F I S C A L   I M P A C T   R E P O R T

		ORIGINAL DATE	1/23/06		
SPONSOR	Hanosh	**LAST UPDATED**	1/27/06	**HB**	144/aHAGC
SHORT TITLE	Oil and Gas Produced Water Credits			**SB**	
				ANALYST	Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY06	**FY07**	**FY08**		
	(0.3)	(0.3)	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files
Taxation and Revenue Department (TRD)
Energy Minerals and Natural Resources Department, Oil Conservation Division (EMNRDOCD)
Interstate Stream Commission (ISC)
New Mexico Oil and Gas Association (NMOGA)

Responses Received From
Energy Minerals and Natural Resources Department (EMNRD)
Interstate Stream Commission (ISC)
New Mexico Oil and Gas Association (NMOGA)

SUMMARY

Synopsis of HAGC Amendment

The House Agriculture and Water Resources Committee amended House Bill 144 in response to questions about the constitutionality of the Interstate Stream Commission being able to indemnify the operator from future liability. The amendment strips the bill of the indemnification. This will not change the fiscal analysis.

Synopsis of Original Bill

House Bill 144 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 The credit was repealed effective January 1, 2006.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 and indemnifies the operator from future liability.

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 that the produced water delivered to the Pecos river contributes fully toward delivery obligation pursuant to the Pecos River Compact, two things must happen: 1. The River Master Manual of the Pecos River Master must be amended to assure that the produced water delivered to the Pecos River would not be accounted as flood water under the artifacts of the compact accounting and thus actually increase New Mexico's obligations; and 2. The state engineer must be authorized to administer the produced water resulting from its point of diversion from groundwater and delivered to the Pecos River so that it is not diverted for other uses either before it reaches the Pecos River or after it reaches the Pecos River, and to insure its delivery to the state line.
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> Section A(3) requires the Interstate Stream Commission to indemnify the "operator" (as defined in the Bill). This Article is likely unconstitutional. Article IX, Section 8 of the New Mexico Constitution has been judicially interpreted to preclude a governmental entity from entering into an agreement subjecting 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. **[Note: HB144 as amended corrects this constitutional question.]**

If Section A(3) is unconstitutional, then only if the remaining provisions of the Bill are self-sustaining and capable of separate enforcement from Section A(3) and not dependent on Section A(3), will the remaining portions of the Bill be "severed" from Section A(3) and survive constitutional scrutiny.
This Bill, read as a whole, appears severable, but such scrutiny ultimately lies within the purview of the judiciary.

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.

TECHNICAL ISSUES

The OCD points out that the definition of "operator" has changed in this bill from the 2002 law that was repealed effective January 1, 2006. Operator now only refers to a person who operates an oil or gas well. The original language defined operator as "a refinery, a natural gas processor or a person who operates an oil or gas well."

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

ISC recommends that the bill be amended at p. 2, line 7, after the 1st occurrence of "to" insert "meeting the state's" for clarity in meaning.

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/nt:yr