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FISCAL IMPACT REPORT

SPONSOR R. Martinez/ **ORIGINAL DATE** 1/27/18
McCamley **LAST UPDATED** _____ **HB** 127
SHORT TITLE NM Unit Fund Water Projects **SB** _____
ANALYST Jorgensen

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY18	FY19		
	(\$50,000.0)	Nonrecurring	New Mexico Unit Fund
	\$50,000.0	Nonrecurring	Interstate Stream Commission

(Parenthesis () Indicate Expenditure Decreases)

Duplicates HB72

SOURCES OF INFORMATION

LFC Files

Responses Received From

New Mexico Attorney General's Office (NMAG)
 New Mexico Finance Authority (NMFA)
 New Mexico Institute of Mining and Technology (NMTech)
 Office of the State Engineer (OSE)

SUMMARY

Synopsis of Bill

House Bill 127 appropriates \$50 million from the New Mexico unit fund to the Interstate Stream Commission (ISC) for four identified purposes: 1) \$12 million to fully implement a regional water project; 2) \$34 million to construct Water Trust Board-approved water supply projects in southwest New Mexico that meet a water supply demand and are included in 2017 infrastructure capital improvement plans; 3) \$3.5 million to collect ground water and geologic data to improve the ground water flow model of the Mimbres basin aquifer system; and 4) \$500 thousand for the evaluation and planning of alternatives for a remote well field for the City of Deming in a comparatively stable area of the Mimbres basin aquifer.

HB127 requires that local project sponsors provide a match between 10 percent and 20 percent. HB127 provides for expenditure of the appropriations in fiscal year 2019 through 2023 and unexpended or unencumbered balances remaining at the end of fiscal year 2023 shall revert to the New Mexico Unit Fund.

FISCAL IMPLICATIONS

The OSE raised concerns that enactment of HB127 would disrupt construction of a diversion project and may reduce funding available for 16 water utilization projects which received \$9.1 million from the unit fund. OSE also notes that spending New Mexico unit funds would deprive the state of the income received through investment of these funds and may prevent ISC from paying staff salaries for employees working on the New Mexico unit, or diversion.

Under the federal Arizona Water Rights Settlement Act (AWSA), New Mexico has the option to use \$66 million (in 2004 dollars) in federal funds to meet water supply demands in the state's "southwestern water planning region" (Catron, Luna, Hidalgo, and Grant counties). The federal Department of The Interior approved moving forward with feasibility studies in November 2015. New Mexico is eligible to receive \$34 million (also indexed to 2004 dollars) in additional funding for a diversion project if the required National Environmental Policy Act (NEPA) review is complete and a "record of decision" is issued by December 2019. OSE notes that enactment of HB127 would likely hamper the completion of the NEPA process thus endangering the funding available for construction of a diversion project. While a project has been selected, the NEPA process has yet to begin.

SIGNIFICANT ISSUES

NMAG notes:

Section 212(i) of the Arizona Water Settlements Act (which cross-references the above-cited federal statutes) provides that

Withdrawals from the New Mexico Unit Fund shall be for the purpose of paying costs of the New Mexico Unit or other water utilization alternatives to meet water supply demands in the Southwest Water Planning Region of New Mexico, *as determined by the New Mexico Interstate Stream Commission* in consultation with the Southwest New Mexico Water Study Group or its successor

Because HB 127 attempts to appropriate monies from the New Mexico Unit Fund for purposes specified by the legislature, it appears to contradict the federal statutes directive that such spending determinations be made by the ISC. If the bill is enacted and subsequently challenged, a court could hold that it is subject to federal preemption.

While federal and state law are clear that the determination of which projects are selected is up to ISC, the Legislature's power of appropriation still extends over state funds such as the New Mexico unit fund. Although the fund statute states that "money in the fund . . . is appropriated to the interstate stream commission," similar continuing appropriation language is used a total of 119 times in statute regarding various funds which are appropriated annually through the legislative process.

The New Mexico Supreme Court’s opinion in *State of New Mexico ex rel. Smith v. Martinez*, 2011-NMSA-043, states:

The New Mexico Constitution vests the power to appropriate money exclusively with the Legislature. Our Constitution further requires that a law making an appropriation must “distinctly specify the sum appropriated and the object to which it is to be applied,” with money being “paid out of the treasury only upon appropriations made by the legislature.” (citations omitted).

Because the New Mexico unit fund statute does not distinctly specify an appropriated sum, it may not meet the constitutional requirement of an appropriation. Although the purpose of the unit fund and the authority to determine which projects are selected are restricted by federal and state law, the power to appropriate the fund resides with the Legislature. This is further shown by ISC’s inclusion of the fund as “other state funds” revenue in its annual budget request each year since fiscal year 2013 and submission of budget adjustment requests to increase use of the fund which also classify it as “other state funds” revenue. Finally, LFC, DFA, and ISC staff reached consensus in the summer of 2016 that the unit fund should be classified as “other state funds.”

According to New Mexico Tech:

From the 1950s to 1990s, some regions (i.e. south of Deming) in southwest NM have seen alarming rates of groundwater level declines, which have slowed some since the 1990s. In other locations, groundwater levels are stable; suggesting groundwater use may be in balance with surface water recharge. Comparisons across the state show that the Mimbres basin in Southwestern New Mexico remains an area of higher concern, due to an overall reduction in the amount of groundwater available in storage. Previous studies of the hydrology of this region have been performed based on limited data from existing wells and mapping. Additionally, there are local groundwater models used for groundwater administration, but these are not comprehensive across the region. Measured trends and predictive analysis suggest a reduction in surface water supplies in the region, limiting potential recharge to groundwater basins. Long term planning and management for the region requires a comprehensive understanding of available groundwater resources across the entire Mimbres basin.

In addition, New Mexico Tech believes the hydrogeologic study portion of this bill would provide an important planning and management tool that would directly benefit state water managers, local municipalities and adjacent communities, and the public.

OTHER SUBSTANTIVE ISSUES

Concerns have been raised about the financial sustainability of the diversion project. In a letter dated November 30, 2017, (Attachment 1) the State Auditor’s Office raised concerns about the viability of future revenue streams necessary to support the operations and maintenance costs of the diversion.

PERFORMANCE IMPLICATIONS

ISC pays approximately \$300 thousand in salaries from the New Mexico unit fund. Should HB127 be enacted, the funding to continue paying these staff salaries may not be available.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB127 is duplicated by SB72.

TECHNICAL ISSUES

HB127 requires the \$34 million of water supply projects be approved by the water trust board rather than the ISC. However, federal and state law are clear that project selection is up to ISC.

CJ/al

Timothy M. Keller
State Auditor



Sanjay Bhakta, CPA, CGFM, CFE, CGMA
Deputy State Auditor

State of New Mexico
OFFICE OF THE STATE AUDITOR

Via Email and U.S. Post

November 30, 2017

John Longworth, P.E., Acting Director
Interstate Stream Commission
P.O. Box 25102
Santa Fe, NM 87504-5102

Re: Interstate Stream Commission – Gila Diversion

Dear Mr. Longworth:

The Office of the State Auditor (“Office”) received allegations on January 25, 2015 expressing concerns about the Interstate Stream Commission’s (“ISC”) plans to divert the Gila River. This information was brought to the attention of the Office’s Special Investigations Division who requested that the Independent Public Accountant conducting the fiscal years 2015, 2016 and 2017 audits evaluate and assess the issues in order for them to determine whether, or not, there have been any non-compliance of laws and regulations. Additionally, the Office ensured that that the Joint Powers Agreement (“JPA”) forming the NM Central Arizona Project Entity (“NM CAPE”) contained a clause which required it to comply with the requirements of the Audit Act.

This month, November 2017, the ISC submitted an annual report to the Legislative Finance Committee and Interim Water and Natural Resources Committee titled the “New Mexico Unit Fund” (“Report”). While this Report, located at <http://nmawsa.org/library/reports/2017-report-on-nm-unit-fund> describes many of the ongoing activities of the ISC, including proposals to use \$9.1 million of the Unit Fund monies for local projects, it omits mention of significant issues such as those raised by the written testimony of the Town of Silver City’s (“Town”) attorney on June 23, 2015, also enclosed, in support of the Town decision to remain outside of the NM CAPE. These comments raise questions about the viability of the future revenue streams necessary to support the excess of estimated project costs over the available Arizona Water Settlement Act funds and concludes, in reference to the JPA¹:

“In contract law, a court will set aside a contract where one side has misrepresented material facts. When the misrepresentation is deliberate with an intent to induce another to contract, the matter moves from contract law to fraud, and at its most extreme, criminal fraud. For the local public official that knowingly and deliberately enters into an

¹ The signatories to the JPA are identified on page 7 of your Report. While the ISC controls the budget and negotiations with the Secretary of the U.S. Department of Interior (“Secretary”) legal responsibilities are transferred to the NM CAPE. Following construction the NM CAPE “will be responsible for reimbursing the Secretary for operation, maintenance, and repair (“OM&R) costs attendant to delivery of the exchange water.” Report, Page 7.

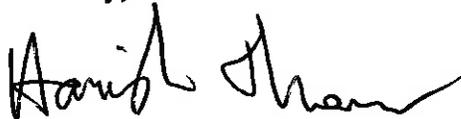
agreement that he or she knows to contain deliberate misrepresentations, it, in my opinion, conduct that may be considered official malfeasance.”

The concerns about future revenue streams are exacerbated by the risk, noted in your Report, that the rate of return on monies provided to the Agency is currently insufficient to support the distribution of the final \$28 million to the ISC². Furthermore, the turnover of staff and Commission members³ at the ISC creates a situation whereby the institutional memory and necessary professional oversight may be unable to detect or prevent fraud, waste and abuse, as defined in the Audit Rule, of public monies in regard to the proposed Gila Diversion. An analysis of the sources of revenue required to cover the estimated costs associated with the ISC's Gila Diversion proposal is necessary information for the oversight agencies.

The original allegations received by the Office were submitted by former ISC Director Norm Gaume. Certain of these matters, related to procurements, the Open Meetings Act, the Inspection of Public Records Act and other issues were litigated and adjudicated, leading to the Court awarding the former director his legal fees. These initial allegations stated that the ISC “intends to waste more than \$20 million on consultant services for preliminary design and permitting.” Your report identifies costs of \$12.9 million through fiscal year 2018, including \$4.4 million to the Bureau of Reclamation. The omission of footnote 15 to your Report prevents us from knowing whether the ISC’s costs on the Gila Diversion will exceed \$20 million next year, and whether the contracted deliverables constitute fraud, waste and abuse.

If you have any information, or questions regarding this matter, please do not hesitate to contact me directly at 505-476-3818 or Hamish.Thomson@osa.state.nm.us.

Sincerely,



Hamish Thomson, CPA/CFF, CFE
Special Investigations Division

cc: Signatory entities to the JPA, via Anthony Gutierrez, Executive Director of the NM CAPE.
ISC Commission, via John Longworth P.E.
Tom Blaine, State Engineer and Secretary of the ISC.
David Abbey, Legislative Finance Committee
Joseph Cervantes, Chair, Interim Water and Natural Resources Committee
Alex Brown, Town Manager, Town of Silver City

Encl: Written Testimony, dated June 23, 2015, of Town of Silver City Attorney Robert Scavron

² The final sentence on Page 3 of the Report states: “Earnings in the Lower Colorado Basin Development Fund to date do not support the additional \$28 million.”

³ The Commissioners identified on the ISC website are Vice-Chair Topper Thorpe, Mark Sanchez, Blane Sanchez, Carrie Hollifield and Samuel Gonzales.

Written Testimony by Town of Silver City Attorney Robert Scavron
Town of Silver City meeting June 23, 2015
Vote on Resolution to sign the Joint Powers Agreement and join the NM CAP Entity

Mayor and Council, normally I give my legal advice to you without written notes in front of me. Tonight, I take a different approach to the presentation of my counsel. The matter before you is of such significance that I have taken the unusual step of drafting my comments beforehand.

Mr. Marshall presented to you his and the Town Manager's analysis of the JPA creating the CAP Entity. I completely agree with them that the JPA before you is a fatally flawed document. More than that, I believe that any public entity that signs on to it opens itself to uncalculated risks and costs, with only a remote prospect of gain.

I would first mention the quorum issues that Mr. Marshall described. The JPA does not limit the number of memberships available, nor provide for any qualifications of membership other than being a public agency. Thus, there may be entities with no financial resources or expertise to contribute. Yet, their vote is equal to a deep pocket entity with far more ability and economic resources. A combination of those empty-pocketed members can, as a majority of a quorum, bind the whole to substantial economic commitments. Further, that group may well end up in charge of making allocations of water to member users, an area ripe for favoritism and controversy. Signing a document that doesn't identify your potential partners, nor place any prerequisites on the quality of such partners is ill advised.

The JPA is requiring the CAP entity to enter into an undrafted New Mexico Unit Contract with the federal government for a large and complex design, construct, operate and maintenance contract. When entering such a contract, understanding how it's going to be paid for is vital. Especially when the obligations are described as perpetual. We note that both the ISC and the State of New Mexico have no financial obligations regarding the New Mexico Unit project beyond what is provided by the Federal Government. The JPA doesn't authorize the CAP Entity to issue bonds or the power to tax. Yet, there is no business plan or due diligence which would allow the prospective signatories to the JPA to foresee whether the federal allocations will be sufficient to permit the project. The Town has been asking the ISC for such business plan since 2004 to no avail. Starting a business without adequate financial resources, projected costs, and a market analysis is a recipe for disaster.

So, when the federal money runs out, where is the money to come from? It won't be from the State or the ISC. It won't be from the federal government which specifically advises the parties as to the limits of its contributions. And, in the absence of any identifiable customer base, it will not be from revenues. The remaining source would be contributions from the members of the JPA group, and in

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reality, only those that have deep pockets and a tax base.

Now, there are some parties who believe they will be protected from liability by putting language into the JPA purporting to give discretion to the JPA member as to funding. The signatory is told that it needs to fund only to the extent that it deems appropriate. It gives the illusion of no potential of local liability. I disagree.

The signatories to this JPA are warranting to the ISC, to each other, and to the Federal Government that they have, individually as well as collectively, the ability to design, construct, operate, maintain and repair the NM Unit project. Warranty means a promise that can be enforced. Ability means more than the ability to contract with a third party. It implies the economic ability to accomplish the duties. Further, the proposed New Mexico Unit contract will have provisions requiring the CAP entity to fully indemnify the federal government for any claims made against either party. You can't make a warranty that you can and will do everything that you commit to, then add a provision that says that, in one's own discretion, you don't have to pay for it. You can't promise to indemnify the federal government and then say there's discretion not to perform. In law, it's called contracting in bad faith. Recall that in New Mexico Statutes, it is a crime to write a check when you have insufficient funds to cover the check, or know that you won't have the funds when the check clears.

The specific risk of potential of unlimited indemnity opens the opportunity for huge liability. Moreover, offering such unlimited indemnity is illegal for a county or municipality to offer, and is likewise probably illegal for the CAP entity as well.

So, what is likely to happen when the federal government demands reimbursement for payments made to the Gila Indian Community for exchange water, or a contractor demands payment for services rendered or makes a claim for indemnity? What happens when the contractor remains unpaid? What happens when the sheriff shows up with a writ of execution for a court judgment against the entity, and the Chair of the CAP entity turns up his palms to the sky and says, sorry, we have no money? Since the CAP entity has no powers under the JPA to issue bonds, borrow money, or make assessments, the Chair, presumably would call on the wealthiest of the members and asks for contribution, to which the municipality or county would respond by asserting that it has the discretion of not funding the CAP entity as per Section III (f) of the JPA. So, the CAP entity is insolvent, but is that the end of the game for the federal government, the contractor, or the judgment creditor? I think not.

The creditor will go to Court and name the individual members of the CAP

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entity as defendants. The member will defend, relying on the same "we've got discretion not to pay" provision, except that a Court will likely consider certain factors beyond the JPA language, including the initial misrepresentations of the CAP entity members who warranted and promised, individually and collectively, that each had the economic ability and expertise to perform under the contract, in perpetuity. In sympathy to the creditor and in the interests of justice, the Court will have the prerogative to decide for itself as "to what extent" the county or municipality is able to contribute. After all, the JPA gives guidance to the court of what financial resources are available to the county or municipality, including the issuance of bonds, the levy of taxes, and assessments. This possibility is not remote, but likely if the project runs into economic difficulty. Especially in the case of a creditor extending goods and services in good faith to an entity that has misrepresented so many material facts, or a federal government that is being denied its indemnity.

There exists another illusory promise of the CAP entity signatories who promise that they shall put the water to beneficial use. If Grant County signs on to the JPA, it will be representing that it will be a beneficial user of the water. In the last hundred years, the County has not invested a dime in water wells, distribution systems, or water rights. And, with Silver City and the mining district municipalities providing water to about 24,000 of the 29,000 people in the County, where is their customer base to justify such beneficial use? So the promise by our County to put the water to beneficial use is another material misrepresentation making this agreement even more distasteful.

I suggest that this Council accept the work of Mr. Marshall, the Town Manager and his staff as being the Town's due diligence. In my opinion, the JPA is filled with misrepresentations regarding the ability to pay, to put the water to beneficial use, and to have the broad abilities to accomplish all the undertakings. In contract law, a court will set aside a contract where one side has misrepresented material facts. When the misrepresentation is deliberate with an intent to induce another to contract, the matter moves from contract law to fraud, and at its most extreme, criminal fraud. For the local public official that knowingly and deliberately enters into an agreement that he or she knows to contain deliberate misrepresentations, it is, in my opinion, conduct that may be considered official malfeasance. Accordingly, as Town Attorney I most strongly advise this Council to refrain from entering this JPA.