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FISCAL IMPACT REPORT

ORIGINAL DATE 3/6/07

SPONSOR Hanosh LAST UPDATED _____ HB 1122

SHORT TITLE Oil and Gas Produced Water Tax Credit SB _____

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
	Insignificant		Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Energy Minerals and Natural Resources (EMNRD)

Office of the State Engineer (OSE)

SUMMARY

Synopsis of Bill

House Bill 1122 reinstates a credit for produced water, a by-product of oil and natural gas drilling, delivered to the Pecos River. The credit was repealed effective January 1, 2006.

The credit is \$1,000 per acre-foot of produced water, not to exceed \$400,000 per year. It is applicable to either personal income or corporate income tax liability. The operator (the party operating the oil or gas well) must deliver the water to the interstate stream commission (ISC) in compliance with all ISC and federal quality standards. Upon the delivery and approval, ISC takes title to the water.

The credit is in effect from January 1, 2007, to January 1, 2011, when it is repealed.

FISCAL IMPLICATIONS

TRD reported in 2005 that the total credits issued since the bills inception in 2002 has been \$300. Several matters have impeded the adoption of this credit by operators. Since they appear to

require significant legal issues involving the control, ownership and transmission of water resources in the Pecos River Compact, it seems unlikely that the credits will be used to any further extent in the near term future. Should legal and technical issues be resolved, the credit could reach as high as \$2.4 million, assuming six companies near the Pecos River qualify for the maximum credit.

SIGNIFICANT ISSUES

Comments from the oil and gas industry indicate that the rules established for the delivery of the produced water have made it prohibitively expensive. The original target was to provide some type of economic relief for the producer, whose clean-up costs are far greater than the credit. Millions of dollars have been invested in an attempt to clean produced water. The credit is an incentive to operators to keep trying new ideas. One of the problems that the industry has encountered and why the credit has not been used very often is the requirement to deliver the produced water below the Avalon Dam, or downstream from the Carlsbad Irrigation District. This would require a pipeline that the industry is not ready to build.

Interstate Stream Commission has identified several issues with the credit:

In order for the produced water delivered to the Pecos River to contribute fully toward meeting the state's delivery obligation pursuant to the Pecos River Compact, the River Master Manual of the Pecos River Master must be amended to ensure that the produced water delivered to the Pecos River will not be accounted as flood water under the compact accounting. If the River Master Manual is not amended and the produced water that is delivered is accounted as flood water, it would actually increase New Mexico's delivery obligations and defeat the purpose of this bill.

ADMINISTRATIVE IMPLICATIONS

Interstate stream commission reports that it has to develop guidelines for the manner in which produced water can be delivered to the Pecos River. Also, the interstate stream commission is required to provide legal confirmation of receipt of the produced water. The monitoring of the produced water delivered to the Pecos River and providing legal confirmation will require additional staff time but difficult to estimate at this time without knowing exactly how many oil and gas operators would participate in the program.

TRD:

Moderate impact. Create a claim form and instructions. Revise forms and instructions for personal and corporate income tax programs. Modify publications. Create a manual review process to record, monitor and track the credits. 1/16 of an FTE would be needed for the manual process. Minimum changes will be needed to the existing Gentax system. Coordination with the Interstate Stream Commission would be required.

TECHNICAL ISSUES

OSE:

The provisions of this bill are similar but not identical to the provisions of NMSA 1978, Sections 7-2-18.9 and 7-2A-20, both of which "sunsetting" as of January 1, 2006. Compared to these "sunsetting" laws, this bill would make two significant changes. First, the bill would change the definition of "produced water" by deleting the phrase "or

refining crude oil or processing natural gas” from the end of the definition. Second, this bill would remove the indemnification provisions of Subsection A(3) of those “sunsetting” laws, which required the Interstate Stream Commission to indemnify the oil and gas well operators that delivered produced water. Those indemnification provisions were likely unconstitutional. The courts have interpreted Article IX, Section 8 of the New Mexico Constitution to preclude a governmental entity from entering into an agreement that would subject it to contingent liability, the amount of which is uncertain at the time of the agreement. See, *Henning v. Town of Hot Springs*, 44 N.M. 321, 102 P.2d 25 (1940); *City of Santa Fe v. First Nat. Bank in Raton*, 41 N.M. 130, 65 P.2d 857 (1937). Relying on these authorities, the Attorney General has interpreted this Constitutional provision as proscribing any state agency from agreeing to indemnification of another party. See, *A.G. Op. 00-04*. This bill otherwise makes no significant changes to NMSA 1978, Sections 7-2-18.9 and 7-2A-20.

This bill would require the interstate stream commission to provide to the oil and gas well operator “legal confirmation of receipt” of the produced water, but does not define this term.

At present, produced water is injected back into the deep geologic formations. A permanent removal of this water from the underground formations could, in the long-term, prove to have impacts similar to additional groundwater withdrawal. The hydraulic connection between the deep geologic formations, aquifer zones and the river is still matter of research and investigation

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The produced water credit in both the Income Tax Act and the Corporate Income and Franchise Tax Act was repealed effective January 1, 2006, and so unless a new credit is enacted, this credit will no longer be available.

NF/csd