# FISCAL IMPACT REPORT

**LAST UPDATED** 2/9/24
**SPONSOR** SCONC **ORIGINAL DATE** 2/7/24
**SHORT TITLE** Oil & Gas Fund Accounting **BILL NUMBER** CS/Senate Bill 249/SCONCS

**ANALYST** Wan Smith

**REVENUE***
**(dollars in thousands)**

| Type | FY24 | FY25 | FY26 | FY27 | FY28 | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|---|
| Oil and Gas Conservation Tax | | $34,502.0 | $49,162.0 | $49,184.0 | $49,033.0 | Recurring | Oil Reclamation Fund |
| Oil and Gas Conservation Tax | | ($34,502.0) | ($49,162.0) | ($49,184.0) | ($49,033.0) | Recurring | General Fund |
| Reversion | | Up to $18,764.0 | Indeterminate | Indeterminate | Indeterminate | Recurring | General Fund |

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

**ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT***
**(dollars in thousands)**

| Agency/Program | FY24 | FY25 | FY26 | 3 Year Total Cost | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| TRD | $22.6 | No fiscal impact | No fiscal impact | $22.6 | Recurring | General Fund |
| EMNRD | $450.0 | $450.0 | $450.0 | $1,350.0 | Recurring | General Fund Other state funds |
| **Total** | **$ 472.6** | **$450.0** | **$450.0** | **$1,372.6** | **Recurring** | **General Fund Other state funds** |

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent analysis of this legislation.

Relates to House Bill 2

## Sources of Information

LFC Files

<u>Agency Analysis Received From</u>
Taxation and Revenue Department (TRD)
Energy, Minerals and Natural Resources Department (EMNRD)

## SUMMARY

### Synopsis of SCONC Substitute for Senate Bill 249

The Senate Conservation Committee substitute for Senate Bill 249 (CS/SB249/SCONC) amends the Tax Administration Act to change the distribution of oil and gas conservation tax revenue to the oil reclamation fund from a percentage to a fixed dollar amount. The bill eliminates the existing tiered distribution structure, which allocates a proportion of conservation tax revenue to the fund based on the current effective tax rate on oil. Instead, the new language would set the distribution to the fund to $5 million per month.

The bill adds language requiring any unexpended or unencumbered balances in excess of $80 million remaining in the fund at the end of a fiscal year to be reverted to the general fund.

The effective date of this bill is July 1, 2024.

## FISCAL IMPLICATIONS

**Revenue.** The bill does not include a recurring appropriation, but diverts or “earmarks” revenue, representing a recurring loss from the general fund. LFC has concerns with including continuing distribution language in the statutory provisions for funds because earmarking reduces the ability of the Legislature to establish spending priorities. CS/SB249/SCONC does not propose to change the source or the destination of diverted revenue from existing law. However, it does change the distribution method in a way that would have a significant impact on the funds that receive this revenue – the general fund and the oil reclamation fund.

The oil and gas conservation tax is levied on the production and extraction of oil and natural gas resources in New Mexico. Revenue generated from this tax is allocated primarily to the general fund, with either two-nineteenths of net receipts or 19.7 percent of net receipts, depending on the conservation tax rate at the time, distributed to the oil reclamation fund in the Energy, Minerals and Natural Resources Department (EMNRD). The purpose of the oil reclamation fund is to address environmental reclamation and remediation of sites formerly used for oil and gas operations. The fund supports well-plugging and associated remediation of nonfederal, orphaned wells conducted by EMNRD’s Oil Conservation Division (OCD).

The distribution change proposed by CS/SB249/SCONC would significantly increase revenue to the oil reclamation fund and reduce revenue to the general fund by an equal amount. Between FY17 and FY21, the average annual distribution of conservation tax revenue to the oil reclamation fund was $3.2 million. As a result of the record-breaking oil production in New Mexico over the last several years, distributions to the fund jumped by nearly 500 percent in the years since. Even at this vastly higher rate of revenue generation, CS/SB249/SCONC would nearly double the oil reclamation fund’s typical monthly allocation.

Based on estimates provided by the Taxation and Revenue Department (TRD), this change would reduce recurring general fund revenue by $34.5 million in FY25 and up to $49.2 million in subsequent fiscal years. This would be a significant impact to the general fund, reducing the recurring funds available for the Legislature to appropriate to other state agencies and programs. If, in future years, conservation tax revenue is insufficient to meet the monthly distribution set by this bill, TRD assumes the difference would need to be covered by the general fund.

Despite this apparent reduction in general fund revenue, the actual fiscal impact may be smaller in practice due to the bill's addition of reversion language to the oil reclamation fund statute. The complexity of implementing such a large expansion (see "Administrative Implications") makes it likely the fund balance will grow beyond $80 million in the near term, resulting in some reversion to the general fund. Current revenue and expenditure projections for the oil reclamation fund would leave an unexpended balance of $64.3 million at the end of FY25. If CS/SB249/SCONC is enacted and appropriations from the fund remain as they are in the House Appropriations and Finance Committee (HAFC) substitute for House Bill 2, the FY25 ending balance would grow to $98.8 million. This would result in a general fund reversion of $18.8 million. Future reversions would depend on appropriations from the oil reclamation fund and how quickly OCD can expand the well-plugging program.

**Operating Budget.** TRD expects implementation of CS/SB249/SCONC will require approximately 400 hours of staff time, equivalent to $22.6 thousand. These costs are only expected to be incurred in FY24 to complete the changes needed for the bill's initial execution. EMNRD estimates the cost of scaling up OCD's well-plugging program and maintaining that level of activity will be $450 thousand annually, covering new staff needed to manage the larger revenue stream and associated administrative expenses.

Costs incurred by OCD may impact the general fund or the oil reclamation fund or both. Statute authorizes EMNRD to use the oil reclamation fund for staff and other administrative purposes, although the Legislature has encouraged the agency to limit this practice.

## SIGNIFICANT ISSUES

New Mexico received $25 million through the well-plugging grant program established by the federal Infrastructure Investment and Jobs Act (IIJA) and is expected to receive at least $72.3 million more. The IIJA grant program provides funds for remediating wells on state and private land. The initial grant was awarded in October 2022, fully encumbered by October 2023, and is on schedule to be fully spent by the October 1, 2024, deadline. With these funds, OCD will plug 134 orphan wells, conduct methane monitoring at 160 wells, and complete remediation and reclamation at six well sites.

On average, the cost to plug an orphan well is approximately $125 thousand; the cost has recently ranged from $50 thousand to $320 thousand per well, according to OCD. Additional expenses for assessment, remediation, and reclamation of a typical well pad with minor issues average $35 thousand but can climb to millions of dollars if major remediation is needed.

CS/SB249/SCONC requires any unexpended or unencumbered balance in excess of $80 million remaining in the oil reclamation fund at the end of a fiscal year to revert to the general fund. One of the fund's revenue sources is forfeited well-plugging financial assurance as required by the Oil and Gas Act, Section 70-2-14 NMSA 1978. Financial assurance is secured to ensure oil and gas wells are appropriately decommissioned and is forfeited to the oil reclamation fund when a well operator fails to comply with statute or the OCD's rules regarding plugging and abandonment of wells.

Money collected from forfeited financial assurance is meant to cover a portion of the cost to remediate an orphaned well. Often, forfeited bonds are not deposited in the oil reclamation fund until OCD has already remediated the well in question using existing fund balance. The bonds thus function as a partial reimbursement when the state must use conservation tax revenue for the up-front costs of remediation. It is unclear whether reverting such monies to the general fund would comport with the legislative intent of the financial assurance statute. Even if it does, the policy would, to some extent, increase the financial burden of well remediation on the state. A similar concern may apply to donations made to the oil reclamation fund for the specific purpose of well remediation. If donations cannot be encumbered in the same fiscal year which they are received, they could revert to the general fund to be used toward a purpose for which they were not intended.

## PERFORMANCE IMPLICATIONS

Additional revenue provided to the oil reclamation fund by CS/SB249/SCONC could, if paired with corresponding appropriations, increase the number of wells plugged by OCD each year, a key performance measure for the division. Thus far in FY24, OCD has plugged 78 wells. Previously, the division plugged an average of 40 wells per year.

## ADMINISTRATIVE IMPLICATIONS

As stated previously, the OCD well-plugging program historically managed annual resources of roughly $2 million to $6 million. The division has ramped up remediation activities substantially to take advantage of IIJA grants and the fund's unprecedented income, but this was a multi-year effort; OCD had to dedicate more resources to administering the program, and new agreements had to be established with well-plugging contractors, who were in high demand, to complete the larger quantity of work.

Even considering these recent efforts, the additional oil reclamation fund revenue would require OCD to dramatically and immediately increase their administrative capacity. It is unclear whether such an expansion is possible, due not only to fiscal constraints, but also the logistical realities of hiring new staff and finding industry contractors with enough availability to rapidly and substantially increase the rate of well-plugging.

## CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

CS/SB249/SCONC would significantly increase revenue to the oil reclamation fund, but the HAFC substitute for HB2 does not include a corresponding increase in appropriations from the fund. For FY25, this would result in an estimated $18.8 million reversion from the oil reclamation fund to the general fund.

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