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HOUSE BILL 601

**48TH LEGISLATURE - STATE OF NEW MEXICO - FIRST SESSION, 2007**

INTRODUCED BY

John A. Heaton

AN ACT

RELATING TO REVENUE; AUTHORIZING CERTAIN HEDGING CONTRACTS FOR THE PURPOSE OF PROVIDING A LEVEL OF PREDICTABILITY OF OIL AND GAS REVENUES; MAKING APPROPRIATIONS.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF NEW MEXICO:

Section 1. CONTRACTS FOR THE HEDGING OF SEVERANCE TAX BONDING FUND AND GENERAL FUND REVENUES.--

A. As used in this section:

(1) "hedging contract" means a written agreement with a counterparty relating to a commodity price for crude oil and natural gas, including contracts commonly known as swap agreements, futures or options providing for payments to or from the counterparty based on levels of or changes in commodity prices, forward rate transactions, cap transactions, floor transactions, collar transactions, options, puts or calls

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1 to hedge price or similar exposure;

2 (2) "net payment" means a payment required  
3 under a hedging contract minus any payments received from the  
4 qualified counterparty or costs paid by the qualified  
5 counterparty;

6 (3) "qualified counterparty" means a person  
7 whose long-term obligations are rated, at the time the hedging  
8 contract is executed, in one of the three top rating categories  
9 of a nationally recognized rating agency, without regard to any  
10 modification of the rating; and

11 (4) "state severance taxes" means the taxes  
12 levied on the severance of oil or natural gas by the Oil and  
13 Gas Severance Tax Act, the Oil and Gas Conservation Tax Act,  
14 the Oil and Gas Emergency School Tax Act and the Natural Gas  
15 Processors Tax Act.

16 B. The state board of finance, on behalf of the  
17 state, may enter into hedging contracts authorized in this  
18 section if the board finds that such a contract would be in the  
19 best interests of the state and determines that the contract  
20 results in a financial benefit to the state. The purpose of  
21 hedging contracts shall be to establish a desired level of  
22 predictability in tax receipts derived from part of the  
23 anticipated crude oil and natural gas production subject to  
24 state severance taxes, in accordance with the terms and  
25 conditions established by the state board of finance, and

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1 subject to the provisions of this section.

2 C. Hedging contracts shall be entered into only  
3 pursuant to rules of the state board of finance. The rules of  
4 the state board of finance shall include the following  
5 criteria:

6 (1) the state board of finance may enter into  
7 a hedging contract only with a qualified counterparty selected  
8 by the board through a competitive selection process or by  
9 competitive bid, provided that the state board of finance may  
10 require more stringent rating levels and may require  
11 collateralization of the qualified counterparty's obligations  
12 at the time of execution of the hedging contract or thereafter;

13 (2) a hedging contract shall not have a  
14 duration of more than five years;

15 (3) a hedging contract shall be tied to an  
16 established publicly traded index, including the Henry Hub  
17 natural gas contract traded on the New York mercantile exchange  
18 and the west Texas intermediate crude oil contract traded on  
19 the New York mercantile exchange; and

20 (4) a proposed hedging contract shall be  
21 prepared with the review and assistance of a financial advisor  
22 to the state board of finance and legal counsel to the state  
23 board of finance. The financial advisor and legal counsel may  
24 be the financial advisor and the bond counsel under general  
25 contract to the state board of finance, or another financial

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1 advisor or legal counsel, selected pursuant to the provisions  
2 of the Procurement Code, as the state board of finance deems  
3 appropriate.

4 D. The state board of finance may determine and  
5 designate the volume of natural gas and oil production that  
6 shall be covered by hedging transactions; provided, however,  
7 that before giving effect to a hedging contract:

8 (1) the aggregate production volume of oil and  
9 natural gas subject to severance taxes to be deposited in the  
10 severance tax bonding fund for a fiscal year covered by hedging  
11 contracts at one time shall not exceed the lesser of:

12 (a) ten percent of the total production  
13 volume of oil and natural gas subject to severance taxes to be  
14 deposited in the severance tax bonding fund for that fiscal  
15 year, as estimated by the consensus revenue estimate group; or

16 (b) ten percent of the total production  
17 volume of oil and natural gas subject to severance taxes  
18 deposited in the severance tax bonding fund in the preceding  
19 fiscal year; and

20 (2) the aggregate production volume of oil and  
21 natural gas subject to severance taxes to be deposited in the  
22 general fund and covered by hedging contracts at one time shall  
23 not exceed the lesser of:

24 (a) ten percent of the total production  
25 volume of oil and natural gas subject to state severance taxes

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1 to be deposited in the general fund for that fiscal year, as  
2 estimated by the consensus revenue estimate group; or

3 (b) ten percent of the total production  
4 volume of oil and natural gas subject to state severance taxes  
5 deposited in the general fund in the preceding fiscal year.

6 E. The net payments, including premiums, periodic  
7 payments, termination payments and costs associated with  
8 entering into and performing the hedging contract, required to  
9 be made by the state under or in connection with a hedging  
10 contract shall be made from money in the fund that is subject  
11 to the hedging contract, except that net payments required to  
12 be made by the state pursuant to a hedging contract relating to  
13 the state severance taxes to be deposited in the general fund  
14 shall be payable only from the state severance tax revenue  
15 deposited in the general fund.

16 F. A contract entered into by the state board of  
17 finance pursuant to this section shall not impair the contract  
18 of the state with, or impair adversely, the owners of bonds  
19 issued by the state.

20 G. The hedging contracts allowed by this section  
21 shall only be made for the purpose of providing a level of  
22 predictability concerning anticipated revenues from state  
23 severance taxes, and not for speculation.

24 H. The net revenues derived by the state from  
25 hedging contracts shall be paid into the severance tax bonding

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1 fund or the general fund as applicable, as though they were the  
2 revenues actually derived from those severance taxes. The  
3 state board of finance shall treat the net revenue derived and  
4 to be derived from hedging contracts entered into under this  
5 section as the revenue actually derived from state severance  
6 taxes on the severance of oil and natural gas, as applicable,  
7 for purposes of:

8 (1) complying with statutory and  
9 constitutional requirements concerning deposits of state  
10 severance taxes in the applicable fund;

11 (2) complying with statutory and contractual  
12 requirements concerning tests applicable to the issuance of  
13 severance tax bonds and supplemental severance tax bonds; and

14 (3) making determinations of projected  
15 revenues for purposes of bonding capacity and budgetary  
16 matters.

17 I. Any obligation made by the state board of  
18 finance pursuant to a hedging contract shall be valid and  
19 binding from the time when that hedging contract is signed by  
20 all necessary parties; the revenues, money or property promised  
21 to the state pursuant to a hedging contract shall immediately  
22 be subject to obligation in accordance with the hedging  
23 contract, without physical delivery of the revenue, money or  
24 property or further act. A hedging contract shall be valid and  
25 binding as against all parties having claims of any kind in

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1 tort, contract or otherwise against the state, irrespective of  
2 whether the parties have notice of the hedging contract.

3 Neither the resolution nor any other instrument by which a  
4 hedging contract obligation is created need be recorded.

5 Section 2. REPORTING.--The status of a hedging contract  
6 entered into by the state board of finance shall be reported to  
7 that board monthly with an annual report provided to the  
8 legislature.

9 Section 3. APPROPRIATIONS.--

10 A. To the extent that net payments required to be  
11 made by the state pursuant to obligations identified in  
12 Subsection E of Section 1 of this act are to be derived from  
13 state severance taxes to be deposited in the general fund,  
14 there is hereby appropriated to the state board of finance from  
15 state severance tax revenues to be deposited in the general  
16 fund amounts necessary to make those net payments.

17 B. To the extent that net payments required to be  
18 made by the state pursuant to obligations identified in  
19 Subsection E of Section 1 of this act are to be derived from  
20 state severance tax revenues to be deposited in the severance  
21 tax bonding fund, there is hereby appropriated to the state  
22 board of finance from state severance tax revenues to be  
23 deposited in the severance tax bonding fund amounts necessary  
24 to make those net payments.

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