LFC Requester:	Ismael Torres

AGENCY BILL ANALYSIS
2024 REGULAR SESSION

WITHIN 24 HOURS OF BILL POSTING, UPLOAD ANALYSIS TO:

AgencyAnalysis.nmlegis.gov

{Analysis must be uploaded as a PDF}

SECTION I: GENERAL INFORMATION

{Indicate if analysis is on an original bill, amendment, substitute or a correction of a previous bill}

Check all that apply:

Original X **Amendment** ____
Correction ___ **Substitute** ____

Date Feb. 5, 2024
Bill No: SB 64

Sponsor: Sen. Ron Griggs
Short Title: SEVERANCE TAX EXEMPTION FOR CERTAIN

Agency Name and Code Number: State Land Office - 539
Person Writing Sunalei Stewart
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SECTION II: FISCAL IMPACT

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY24	FY25		
None	None		

(Parenthesis ( ) Indicate Expenditure Decreases)

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY24	FY25	FY26		
Indeterminate minimal positive	Indeterminate minimal positive	Indeterminate minimal positive	Recurring	LGPF

(Parenthesis ( ) Indicate Expenditure Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	Negative indeterminate	Negative indeterminate	Negative indeterminate	Negative indeterminate	Recurring	LMF

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates/Conflicts with/Companion to/Relates to:
Duplicates/Relates to Appropriation in the General Appropriation Act

SECTION III: NARRATIVE

BILL SUMMARY

Synopsis:

This bill would make changes to the Oil and Gas Severance Tax Act (the "Severance Tax Act") and the Natural Gas and Crude Oil Production Incentive Act (the "Incentive Act"), excluding from taxation under the Severance Tax Act oil and natural gas produced from a "stripper well property" and sold from "a production compliance project," during the first ten years of the production compliance project or until such time as the amount of the tax that otherwise would have been imposed under the Act equals the cost of the production compliance project.

The Severance Tax Act and the Incentive Act each has a pre-existing definition of "stripper well property." See NMSA 1978, § 7-29-2 and § 7-29B-2(L).

"Production compliance project" is defined in the bill as "a procedure undertaken by the operator of a natural gas or crude oil well that, in order to continue production from the well, is required by rules promulgated on or after January 1, 2022 by the oil conservation commission to reduce the venting and flaring of natural gas from wells and production equipment and facilities and of natural gas from natural gas gathering systems or by the environmental improvement board to reduce ambient ozone concentrations."

The Oil Conservation Division ("OCD") would be authorized to approve a natural gas or crude oil well as a production compliance project if:

- The OCD approved or certifies the well as a stripper well;
- The operator has total production in New Mexico of not more than 1,000 bbls/day;
- The project was implemented in accordance with OCD approval to install, upgrade or replace (a) tank controls; (b) pneumatic devices; (c) actuators; (d) vapor recovery units; (e) forward-looking infrared cameras; and (f) smokeless combustion chambers.

The OCD would transmit the approval to New Mexico Taxation and Revenue Department ("TRD"), and TRD would be authorized to recognized the Severance Tax Act exemption upon an application made by the taxpayer and the taxpayer's submission of its verifiable total costs incurred in completing the project.

FISCAL IMPLICATIONS

The bill would incentivize producers to continue operating poorly producing stripper wells that pay the New Mexico State Land Office ("NMSLO") very little in royalty (and thus would provide an undetermined but minimal increase in the amount transferred to the Land Grant Permanent Fund). However, continuing operation of these types of wells through tax subsidies could result in the state/taxpayers incurring the legacy remediation and reclamation costs of the wells. Delayed closeout of low performing wells ultimately increases the likelihood the state will have to take responsibility for proper plugging of those wells that might have been plugged by the operator. Thus, the bill could result in an increased future financial liability for NMSLO and the expenditure of an undetermined amount of money for proper plugging and site remediation, which may be significantly more than any well royalty earnings. These costs would be paid out of the Land Maintenance Fund (which includes the earnings for state land trust beneficiaries, such as public schools, universities and hospitals).

SIGNIFICANT ISSUES

The Severance Tax Act and the Incentives Act already give favorable tax treatment to production from stripper wells, which are very low-producing wells (defined as wells producing an average daily production of less than 10 bbls oil/day or average daily production of 60 mcf gas/day for the preceding calendar year). As compared to a default severance tax rate of 3.75% for oil and gas production, stripper well production is taxed at between 1.875% and 2.1875%. Thus, the benefit of still more favorable tax treatment should be scrutinized closely, particularly because incentivizing producers to prolong the lifespan of marginally projective wells rather than proper plugging of such wells might increase the extent to which such wells ultimately are orphaned without being properly plugged, leaving the state and taxpayers with a legacy issue that properly belongs to operators.

The NMSLO manages approximately 6,000 active oil and gas leases spread across roughly two million acres of mineral estate. The NMSLO is particularly concerned with potentially very expensive and harmful legacy issues associated with low producing wells that pay very little in royalties. Since launching its accountability and enforcement program in 2020, the NMSLO has compelled operators to properly plug over 400 inactive oil and gas wells at their cost, saving the state and the taxpayer from taking responsibility for cleaning up after companies. Almost all of the wells plugged under that program previously had been operated as stripper wells. Further, when plugging the sites, the NMSLO has required industry to remediate historic spills, which can often cost hundreds of thousands of dollars to address. The bill potentially could undermine or hinder the effectiveness of that program.

Notably, the bill excludes larger operators, capping operator production at 1,000 bbl/day for inclusion in the program. When working with operators and lessees, the NMSLO finds that most wells, as they end the end of their lifecycle, tend to pass from more capitalized to lesser capitalized companies. In doing so, the margins within which the companies operate get smaller and smaller and, often, the companies do not have enough capital to plug and abandon the well at the end of the life cycle. NMSLO suggests that any company wishing to take advantage of this program post a higher plugging and abandoning bond with OCD and NMSLO, as the risk-potential increases, as the well would continue to sputter along.

PERFORMANCE IMPLICATIONS

ADMINISTRATIVE IMPLICATIONS

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

TECHNICAL ISSUES

The bill would insert in the Severance Tax Act and the Incentives Act duplicate definitions of "production compliance project" and other overlapping provisions which might create confusion or potential conflict, now or in the future.

OTHER SUBSTANTIVE ISSUES

This bill would likely include a large proportion of stripper wells where the operator, as a whole, produces less than 1,000 bbls/day. Many of these operators are eligible for delayed implementation of OCD's methane rule requirements limiting venting and flaring, and continued operation of these types of wells may have an adverse impact on efforts to curb emissions.

ALTERNATIVES

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

AMENDMENTS

Include a new provision requiring any operator taking advantage of a production compliance project tax savings to post additional financial assurance with the OCD and NMSLO.