FISCAL IMPACT REPORT

		LAST UPDATED	02/02/24
SPONSOR	HJC	**ORIGINAL DATE**	01/22/24
SHORT TITLE	Oil & Gas Act Changes	**BILL NUMBER**	CS/CS/House Bill 133/HENRCS/HJCS
		ANALYST	Torres, Ismael/ Wan Smith

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
Application Fees	$393.5 to $455.2	$3,148.3 to $3,641.6	$3,148.3 to $3,641.6	$3,148.3 to $3,641.6	$3,148.3 to $3,641.6	Recurring	OCD Systems and Hearings Fund
Oil and Gas Severance Tax**		($530.0)	($4,150.0)	($14,280.0)	($21,380.0)	Recurring	Severance Tax Bonding Fund
Severance Tax Bonding Capacity**		Dependent upon bonding, negative	Dependent upon bonding, negative	Dependent upon bonding, negative	Dependent upon bonding, negative	Recurring	Capital Outlay
Oil and Gas Emergency School Tax**		($510.0)	($3,500.0)			Recurring	Early Childhood Trust Fund
Oil and Gas Emergency School Tax**			$3,400.0	($12,420.0)	($18,630.0)	Recurring	Severance Tax Permanent Fund
Oil and Gas Conservation Tax**		($10.0)	($40.0)	($140.0)	($210.0)	Recurring	Oil and Gas Reclamation Fund
Oil and Gas Conservation Tax**		($20.0)	($170.0)	($580.0)	($870.0)	Recurring	General Fund
Oil and Gas Ad Valorem Production Tax**		Dependent on local property tax rates	Dependent on local property tax rates	Dependent on local property tax rates	Dependent on local property tax rates	Recurring	Local govs/ GOBs
Oil and Gas Ad Valorem Equipment Tax**		Dependent on local property tax rates	Dependent on local property tax rates	Dependent on local property tax rates	Dependent on local property tax rates	Recurring	Local govs/ GOBs
State Land Office Rental and Bonus Income**		Negative	Negative	Negative	Negative	Recurring	General Fund
State Land Office Royalty Payments**		($620.0)	($4,530.0)	($15,640.0)	($23,440.0)	Recurring	Land Grant Permanent Fund

Federal Land Rental and Bonus Income**		Negative	Negative	Negative	Negative	Recurring	General Fund
Federal Land Royalty Payments**		($1,000.0)	($6,860.0)			Recurring	Early Childhood Trust Fund
Federal Land Royalty Payments**			($200.0)	($24,370.0)	($36,550.0)	Recurring	Severance Tax Permanent Fund
Investment Income Distributions from Permanent Funds**					($20.0)	Recurring	General Fund
Gross Receipts Tax**		($150.0)	($2,400.0)	($8,180.0)	($12,150.0)	Recurring	General Fund
Gross Receipts Tax**		($10.0)	($180.0)	($630.0)	($930.0)	Recurring	Local Gov.
Well Plugging Risk Pool Fee		Indeterminate but minimal gain	Indeterminate but minimal gain	Indeterminate but minimal gain	Indeterminate but minimal gain	Recurring	Oil and Gas Reclamation Fund

Parentheses ( ) indicate revenue decreases.
*Estimates on the impacts of this bill are particularly difficult to discern. Numbers provided are intended to illustrate a potential magnitude of impact and not an exact amount. Please see *Fiscal Implications* for more information.
****Values for revenue types are the upper limits for the revenue impacts.**

Relates to House Bills 30, House Bill 31, and House Bill 32

Sources of Information

LFC Files

Because of the short timeframe between the introduction of this bill and its first hearing, LFC has yet to receive analysis from state, education, or judicial agencies. This analysis could be updated if that analysis is received.

SUMMARY

Synopsis of HJC Substitute for House Bill 133

The House Judiciary Committee Substitute for House Bill 133 makes several changes to the Oil and Gas Act (Chapter 70 Article 2 NMSA 1978). First, the bill amends Section 70-2-12 NMSA 1978 to give the Oil Conservation Division (OCD) of the Energy, Minerals and Natural Resources Department (EMNRD) additional authority.

Specifically, OCD would be authorized to:

- Regulate the transfer of oil and gas wells or facilities, including placing limitations on transfers to mitigate risk to the state or when an entity has a significant history of noncompliance, fails to provide adequate financial assurance, or lacks sufficient financial capacity to cover facility liabilities; and
- Permit the conversion of an oil and gas well to a facility for energy storage or geothermal development and establish fees and financial assurance requirements for these purposes.

The substitute bill amends the financial assurance requirements of the Oil and Gas Act (Section 70-2-14 NMSA 1978) to establish tiers of blanket plugging financial assurance based on an operator's quantity of active wells and to increase the maximum blanket bond from $250 thousand to $10 million. Maximum amounts for each tier are set as follows:

1. $250 thousand for an operator with fewer than 50 wells and total oil and gas production of fewer than 100 thousand barrels of oil equivalent per year
2. $350 thousand for an operator with between 50 and 99 wells and total oil and gas production of 100 thousand to 199 thousand barrels of oil equivalent per year
3. $500 thousand for an operator with between 99 and 149 wells and total oil and gas production of 200 thousand to 499 thousand barrels of oil equivalent per year
4. $750 thousand for an operator with between 150 and 299 wells or total oil and gas production of 500 thousand to 749 thousand barrels of oil equivalent per year
5. $5 million for an operator with between 300 and 500 wells or total oil and gas production of fewer than 1.25 million barrels of oil equivalent per year
6. $10 million for an operator with more than 500 wells and total oil and gas production of greater than 1.25 million barrels of oil equivalent per year

The HJC substitute also adds to the categories of financial assurance the option of a well plugging risk pool fee, not to exceed $500 per well, that OCD may assess on a subset of an operator's wells to offset bonding obligations. The monthly risk pool fee is nonrefundable and would be deposited in the oil reclamation fund. The bill adds a third category of one-well plugging financial assurance in an amount determined sufficient to reasonably pay the cost of plugging the well or wells covered by the financial assurance.

The bill specifies that, in establishing categories of financial assurance, OCD shall consider operator size and relative risk among the factors already named in statute. In addition, the bill moves the responsibility for collecting a forfeiture of financial assurance from the Office of the Attorney General (NMAG) to OCD.

The remaining amendments to existing statute made by the committee substitute relate to penalties and fees. The bill increases the maximum daily civil penalty for noncompliance with the Oil and Gas Act from $2,500 to $10 thousand per violation; in cases where a risk to public health and safety or the environment exists, the penalty is increased from $10 thousand to $25 thousand. Additionally, the existing $200 thousand cap on administrative penalties is increased to $3.65 million.

The substitute bill increases all but one[1] of OCD's application fees by a factor of three and gives OCD authority, beginning in 2027, to annually adjust fees for inflation. The bill also expands the allowable uses of the OCD systems and hearings fund, where application fees are deposited. Currently, money in that fund is appropriated to OCD "to develop and modernize the division's online application processing system, online case management system and online case file system and for other technological upgrades and hearing administration costs." The bill adds "data reporting and visualization systems" to the list of items the fund should be used to develop and specifies that appropriations may also be used for equipment upgrades and information technology personnel "necessary to support the efficient and transparent implementation and enforcement of the Oil and Gas Act."

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[1] The fee for commercial surface waste facility permitting is not increased by the legislation.

The committee substitute creates a new section of the Oil and Gas Act that requires operators to ensure at least 98 percent of natural gas produced or gathered by the operator's facilities is captured in a calendar year, beginning in 2027. The new language states that natural gas meeting any of the following conditions does not count as uncaptured gas:

- Released during an emergency;
- Beneficially used by the operator:
- Not suitable for transportation or processing due to nitrogen, hydrogen sulfide, or carbon dioxide concentrations:
- Vented as a result of normal operation of pneumatic controllers and pumps:
- Vented or flared from an exploratory well

The bill requires OCD to adopt rules for implementing the new provisions.

This bill does not contain an effective date and, as a result, would go into effect 90 days after the Legislature adjourns, or May 15, 2024, if enacted.

FISCAL IMPLICATIONS

Potential Impacts to Production of Oil and Gas

The table on page one presents an estimate of potential impacts intended to illustrate a magnitude rather than an exact amount. To gauge potential impacts on production, LFC staff utilized data from Rystad Energy, an energy analytics firm.

Firstly, future oil and gas production was estimated by considering completed wells, wells currently in progress, wells in the drilling phase, legacy wells, drilled but uncompleted wells, and already permitted wells. This analysis focused only on the remaining estimated future production attributed to not-yet-permitted wells, which, on average, accounts for approximately 16 percent of the projected future production. Fiscal implications for already permitted wells were not considered in this bill's analysis. As a result, fiscal impacts are delayed until production begins for not-yet-permitted wells. If this legislation negatively impacts production from already permitted wells, the financial costs estimated on page one could increase significantly and commence earlier than indicated.

Secondly, staff further refined the production impacts from not-yet-permitted wells by applying the share of oil and gas produced by smaller, private producers as a proxy for the wells most likely affected by increased financial assurances, capture requirements, and other regulatory costs. Producers with less than 1 million barrels of production a year in 2023 were chosen for this proxy and represent less than 2.3 percent of New Mexico's total production. This amount was chosen from cash flow analysis based on LFC analysis; however, costs vary greatly by producer and producers with half the production may still be able to produce profitably under these methodological assumptions. Therefore, the actual number of impacted producers is likely to be less than what is estimated here. This share of smaller producers was applied to the not-yet-permitted oil production. Larger producers, presumed more capable of handling increased regulatory costs, were not expected to be significantly impacted. However, if this legislation does substantially and negatively affect production from these larger sources beyond the estimated impact, the financial costs projected on page one could increase significantly.

Finally, the first and second estimates of impacts were applied to production representing a potential impact of less than 1 percent of future production that could be affected. The resulting fiscal impact analysis applied production impacts to the consensus revenue estimating group forecast for prices and taxable deductions, published in December 2023. Revenue impacts were then calculated by the affected fund. Similarly, for gross receipts tax impacts, a regression on Eddy County and Lea County matched taxable gross receipts and oil production was used to convert the possible impact to those collections. The lowest possible tax rate was used to determine losses. If losses occur in higher tax districts, oil prices rise, or deductions fall, costs represented on page one could increase significantly. Similarly, if oil prices fall or deductions rise, costs represented on page one could decrease significantly.

Other General Fund Revenues

Civil penalties assessed by OCD are reverted to the general fund. Raising the penalty caps may therefore increase general fund revenue, but by an indeterminate or negligible amount due to the unknown effect increased penalties will have on deterrence. Additionally, most notices of violation are resolved in settlement, so the impact of penalty limits on the eventual amount assessed on an operator is minimal, according to the agency. In FY23, violations of the Oil and Gas Act resulted in $2.15 million in civil penalties reverted to the general fund.

Agency Revenues

Application fees collected by OCD are deposited in the OCD systems and hearings fund. The committee substitute increases the fees for four of the five application types by a factor of three. In FY23, revenue from the application fees amended by the legislation was $1.82 million. EMNRD therefore estimates annual revenue to the systems and hearings fund would be three times that amount, or approximately $5.46 million, in the first full fiscal year after the bill's fee increases take effect. This would be a revenue increase of $3.64 million beginning in FY25. Using the FY20-FY23 average OCD fee revenue instead of the FY23 total to estimate the revenue impact, the projected FY25 increase is $3.15 million.

Because the legislation would go into effect on May 15, 2024, if enacted, the estimated revenue increase for FY24 is between $393.5 thousand and $455.2 thousand, which is the estimated range of the annual revenue increase prorated for one and a half months.

The bill's increase to OCD's blanket financial assurance requirement has no estimable direct revenue impact, since the state only receives bonds that are forfeited. It may, however, eventually affect the balance of the oil reclamation fund, which is OCD's source of funding for plugging orphan wells beyond the costs covered by operators' financial assurance. An orphan well is an inactive well that has no viable operator of record, meaning the well's owner is bankrupt or no longer exists and therefore cannot carry out its well-plugging responsibilities. The current average cost to plug an orphan well, according to OCD, is $125 thousand. Remediation costs vary much more widely: The division uses an estimate of $110 thousand for projection purposes, but an individual remediation could cost millions of dollars if the site had a significant leak.

The oil reclamation fund derives most of its revenue (typically 90-100 percent) from a portion of oil and gas conservation tax proceeds. Other revenue comes from forfeited financial assurance: when an operator forfeits a bond, the proceeds are deposited in the oil reclamation fund. Bond forfeitures, however, are rare and only cover a small portion of OCD spending on well remediation. For example, in the last five fiscal years, only $250.3 thousand in forfeited bonds has been collected, while OCD has spent over $9 million on orphan well plugging. Therefore, although raising the blanket bond limit would have an impact of uncertain magnitude on the oil reclamation fund, it would undoubtedly increase the proportion of well remediation expenditures funded by operators' financial assurance.

The committee substitute's addition of a well plugging risk pool fee would generate new revenue for the oil reclamation fund. Because the bill language leaves the assessment of the risk pool fee to the discretion of OCD, the amount of revenue generated will depend on how the division decides to implement the new policy. Without analysis from EMNRD on this provision of the committee substitute, an estimate of additional revenue is not known.

Oil and gas conservation tax revenue is projected to take a hit due to the potential production impacts discussed previously. As this is the main source of revenue for the oil reclamation fund, in a typical year, declines could negatively affect OCD's ability to remediate orphan wells. However, in FY22, conservation tax revenue increased by 377 percent, bringing the balance of the fund to $27 million. Therefore, the projected decrease in conservation tax revenue would have a negligible effect on the oil reclamation fund.

SIGNIFICANT ISSUES

OCD Authority

The changes made by Section 1 of the substitute bill to OCD's authority regarding well transfers allow the division to consider operator compliance and other risk factors when evaluating applications. This primarily has relevance to potential transfers from large operators to small operators that buy wells when average production volume is lower. According to EMNRD, these small operators have less capacity to provide adequate financial assurance and fewer resources to comply with OCD requirements. Consequently, well transfers of this nature frequently result in an orphaned well that the state must assume responsibility for and remediate using funds from OCD's oil reclamation fund. Taking into account the likelihood that a well transfer would increase the state's liability would give OCD more opportunities to prevent abandoned well occurrences that consume state resources.

The other piece of the expanded authority granted to OCD by Section 1 relates to repurposing abandoned wells for uses outside of oil and gas development or wastewater reinjection. As the state and the energy industry continue to move away from fossil fuel extraction, interest in converting wells to kinetic energy storage or geothermal development site, for example, is rising. Authorizing OCD to create a regulatory framework for such conversions would allow for continued economic activity at former well sites outside of the oil and gas industry.

Gas Capture Requirement

In Section 5, the bill requires operators capture at least 98 percent of natural gas produced or gathered by the operator's facilities in a calendar year. However, NMAG points out that OCD regulations already require a 98 percent natural gas capture rate by December 31, 2026 (see NMAC 19.15.27.9), making the proposed statutory amendments redundant. NMAG further notes that the bill's language is more general than the existing regulations, and it is thus unclear "whether the bill is intended to impose any requirements not already in place." This creates a potential interpretation of Section 5 of the bill that the existing natural gas capture rule does not comport with legislative intent.

ADMINISTRATIVE IMPLICATIONS

If this bill is enacted, EMNRD will need to promulgate rules to update NMAC 19.15.7., 19.1.58, 19.15.15, 19.15.25, and 19.15.107.

Eliminating the requirement for NMAG to collect forfeited financial assurance would reduce the administrative burden on that agency and streamline forfeiture collections by keeping the entire process in OCD.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 133 duplicates, in part, House Bill 30, House Bill 31, and House Bill 32. House Bill 133 also conflicts, in part, with House Bill 30, House Bill 31, and House Bill 32.

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