

MEMO



DATE: November 13, 2017
TO: 2017 Special Committee on Natural Resources
FROM: Tracy Streeter, Director
RE: Follow Up Questions

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In response to questions that have been asked both during the October 31, 2017 Committee meeting and since, we offer the following responses.

How do industrial water fees work regarding oil and gas drilling?.

Oil and gas activities are considered industrial use under the Water Appropriation Act. Drilling of new oil and/or gas wells use water under a temporary permit and typically use less than 1 million gallons of water. The use of water is required to be metered. However, water use reports are not required for small use temporary permits.

How can we address fees on water that is used in drilling, then injected, and essentially lost to use for several generations?

K.S.A. 82a-728 exempts water produced with oil and gas production from permitting under the Water Appropriation Act. As such they are not classified as an industrial use and charged a fee for the water that is brought to the surface as a result of the oil and gas production, and then reinjected into another geologic formation.

Any water used in secondary or tertiary oil recovery is permitted, metered and fee assessed as an industrial use.

Background on a tax on bottled water.

The *Long Term Vision for the Future of Water Supply in Kansas*, published January, 2015, identified a Blue Ribbon Funding Task Force (Task Force) as a critical, immediate action item. The Task Force was charged with developing a balanced, affordable and sustainable method to provide financing for water resource management and protection, including alternatives that utilize public and private partnerships. One of the fee sources evaluated by the Task Force was a bottled water fee.

The Task Force, based on consultation provided from the Kansas Department of Revenue (KDOR), found this alternative less attractive due to the question of where to collect this fee. It was found that a fee at the point of sale would be logistically difficult to implement while a fee on the wholesale quantity would be disproportionately large on Kansas bottlers.

Definition of “Bottled Water”

According to the Streamlined Sales and Use Tax Agreement (SSUTA), “bottled water” means “water that is placed in a safety sealed container or package for human consumption. Bottled water is calorie free and does not contain sweeteners or other additives except that it may contain: (i) antimicrobial agents; (ii) fluoride; (iii) carbonation; (iv) vitamins, minerals, and electrolytes; (v) oxygen; (vi) preservatives; and (vii) only those flavors, extracts, or essences derived from a spice or fruit. “Bottled water” includes water that is delivered to the buyer in a reusable container that is not sold with the water.”

KDOR provided the Kansas Water Office two options in support of Blue Ribbon Funding Task Force efforts that could be implemented and keep Kansas in compliance with SSUTA; assessing a unit tax on packages sold (cents/bottle) or assessing a gallonage tax on packaged water (cents/gallon).

Tax on packages Sold

Fee at Retail Level

Statute should specify whether the fee would be imposed directly on the consumer or if it would be imposed on the seller.

- On the seller it would be included in the sales price unless the statute authorizing or imposing the fee provides that the seller may, but is not required, to collect such tax from the consumer.
- If the fee would be excluded from the sales price, the statute should require it to be separately stated on the invoice provided to the purchaser.

Fee at Wholesale Level

If the fee would be imposed at the wholesale level, it would be assumed that the fee would be included in the cost of the product to the retailer and included in the sale price.

Anticipated Revenues: ¹

Bottles/gallon	Bottles Used	Annual Revenue \$0.01/bottle	Annual Revenue \$0.04/bottle
4	425,099,586	\$4,250,996	\$17,003,983
5	531,374,483	\$5,313,745	\$21,254,979
6	637,649,379	\$6,376,494	\$25,505,975
7	743,924,276	\$7,439,243	\$29,756,971
8	850,199,172	\$8,501,992	\$34,007,967

Discussion points for fee imposed directly on consumer

- If the fee were imposed directly on the consumer, the retailer would need to modify its receipts to report the tax to the consumer. This would create a greater hardship on smaller retailers who may not have a sophisticated computer system to track such sales and taxes.
- Bulk sales and the use of refillable containers, such as home and office delivery services (ie. LindySpring and others), would need to be addressed.
 - Would all containers be taxed, or only those containers within a certain size range?
 - Would all sized containers be taxed at the same rate? This may lead to a perceived unfairness by the consumer. For example, with a \$0.04/bottle tax, a 24 pack of 16.9 ounce bottles would be taxed at \$0.96. A 24 pack of 16.9 ounce bottles contains about 3 gallons of water. Purchasing the same 3 gallons of water in one gallon containers would only bear a \$0.04/bottle tax of \$0.12.
- Consumer concern may also arise from a bottle tax being applied to bottled water but not to other beverages sold in similar containers.

¹ According to the International Bottled Water Association, U.S. per capita consumption of bottled water in 2015 was 36.5 gallons. With a Kansas population of 2.912 million, this equates to 106.3 million gallons of bottled water consumed in 2015. Since bottled water is sold in various sized containers, it is not clear how to determine how many bottles would be used per gallon of water. The table shows how many bottles would be consumed based on the number of bottles used per gallon of water.

Gallage Tax

If a gallage tax were imposed, the following table shows potential revenues at various tax thresholds.

Cents/Gallon	Annual Revenue
\$0.01	\$ 1,062,749
\$0.02	\$ 2,125,498
\$0.03	\$ 3,188,247
\$0.04	\$ 4,250,996
\$0.05	\$ 5,313,745
\$0.10	\$ 10,627,490
\$0.15	\$ 15,941,234
\$0.20	\$ 21,254,979
\$0.25	\$ 26,568,724
\$0.30	\$ 31,882,469
\$0.35	\$ 37,196,214

With regard to upstream activities, there are costs to municipals when they have to treat for nitrates. Who ends up with the costs of the upstream activities? How can we address that?

Addressing upstream activities is funded through a combination of federal, state, local and individual actions. The majority of the funds for upstream best management practices come through the USDA-Natural Resources Conservation Service. These practices typically require a cost share of 20-30% by the landowner.

The state also has programs to implement best management practices through KDA-Division of Conservation and KDHE through the WRAPS program. Similar to the federal program, individual cost share is common with the exception of streambank stabilization.

Local counties contribute to their conservation district for the administration of the programs.

Regarding water assurance districts and how they pay for certain amount of water storage; do they pay for upstream maintenance and quality? Is there a formula or charge that we could look at to ensure water assurance districts are contributing?

Water assurance districts have not typically paid for upstream watershed protection activities. They do repay the state's cost to acquire the storage, the proportional share of the operation and maintenance costs of the Corps of Engineers and the state's cost to administer and enforce the program.

We currently have Burke Griggs under contract looking at these and other storage related issues. His preliminary legal assessment is that the Water Assurance statute allows for us to assess them for maintaining the storage. The assurance districts disagree. We have approached the Kansas River Water Assurance District about partnering in the Milford Lake Regional Conservation Partnership Program to implement watershed practices. Their response was that they are a quantity organization and don't believe the purpose of the project, or individual practices, would benefit their storage. Four of the municipal members are participating financially.

You may also remember that we attempted to engage the Neosho WAD for cost share in the John Redmond dredging, but they pushed back and ultimately are not being charged for that effort. The recent talk I think has raised the profile of their involvement and some higher level players are beginning to change their mind about participating. They want to do it voluntarily and have a large say in what gets funded however.

Regarding the purchase of water storage in reservoirs, is water storage capacity based on the original design of the reservoir or does it reflect the impact of sedimentation? If it does not reflect the impact of sedimentation, what are the prospects of negotiating with the Corps of Engineers about the silting in (O&M costs, economic value).

Our contracts are for a percentage of the storage and a specified quantity after the designed sediment storage has filled. So in essence we are purchasing the designed water supply storage. We get the benefit of using a proportional share of the unfilled sediment storage until it is filled. While normal thinking would be that the cost would go down, we continue to accrue interest as the overall asset depreciates due to sedimentation. The price will not go down as sediment increases.

We continue to talk with the Corps of Engineers about the prospect of them either participating in storage maintenance and protection activities or giving credit against our bills for work that we complete. Unfortunately, their federal mission is flood risk, navigation and environmental restoration. Water supply is not a federal mission and they do not have a mechanism to either participate or credit us for work done. Such a change would require congressional action. We have proposed this change in previous versions of the Water Resources Development Act amendments.

We have also requested the Corps of Engineers to help evaluate the economic value of the water supply storage. They have significant background and expertise in this type of work, focused on flood control and navigation. To date we have not gotten much traction on this approach.

A person contacted the Chairman and stated that irrigators pay 37% of the SWPF today through the herbicide and pesticide fees. Is that accurate? While irrigators may use more of both products, non-irrigators (farmers and urbanites) contribute significantly. Please see if you can determine what an accurate estimate is for irrigator, non-irrigator payment into the SWPF for herbicide and pesticide use.

The answer is no but we could not determine an exact percentage. Of the fees irrigators would pay to the SWPF, this would include the Fertilizer Fee and the Pesticide Registration Fee. The Fertilizer Fee generates an average of \$3.373 million for the period 2012-2014. In reviewing average water use reports for the period 2011-2015, 3.658 million acre-feet was used statewide. The 42 counties overlying the Ogallala/High Plains Aquifer used 3.4 million acre-feet, or 93 percent of the statewide total. These same 42 counties contributed \$1.1 million, or 33% of the statewide average fertilizer fee. Please keep in mind, these fees would include fertilizer applied on dryland acres as well.

A quick review of the pesticide registration fees shows that roughly 20% of the fees paid relate to agricultural activities. The remainder is for things such as household insecticides, lawn care, and pest or termite control businesses.

Taking 20 percent of the pesticide registration fees for actual FY2017, and the \$1.1 million of the statewide fertilizer for the 42 counties over the Ogallala region, results in between 11 and 12 percent of the total SWPF fee revenue for FY 2017.

Under the Clean Drinking Water Fee Act, I believe 10% of revenues collected are to go for small drinking water system support. Please determine how much we have been shorting them.

Kansas statute provides that not less than 15% shall be used to provide on-site technical assistance for public water supply systems. The following table represents the total expended Technical Assistance to Water Users and the underfunding in the Technical Assistance to Water Users line item.

Fiscal Year	Clean Drinking Water Fee Fund Revenue	Technical Assistance Expended	Actual Percentage Expended	Required 15%	Short
2013	\$ 3,320,650	\$ 413,000	12%	\$ 498,097.50	\$ (85,098)
2014	\$ 2,897,102	\$ 404,409	14%	\$ 434,565.30	\$ (30,156)
2015	\$ 2,789,450	\$ 370,721	13%	\$ 418,417.50	\$ (47,697)
2016	\$ 2,658,398	\$ 380,708	14%	\$ 398,759.70	\$ (18,052)
2017	\$ 2,724,051	\$ 377,646	14%	\$ 408,607.65	\$ (30,962)

As I hear the agriculture interests, they do not need or want any more assistance from the State Water Plan than they already receive. The municipal interests do not want to pay any more, though they see needs (e.g., reservoir sustainability, calling them into service). I also see a need for dedicated research funds to address sedimentation rates (what is normal water flow rate, what is high flow rate, how do we reduce both; what is normal flow nutrition (phosphorus, nitrogen, etc.) flow rate, what is high flow rate, how do we cost-effectively reduce both?

High flow rate versus normal flow rate is specific to a given stream gage location. Reduction of flow at a location is based on increasing available storage upstream to hold water during high rainfall events. That can be accomplished either through reservoir or floodplain wetland development. To date, there has been very little support locally to take high value crop land out of production to convert to floodplain wetland. Likewise, regulations, private property rights and funding levels have made further reservoir development difficult.

Nutrient runoff is also a function of rainfall. Most of the nutrients are carried to the streams and reservoirs by high rainfall events. On field practices are seen as the most cost effective options for keeping nutrients where they are applied.

Regarding the future use storage in Milford and Perry reservoirs, if the water marketing program paid for the 2018 call-in of all future use storage in both Milford and Perry reservoirs, what is the required increase in the marketing variable rate?

The Committee requested for the Kansas Water Office to determine the increase in the required variable rate if the remaining future use storage in both Milford and Perry reservoirs is called into service in 2018 and the water marketing program pays for both the additional principal and interest payments and the estimated additional operation and maintenance costs associated with this storage. Based on the 2017 PWS Comprehensive Capital Development Program (CCDP), an estimated increase of \$0.40 per 1,000 gallons would be required. This reflects the rate increase necessary for the marketing program to pay for the future use storage call, while continuing to support the debt paydown schedule and protection and restoration project funding in the approved 2017 CCDP. The marketing rate for CY 2018 is currently set at \$0.392 per 1,000 gallons.

The Committee also requested that the Kansas Water Office determine what rate would be necessary (per 1,000 gallons of water) if the future use storage in Milford and Perry reservoirs was called into service and paid for by the Kansas River Water Assurance District (KRWAD).

Assuming annual principal and interest and estimated additional operation and maintenance costs of approximately \$3.77 million (if called into service in 2018), the rate would be approximately \$0.10 per 1,000 gallons. This estimated rate is based on the KRWAD 2016 annual diversions totaling approximately 38.5 billion gallons.