Kansas
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COMMENTS TO THE SENATE ASSESSMENT AND TAXATION COMMITTEE

OPPOSING REPEAL OF THE SEVERANCE TAX EXEMPTION IN SENATE BILL 339

FEBRUARY 14/15, 2012

Thank you, Mr. Chairman and members of the Committee. One of the most overlooked parts of this tax plan is repeal of the two-year severance tax exemption on new pools. Make no mistake about this provision. It is a tax increase. It repeals a tool designed to attract investment and create jobs, and runs counter to the purported reason for the underlying tax legislation: to boost jobs, create economic development, establish an even playing field and help Kansas compete with other states.

A severance tax is not the only tax Kansas imposes on oil and gas production. Kansas also levies an ad valorem tax on reserves in the ground, based on estimates. In other words, oil and gas producers pay ad valorem taxes on production they have not realized. Combined, our state's severance and ad valorem taxes are a double-whammy on every barrel of crude oil and mcf of natural gas produced here, and compares unfavorably with neighboring states. For instance, Oklahoma has a severance tax, but imposes no ad valorem tax. Guess where the investment would be more attractive?

Repeal of the severance tax moratorium targets potential development of the Mississippi Limestone formation in south central Kansas, even before it starts and definitely before the production companies know what's there.

During town hall meetings last fall and winter at Chaparral High School and in Wellington, three of the companies in the Mississippi Limestone were reticent in their predictions about what the ultimate outcome would be from their initial exploration. They were honest with local residents and made no grandiose promises about what their exploration would find. All said they really wouldn't know for 12 to 18 months. So far, leaseholds have been established over huge acreages in south central Kansas, local residents have benefitted from the activity and cities and counties have welcomed the potential jobs and dollars invested in the area.

Development in the Mississippi Limestone formation of south central Kansas could be an economic boon for the state, for jobs, for landowners and for local governments and communities. We respectfully ask that the committee carefully consider the ramifications of repealing this investment tool, and request that it be dropped from the bill. Thank you for your time and courtesy.

Ken Peterson, executive director

w/attachments

Sn. Assmnt & Tax
2-15-12

Attachment # 21

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Kingman Leader Courier
By Nancy D. Borst (complete text below)
January 2012

A surge in new technology oil exploration in a relatively shallow limestone play in Oklahoma and southern Kansas has attracted a global company to Kingman County. Officials from Shell Oil Company have met with Kingman County Commissioners to discuss the company's plans to drill at least one exploration well in the county this year. "Shell basically came on a good will mission," said Commission Chair Carol Voran of the Jan. 11 meeting. Scott Scheffler, communications specialist with Shell, confirmed the company is working in the county. "By the middle of 2012, Shell plans to have at least three rigs working in southern Kansas to explore the potential of our acreage position," Scheffler said. "Only after drilling over many locations will we understand the chances for a long-term development in the area." An exploration well is slated to go in near Duquoin in far southern Kingman County with drilling likely to begin in May. The company is evaluating the Mississippi Limestone Play to determine whether there is enough commercially viable resource (oil and gas) to justify a significant investment beyond a 12 to 18 month appraisal period. The Mississippi Limestone is a thin, porous lime deposit that encompasses millions of acres in Oklahoma and southern Kansas. It has an average depth of 6,000 feet and the formation thickness is 200 to 300 feet. In other words, it is shallow and less expensive to drill. This area is nothing new to oil and gas exploration. It has been the site of decades of drilling and its geology is well known. But, according to the October issue of the American Oil & Gas Reporter, "what has suddenly jumped the Mississippi Limestone to the front of the line as a top-flight onshore liquids play is the same set of technologies that independent operators are deploying to enable economic shale development: horizontal drilling and multistage completions." Wells will be drilled horizontally and will include the "fracturing" process to aid the flow of hydrocarbons from the shale rock. An added bonus to working in this area is ready access to transportation infrastructure, equipment and skilled workers. Shell acquired most of its leasehold position through acquisitions from a few independent exploration companies, said Scheffler. That included 10 producing wells, producing approximately 100 bbl/day. The company also continues to lease additional acreage in Barber, Harper, Kingman, Pratt, Reno, Sedgwick and Sumner counties, but Shell is primarily focused on Barber, Harper and Kingman counties. The company declined to specify total acreage or terms of acquisitions or leases. Shell, which also was active in south central Kansas from 1930 through the 1990s, has established an office in Harper.

Scheffler said it is common practice for Shell to keep local stakeholders engaged as the company makes plans for an area. Voran said, "Their perspective was 'what can we do for you?'" "Shell wants to partner with us for emergency services if there is a need for water for fire. They have some availability for that," she said. "All the wells they're drilling are to gather data to decide whether to come in full force." She said there may be some willingness by the company to make financial contributions to the county toward things such as first response. Shell gave commissioners the example that if it helps provide training on using the foam method of firefighting, it may be willing to purchase foam adapters. "The real emphasis is on training," Voran said. "They are concerned about emergency response times." At this point, there are no long-term certainties. But the county must be prepared in case the play pans out for Shell. "We can't invest a lot in infrastructure because we don't know if it's going to be permanent," Voran said. "We can't ignore the fact they are doing an appraisal." Scheffler said Shell's rigs will remain on their pad locations for more than a month to drill a producing well. The fracking process usually takes approximately 24 hours to complete with the equipment on the pad site for about seven days. Shell will not use pump jacks, thus reducing its footprint once the rig moves on. Shell plans to have three to four rigs operating in Kansas by the end of this year.

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Kansas Senate
Committee on Assessment and Taxation

A Comparison of Kansas Oil and Gas Incentives
With Competing States

Kansas has an excellent opportunity to attract investment capital and create jobs in the oil and gas industry by taking advantage of the newly developing Mississippian Lime formation in south central Kansas. The formation is expected to yield oil and natural gas liquids, much more highly valued minerals in today's low natural gas price environment. A critical component of the state's success will be retention of the severance tax moratorium for New Pool Discovery Wells.

The New Pool program provides a 24-month severance tax moratorium on new oil wells in a new pressure system and greater than ½ mile from an existing oil well. In the early stages of development, the New Pool program will help Kansas compete for investment capital that is currently being deployed by the industry in other states with similar incentive programs.

It is important to note that a Mississippian Lime formation horizontal well will cost on average $3 - $4 million per well. Each drilling rig operating in the play is expected to support 75 – 100 jobs that will significantly contribute to personal income taxes and sales tax collections. And, as wells are brought on line for production, they will expand the ad valorem tax base in the impacted counties. Exponential growth of producing wells will add to the state treasury by increasing severance tax collections after the investment incentive period is over.

Below are excerpts from recent economic impact studies in three states with drilling incentive programs in place:

LOUISIANA - Horizontal Well Severance Tax Investment Incentive

- According to LSU Economist Dr. Loren Scott's 2011 *Economic Impact of the Horizontal Well Severance Tax Investment Incentive*:
    - "A repeal of this incentive would actually cause state revenues to decline, not increase."
    - For **every dollar the state gave up via the horizontal well severance tax investment incentive it gained $2.94 in revenues** to the State Treasury. Using the Department of Revenue's Tax Exemption Budget data, we estimate that in 2010, the state gave up $125.3 million, but it gained $367.7 million.
    - A sensitivity analysis was conducted to determine what would happen to the state budget if removing the horizontal incentive caused activity in the Haynesville Shale to drop by 25% or 50%. For every year from 2012-14,

the state treasury ended up collecting less money from removing the incentive, not more.

- Removing the horizontal tax incentive would make the Haynesville Shale even less competitive and hasten the exodus of exploration activity out of Northwest Louisiana.

OKLAHOMA – Gross Production Tax Incentive

- According to Oklahoma City University's 2009 *Oklahoma's Oil and Natural Gas Industry Economic Impact and Jobs Report*:
    - Oklahoma production of oil and natural gas offers a vital revenue stream to the state.
    - More than 71,000 oil and gas workers comprise 3.5% of the total Oklahoma workforce.
    - The industry generated an estimated **$7.6 billion in direct labor income** payments, representing almost 5.5% of total Oklahoma personal income
    - While a handful of firms dominate the national spotlight, it is worth noting that **the industry continues to serve as an important source of economic activity to small producers and the self-employed across the state**.
    - Direct activity stemming from industry production within the oil and gas industry in 2009 is estimated to be $26.2 billion with drilling activities contributing another $4.6 billion. **Combined, production and drilling activity account for 20% of Oklahoma's gross state product.**
    - Production activities generated an estimated **$18.1 billion in multiplier effects** (indirect plus induced) representing additional production for other state industries.
    - Since 1999, annual gross production taxes have increased by 400%.

TEXAS – High Cost Gas Program

- According to Billy Hamilton Consulting's 2012 *The Texas High-Cost Gas Program: Benefits to the State Economy*:
    - During the 2000s, high-cost gas directly or indirectly contributed a total of **$63 billion per year in economic output, $32 billion per year in earnings and 502,000 jobs per year in the Texas economy**.
    - At the height of the natural gas boom in 2008, high-cost gas directly or indirectly supported about **10% of overall Texas GSP**, seven percent of earnings and approximately five percent of employment statewide.
    - "Discontinuation of the high-cost investment tax credit would be a self-defeating policy for the state in the short term and the long term. This study has concluded that without the high-cost gas investment tax credit, Texas would lose:

- Total short term losses for Texas in 2012:
    - A loss of **35,000** jobs;
    - A loss of **$3.8 billion** in economic output (GSP); and
    - An initial direct loss of **$1.5 billion** to the Texas economy in 2012, increasing over time.
- Total long term losses for Texas for 2012-2035:
    - Average loss of **94,400** jobs every year in the Texas Economy;
    - Average loss of **$10.4 billion** every year in economic output (GSP); and
    - Initial direct loss of **$7.5 billion every year** by 2035.

o "In the current low-price environment, the high-cost gas investment tax credit remains vital to ensure that the development of new gas reserves continues into the future."

Today, there are 23,000 Kansans directly employed in the oil and gas industry. These jobs support an additional 44,000 related jobs. In total, the industry generates $2.7 billion in household income and $930 million in tax revenue.

SUMMARY

Retention of the New Pool program will attract capital investments that will stimulate exploration and production companies to invest billions of dollars in drilling expensive deep horizontal wells in Kansas for years to come. The positive results of incentive programs can be seen in other states where oil and natural gas development is occurring. As all of these states and more compete for investment dollars, elimination of the New Pool incentive would have a chilling impact on the future economic impact of the industry in the Mississippian Lime formation in Kansas.