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FISCAL IMPACT REPORT

SPONSOR Morales **ORIGINAL DATE** 3/3/17
LAST UPDATED 3/15/17 **HB** _____

SHORT TITLE Royalty Rates on State Trust Lands **SB** 375/aSCONC

ANALYST Armstrong

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY17	FY18	FY19		
	\$0.0 - \$2,400.0	\$0.0 - \$2,400.0	Recurring	Land Grant Permanent Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Response Received From
 State Land Office (SLO)

SUMMARY

Synopsis of SCONC Amendment

The Senate Conservation Committee amendment removes Section 3, requiring the commissioner of public lands to collect and publish data on natural gas venting, flaring, and leaks.

Synopsis of Bill

Senate Bill 375 (SB375) increases the maximum royalty rate the commissioner of public lands may impose on premium development leases to 1/4. The bill also allows the commissioner to modify lease terms to levy royalties on vented or flared gas. Finally, SB375 requires the commissioner to collect and publish data on natural gas venting, flaring, and leaks. To meet this requirement, the commissioner may rely on data already submitted to the Energy, Minerals and Natural Resources Department or modify leases to require monthly reporting of the amount of gas vented, flared, or otherwise allowed to escape.

FISCAL IMPLICATIONS

SB375 does not require increased royalty rates so could have no impact on future land grant permanent revenues. The amount of any increase depends on the number of leases issued with an

increased royalty rate and the amount of production under those leases. Assuming 25 new leases per fiscal year and additional production of 980 thousand barrels of oil and 4.4 million MCF of gas, the maximum amount of increased revenue is \$2.4 million.

SIGNIFICANT ISSUES

According to SLO's 2016 annual report:

Oil and gas leasing is highly regulated. The leases are statutory, the methodology for evaluation of tracts to lease is clearly defined by law and elements of the sale notice itself are based in statute. Lease terms and royalty rates have not been changed by the Legislature since 1985. In Restricted Areas (generally areas of known production, such as the San Juan and Permian basins) leases are issued for a term of 5 years at royalty rates of 1/8, 1/6, 3/16 or 1/5 and can be held by production after the initial term. Leases in Frontier Areas (non-proven or "wildcat" areas) are issued for 10 years at a 1/8 royalty rate and can likewise be held by production. New Mexico statutes 19-10-1 through 19-10-70 NMSA and State Land Office Rules 19.2.100 and 19.2.17 NMAC deal specifically with oil and gas activity on state lands.

SLO analysis notes:

While the bill would authorize (but not require) the commissioner to include lease language requiring lessees to pay royalty on gas that is extracted but not produced, saved and marketed, the state land office anticipates that such a requirement would delay drilling and production of oil in areas that do not have sufficient infrastructure to market gas and thus negatively affect royalty (i.e., permanent fund) revenue on newly issued leases. In addition, the inclusion of such language would make such leases less attractive and thus have a negative effect on bonus (i.e., maintenance fund) revenue from such leases.

TECHNICAL ISSUES

SLO provided the following:

While Section 1 of the bill adds new subparagraphs (E) and (F) of Section 19-10-4 giving the commissioner "the authority" to include lease terms imposing royalty on gas extracted but not saved and marketed, Section 2 of the bill modifies the development form of lease to impose a royalty on all gas "extracted" under the lease and to delete language imposing the royalty on gas "produced, saved and marketed." The conflict between the two sections creates an ambiguity and the possibility that it would be construed to *require* royalty on gas that is extracted but not produced, saved and marketed under a development form of the lease (rather than giving the commissioner authority either to modify the lease in that manner), which does not appear to be the intent of the bill.

This bill could create an ambiguity in using the phrase "modify the lease terms." The ambiguity would be resolved by stating that the commissioner may "include lease terms" of the type specified "notwithstanding anything else in the lease to the contrary."