

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE.

The meeting was called to order by Chairperson David Corbin at 10:45 a.m. on February 13, 2001, in Room 519-S of the Capitol.

All members were present except:

Committee staff present: Chris Courtwright, Legislative Research Department
Don Hayward, Revisor of Statutes Office
Shirley Higgins, Committee Secretary

Conferees appearing before the committee: Dick Brewster, bp
Jack Glaves, Occidental Oil and Gas Company (Oxy)
Bob Krehbiel, Kansas Independent Oil and Gas Association
Charles Wilson, BEREXCO Inc.
Senator Mark Taddiken
Bill Becker, AgraMark
Joe Lieber, Kansas Cooperative Council
Mike Beam, Kansas Livestock Association
Greg Krissek, Kansas Corn Growers and
Kansas Grain Sorghum Producers Association
Bill Fuller, Kansas Farm Bureau

Others attending: See attached list.

The minutes of the February 7, 2001, meeting were approved.

SB 51—severance taxation; concerning incremental severance and production of oil and gas, exemption—as amended by Committee on Utilities.

Dick Brewster, representing bp, testified in support of **SB 51**. He noted that the bill amends a statute enacted three years ago and that the existing statute is designed to bring incentives for bringing to the market incremental production which occurs as the result of production enhancement projects. He explained that incremental production (production over and above the base production of the well) is exempt from the severance tax under the provisions of the bill for a period of seven years, if the project qualifies. In addition, certain oil or gas brought to market by virtue of three dimensional seismic based wells is exempted. Mr. Brewster recommended three amendments. The first amendment would clarify the definition of base production for a gas well, the second would provide an exemption from coal bed gas production, and the third would strike the price threshold. (Attachment 1)

As part of his testimony, Mr. Brewster distributed copies of data from the Natural Gas Supply Association furnished by Ken Peterson, Kansas Petroleum Council. The data concerns current natural gas supplies and what the Association feels the future holds for the natural gas market with regard to the growing demand for natural gas. (Attachment 2) Mr. Brewster noted that, today, natural gas consumption in the United States is between 21 and 22 trillion cubic feet a year. In the next decade and half, consumption will increase to 30 trillion cubic feet. It is estimated that the industry will spend \$650 billion to keep pace with the demand for natural gas. For this reason, the Association encourages the removal of the price threshold on the incentives so that Kansas remains competitive with other states in attracting oil and gas investment dollars.

John Glaves, Occidental Oil and Gas Company (Oxy), testified in support of **SB 51**. He explained that Oxy is one of the most active producers in the southwest Kansas area and is particularly involved in deeper exploration ventures, which are relatively expensive and high risk. He noted that existing tax incentives have encouraged Oxy to drill 32 wells and that Oxy particularly utilizes the exemption in extensive three dimensional seismic, which is vital to exploration in Hugoton. He said that the exemption has resulted in over 300 applications, and as its availability

becomes more generally known, it will be a continued source for new investment capital for Kansas exploration. In this regard, he called attention to a pie chart attached to his

CONTINUATION SHEET

written testimony, which shows the types of projects utilized by the industry, and to a list of applications filed by independents, which was compiled by the K.C.C. He said the utilization of the exemption and the employment of the technologies that qualify for the exemption have resulted in additional drilling and additional production. He also called attention to a chart showing that the production of gas in Kansas has been declining every year since 1985. He emphasized that something must be done to abate the decline. In conclusion, Mr. Graves said the exemption would encourage deeper drilling to discover buried stream beds which can be very productive. He noted that the fiscal note is low, \$725,000 to \$750,000. ([Attachment 3](#))

Bob Krehbiel, Kansas Independent Oil & Gas Association (KIOGA), testified in support of **SB 51**. He informed the Committee that Eastern Kansas Oil and Gas Association authorized him to testify on their behalf. He went on to state that the purpose of this exemption to the severance tax was to encourage investment in the kinds of enhanced production cited in the statute, to increase production, to prevent waste, and to create jobs and the associated economic activity which results. However, recent price increases above the price limitations have eliminated the use of this incentive for exploration. Mr. Krehbiel contended that maintaining the viability of the incremental production exemption to the severance tax is critical to the continuance of enhancement activity in Kansas. In this regard, he cited a recent study commissioned by the Interstate Oil and Gas Compact Commission, which indicates that such incentives pay off for the state's economy. ([Attachment 4](#)) Mr. Krehbiel gave a copy of the study to Chairman Corbin, who indicated that it will remain on file in his office for review by interested committee members.

Charles Wilson, BEREXCO Inc., gave final testimony in support of **SB 51**. He began by itemizing projects qualifying for the exemption. He said BEREXCO saw the value of the tax incentive to re-invest cash flow into enhancing its existing production, and he discussed statistics regarding BEREXCO's enhancement activity after the exemption was made effective July 1, 1998. He maintained that the exemption for incremental production from severance taxation makes Kansas competitive for new project investments. He commented that producers, the state, and the county economies, will all be net winners with the passage of **SB 51**. ([Attachment 5](#))

Chairman Corbin called attention to written testimony in support of **SB 51** submitted by Ron Hein on behalf of Pioneer Natural Resources USA, Inc. ([Attachment 6](#)) and Erick E. Nordling, Southwest Kansas Royalty Owners Association ([Attachment 7](#)). There being no others wishing to testify, the hearing on **SB 51** was closed.

SB 84—Income taxation; providing a credit for investments in certain agricultural cooperatives.

Senator Mark Taddiken, testified in support of **SB 84**. He explained that the purpose of the bill is to assist agricultural producers in retaining control of their products further into the processing chain, thus increasing their potential for profit. The bill provides tax incentives to assist in raising the needed capital. It allows a credit of 25 percent of the amount invested up to a maximum of \$2,500. An investor would be able to sell or transfer the credit if they so desired. Senator Taddiken offered two amendments. One would restrict any single project from receiving more than 25 percent of the total yearly tax credits, and the other would reserve 10 percent of the total yearly tax credits for projects costing less than \$1 million. Senator Taddiken believes the program would not only assist rural Kansans but also would have a positive impact on the state treasury in the long run. ([Attachment 8](#))

Senator Lee commented that she recently received an e-mail concerning this issue from Jennifer Mathes who served on the Governor's 21st Century Task Force on Agriculture. Ms. Mathes stated that the task force's recommendation was not limited to cooperatives but included other value-added sectors in the state. Senator Lee asked if there was specific reason for limiting the bill to cooperatives. In response, Senator Taddiken said the bill is an attempt to pass the profits to farmers or producers, and one concern with opening it up to any business was the possibility that taxpayers would be funding some of the larger value added businesses. Senator Lee clarified that Ms. Mathes discussed the task force's intent to encourage individual producers to invest in a project that could stimulate their local economies. Senator Lee will submit the e-mail with Ms. Mathes' suggestions at the next committee meeting for the Committee's consideration.

Bill Becker, AgraMark, testified in support of **SB 84**. He explained that he is a producer in northeast Kansas and discussed the changes he has seen in agriculture since he began farming in 1977. When he began, he decided to add value to his crops by feeding livestock. He had a fairly large pork production facility and also fed cattle. With the

event of consolidation in agriculture and corporate livestock feeding, he decided to leave pork production. He had to increase his crop production to offset the loss from adding value with livestock.

CONTINUATION SHEET

Fifteen years ago when he sold livestock, he achieved approximately 50 percent of what the consumer spent for meat. For the past ten to twelve years, he has delivered corn directly to a local corn processor, who processes the corn into corn grits which are rolled into corn flakes. Corn flakes are sold at about \$3.00 a box, and about 15 cents of that \$3.00 goes back to the producer. By no longer adding value, over time he has lost the percentage share of what is received from the consumer.

Mr. Becker went on to say that, about four years ago, he had an opportunity to represent Farmland Industries in the National Institute for Cooperatives in Minnesota. At that time, producers in the rural area of Minnesota he toured were addressing the same problems with cooperatives as Kansas. One thing he noticed was that rural development there was different from Kansas. New homes were being constructed in the rural area he visited. He discovered that the added value in processing plants there brought value back to the producer and created jobs. Many of the new homes were not homes for producers but were homes for contractors and other new people moving into the area.

Mr. Becker explained that six months after he returned from Minnesota, an elevator operator in his local area (Everest) made a decision to sell the facility, but could find no buyer. Mr. Becker was one of twenty-one local producers and businessmen who combined resources and bought the facility. After four years, they have approximately a 25 percent return on their investment, and the City of Everest has been revitalized. He explained further that his group decided that it should have an organization larger than the core group in the Everest community; therefore, they put together another cooperative that is focused entirely on marketing crops in niche markets and bringing value back into their production. The first year, it brought back approximately \$230,000 to member owners. Recently, the group purchased a Quaker Oats facility at St. Joseph. He feels that the Quaker Oats facility will give the group an opportunity to move up the value chain and achieve some of the values seen in agriculture twenty years ago. Mr. Becker emphasized that one of the keys to the Quaker Oats opportunity was the tax credit in the State of Missouri, which has a cap of \$6 million, \$1.5 million per individual opportunity and a \$15,000 level for an individual producer. He pointed out the tax credit allows a producer to bring forth much more equity than if it was not in place.

Joe Lieber, Kansas Cooperative Council, testified in support of the concept of **SB 84** and discussed what he perceives to be technical problems with the language. He questioned the meaning of “economic value” on line 21, and “eligible person” in Section 1(3). He also questioned if a traditional farm cooperative which needs a new feed mill could sell stock to its current members to build it and if a traditional farm cooperative could sell stock to a producer that promises to deliver a specified quantity of product consistent with a marketing agreement. He offered an amendment to ensure that traditional farm cooperatives can be involved. He also addressed concerns regarding how the tax credit would be divided. In this regard, he called attention to examples of the Missouri and Oklahoma laws that address his concerns attached to his written testimony. In conclusion, Mr. Lieber said the Committee should be aware that not all added value cooperatives are successful. (Attachment 9)

Chairman Corbin called the Committee’s attention to written testimony in support of **SB 84** submitted by Representative Sharon Schwartz, who was unable to testify due to the fact that the House of Representatives was in session. (Attachment 10)

Mike Beam, Kansas Livestock Association, testified in support of **SB 84**. He began by expressing appreciation to Senator Taddiken and others who requested the introduction of the bill. He pointed out that subsection (c) provides that the tax credits to be transferred to others with a state income tax liability. In his opinion, the provision will cause more producers to participate. He commented that most marketing cooperatives view themselves as meal providers instead of commodity producers. He noted that agricultural marketing cooperatives are not a new concept, and followed with a discussion of examples of successful cooperative marketing ventures (Sunkist Growers, Blue Diamond Growers, Ocean Spray, and US Premium Beef). He believes that the best opportunity for many Kansas producers is to pursue similar marketing arrangements. (Attachment 11)

Greg Krissek, Kansas Corn Growers and Kansas Grain Sorghum Producers Association, testified in support of **SB 84**. He said one of the best opportunities that exists for Kansas’ producers involves going beyond merely producing a generic unprocessed commodity, and the return on investment in farming pales when compared to the returns common to the food and agricultural commodity processing industries. Mr. Krissek discussed new Missouri ethanol plants which formed with cooperatives as part of their legal structure so that their members could utilize a similar

income tax credit available under Missouri law. He believes potential Kansas ventures would increase in number with the availability of the income tax credit provided in the bill. (Attachment 12)

CONTINUATION SHEET

Bill Fuller, Kansas Farm Bureau, gave final testimony in support of **SB 84**. He agreed with other conferees that the bill will provide a financial incentive for many farmers and ranchers to invest in producer owned businesses that will add value to the crops they grown and the livestock they raise. He commented that subsection (d) on page 2 of the bill limits the fiscal exposure to the state budget to \$2 million. He said the limit may be even more necessary today when the Legislature is dealing with a tight budget as a result of reduced revenue collections. (Attachment 13)

There being no others wishing to testify, the hearing on **SB 84** was closed.

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

The next meeting is scheduled for February 14, 2001.