Approved: April 30, 2003
Date

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE

The meeting was called to order by Chairperson David Corbin at 11:25 a.m. on April 3, 2003, in Room 519-S of the Capitol.

All members were present except:

Committee staff present: Chris Courtwright, Legislative Research Department
Shirley Higgins, Committee Secretary

Conferees appearing before the committee: Steve Johnson, ONEOK Field Services
Ron Hein, Pioneer Natural Resources U.S.A.
Dennis Stell, Duke Energy Field Services
David Bleakley, Eastern Kansas Oil and Gas
Joan Wagnon, Secretary, Kansas Department of Revenue

Others attending: See attached list.

SB 267–Oil and gas percent of proceeds gas purchase contracts

Senator Corbin noted that the Chairman of the Senate Ways and Means Committee requested a hearing on **SB 267**. However, there were no conferees in support of the bill present.

Steve Johnson, representing ONEOK Field Services (OFS), testified in opposition to **SB 267**. He contended that the bill, in all probability, would be impossible to implement because the intent is unclear. He discussed the advantage of a Percent of Proceeds (POP) agreement, noting that the POP agreement is a standard contract form which has been used for many years to purchase natural gas from producers. Due to the difficulty of making a definitive calculation using the language in **SB 267** and OFS's desire to leave the negotiation of contracts between the parties involved, Mr. Johnson requested that no action on the bill be taken until OFS has an opportunity to gain a more thorough understanding of the intent of the bill and offer further comments. (Attachment 1)

Ron Hein, representing Pioneer Natural Resources U.S.A., testified in opposition to **SB 267**. In his opinion, the bill would ultimately result in reduced revenue to both royalty owners and the state. He explained that, under current POP contracts, royalty owners and the state generally share in the increased value of the bi-products of processing and also share the risk that the net value obtained from processing will not exceed the net value of the wellhead sale. The bill would place all the risk of POP contracts, even those entered into in good faith, upon the producer. By altering the risk/reward balance of these contracts, gas which could and should be processed will not be processed, causing a loss to producers, royalty owners, and the state. In conclusion, Mr. Hein noted that the sponsor of the bill is aware of the concerns about the proposal and agrees that the issue should be studied by an interim committee. (Attachment 2)

Dennis Stell, Duke Energy Field Services (DEFS), testified in opposition to **SB 267**. At the outset, he informed the Committee that he is currently responsible for the natural gas gathering and processing (G & P) activities of DEFS in Kansas. He discussed the following types of contracts for compensation for services provided by G & P companies: (1) fixed fee, (2) variable fee, (3) percent of index (POI), (4) two part payment percent of proceeds (POP), and based on indices (POPI). He noted that POI and POP-POPI contracts are beneficial to G & P companies because they provide some upside opportunity when prices are favorable, and they benefit producers because, when prices go down, so does the dollar amount retained by the G & P service provider. In his opinion, depending on the pricing environment, POP contracts can actually increase the amount of severance taxes paid. To illustrate, he referred to a table attached to his written testimony. In conclusion, Mr. Stell expressed his concern that the bill would outlaw a type of contract that best aligns the interest of producers and G & P companies. He observed that, although the intent of the bill may be to extract additional taxes and royalty payments from producers, the result of the bill may be to further discourage new drilling and investment by producers to extend the lives of existing wells. Over time, this will contribute to premature abandonment of wells and loss of recoverable reserves. (Attachment 3)

David Bleakley, Eastern Kansas Oil and Gas (EKOG), testified in opposition to **SB 267**. As a producer and gas gatherer, EKOG consulted with many persons to find which type of agreement most fair to the gas producer, gas gatherer, and the royalty owner. The overwhelming recommendation was the POP contract. EKOG has found that the POP works very well compared to a fixed price. For the Committee's further information, Mr. Bleakley called attention to a copy of a letter addressed to the Committee from Jon R. Viets, an attorney who recommended the POP agreement not only to EKOG but also to many royalty owners, producers, and gas gatherers. Mr. Viets concludes, "If the legislature believes the severance tax scheme needs to be fixed, then it should enact a tax on the volume of gas, without reference to price. If the Legislature believes royalty owners should receive higher royalty shares than those specified in the underlying oil and gas leases, it should do so by open fiat." (Attachment 4)

Senator Corbin called attention to informational material on **SB 267** provided by Bob Krehbiel, Kansas Independent Oil and Gas Association. (Attachment 5) In addition, written testimony in opposition to **SB 267** was submitted by Douglas L. Lamb, President of Quest Resource Corporation, (Attachment 6) and Erick E. Nordling, Executive Secretary, Southwest Kansas Royalty Owners Association (Attachment 7).

There being no others wishing to testify, the hearing on **SB 267** was closed.

HB 2416–Amnesty from assessment or payment of penalties and interest on certain unpaid taxes

Senator Corbin pointed out that **HB 2416** went through the House on the Consent Calendar.

Joan Wagnon, Secretary, Kansas Department of Revenue, explained that the Department has implemented a two-phased tax amnesty program, with Phase 1 beginning in early February. In Phase 1, the Department is exercising its existing authority to settle disputed matters, including those pending before the Office of Administrative Appeals, the Board of Tax Appeals, or in the judicial review process. Phase 1 involves an aggressive campaign to pursue settlement negotiations on pending assessments prior to June 30, 2003. Secretary Wagnon explained further that the Secretary of Revenue has the authority to waive penalty but never interest. **HB 2416** will provide legislative authority beginning on July 1, 2003, to implement Phase 2, which will involve a tax amnesty program to be conducted this coming fall to offer waiver of penalties and interest to taxpayers with accounts in collection or who are non-filers or under-reporters if the underlying taxes are paid in full in one payment rather than through a payment plan. The purpose of the amnesty program is to convert as many outstanding accounts receivable as possible into much needed revenue during the first half of Fiscal Year 2004. (Attachment 8) Secretary Wagnon noted that the revised positive fiscal impact on the State General fund resulting from the amnesty program is $19.5 million for Fiscal Year 2004. In addition, she pointed out that the bill does not create new taxes but rather deals with tax liabilities that are currently due and owing.

Following brief questions and comments from the Committee, the hearing on **HB 2416** was closed.

Senator Haley moved to recommend **HB 2416** as favorable for passage, seconded by Senator Lee. The motion carried.

The meeting was adjourned at 12:00 p.m.

No further meetings are scheduled.