answer questions.