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FISCAL IMPACT REPORT

SPONSOR Stell **DATE TYPED** 2/9/2004 **HB** 153/aHENRC

SHORT TITLE Permission for Produced Water Disposal **SB** _____

ANALYST Aguilar

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY04	FY05			
	(\$300.0)	Significant	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

Duplicates SB 313

SOURCES OF INFORMATION

LFC Files

Responses Received From

Energy, Mineral and Natural Resources Department (ENMRD)
 Commissioner of Public Lands (SLO)
 New Mexico Taxation and Revenue Department (TRD)
 Office of the State Engineer (OSE)
 Office of the Natural Resources Trustee (ONRT)
 New Mexico Department of Agriculture (NMDA)
 New Mexico Environment Department (NMED)

SUMMARY

Synopsis of HENRC Amendment

The House Energy and Natural Resources Committee amendment makes technical changes to language to provide consistency and to avoid conflict with federal environmental laws.

The amendment removes language limiting the tax credit to those who generate electricity and includes taxpayers who dispose of produced water in the generation of electricity.

The amendment adds language limiting the total tax credit accumulated over time to no more than 50 percent of the capital cost of equipment used for gathering, transporting or treating produced water for use in an electric generating facility.

The HENRC amendment expands the scope of tax liabilities available from which to deduct the tax credit. The additional opportunities include a taxpayer's modified combined tax liability (compensating tax, gross receipts tax, PIT and corporate tax) and personal tax liability.

The amendment makes technical changes to language relating to permits from the state engineer.

Synopsis of Original Bill

Section 1 of House Bill 153 provides for a tax credit against the Corporate Income and Franchise Tax for use of produced water in the generation of electricity.

Sections 2 and 3 of HB 153 amend the Oil and Gas Act to clarify the authority of the Oil Conservation Division of the Energy, Minerals and Natural Resources Department (OCD) to regulate the disposition of produced water, including disposition by use in drilling for or production of oil or gas, in road construction or maintenance or other construction, and in the generation of electricity or in other industrial processes, and that a permit from the State Engineer is not required for such disposition.

Significant Issues

House Bill 153 creates a new corporate income tax credit for taxpayers who generate electricity and dispose of produced water in the generation of electricity. The credit amount equals \$1 thousand per acre foot of produced water disposed of in the tax year. Total credits are limited to \$3 million per year and the taxpayer would be required to obtain certification from EMNRD in order to be eligible for the credit. The disposal of the water would have to be in accordance with rules developed by OCD. If allowable credits exceed the taxpayer's current liability, the excess could be carried forward for up to 3 consecutive years.

HB 153 would define produced water as water that is an incidental byproduct from drilling for or production of oil or gas.

The State Engineer is prohibited from requiring a permit for the disposition of produced water as long as the disposition conforms to rules promulgated by the OCD.

ENMRD reports that sections 2 and 3 of the bill clarify the authority from which permits must be obtained for use of produced water; a permit from OCD is necessary and sufficient authority for such use and a permit from the State Engineer is not necessary. Provisions of Sections 72-12-1 through 72-12-28 NMSA 1978 could be construed to require a permit from the State Engineer, as well as OCD, for use of produced water unless the water is extracted from an aquifer the top of which is at a depth of 2,500 feet or below. The certainty regarding regulatory requirements this bill provides will facilitate the use of produced water as a substitute for fresh water in applications where its use is economically and environmentally appropriate. The enactment of Sections 2 and 3 will help to conserve scarce fresh water in the present drought. The need for and desirability of enacting Sections 2 and 3 exist independently of any decision made with regard to Section 1.

The State Land Office (SLO) reports that it has an interest in the disposition of produced water, and has a business in the issuance of saltwater disposal easements. Further, SLO has a business of issuing water easements for the production of water to be applied to beneficial uses. It is not clear whether an outcome of this bill would be to place any of that business under the jurisdiction

of OCD. SLO also notes only the Commissioner of Public Lands has jurisdiction over trust lands and SLO has a continuing concern regarding the proper disposition of produced water on trust lands.

Additionally, the SLO has a concern that the production of water or electricity to be sold on oil and gas leases issued by SLO is not a business that is permitted under the terms of those leases. Such additional uses should not be implied from the current oil and gas lease, but should be required to be covered by separate leases from SLO, which leases would call for appropriate payment of royalties or rentals to the trust.

FISCAL IMPLICATIONS

TRD notes that not enough information on the amount of produced water being used in the electric generating process is provided. The total volume of produced water in the state is large. In addition, the total amount of water being used in power plant cooling is also large. Statewide water use for this purpose is well in excess of the 3,000 acre-feet that would maximize the utilization of this credit. The tax incentives in the bill are sufficiently lucrative that they should encourage the proposed activity. TRD does not have specific information on the technical challenges that would determine the speed with which this application is developed. The fiscal impacts assume that the application will grow, but it will be a few years before the credit usage is maximized.

ADMINISTRATIVE IMPLICATIONS

OCD permits for the indicated uses of fresh water are already required by existing rules; therefore the division does not anticipate any material increase in its administrative duties from the enactment of this bill.

TECHNICAL ISSUES

OCD recommends the following technical correction for consideration:

There is a difference in language between Section 1 of the bill, which provides a tax credit for "disposal of produced water," and Sections 2 and 3 which refer to "disposition of produced water." The difference between "disposal" and "disposition" may have implications regarding applicability of federal environmental laws. In the interest of consistency and avoiding conflict with federal environmental laws, if a credit is to be allowed as provided in Section 1, the language in Section 1 and in the title of the bill referring to "disposal" should be changed to "disposition."

Section 2 provides that, "The state engineer shall not require a permit for the disposition of produced water disposed of in accordance with [OCD] rules . . ." The phrase "disposed of" in this context may create confusion. The apparent intent is that the State Engineer shall not require a permit for any disposition authorized by OCD pursuant to the bill. To state this intent clearly without any confusion with "disposal" as defined under federal environmental laws, this sentence should be amended to read, "[t]he state engineer shall not require a permit for the disposition of water ~~disposed of~~ in accordance with [OCD] rules . . ."

The definition of produced water in the bill does not coincide exactly with existing provisions of the Oil and Gas Act. Although the Oil and Gas Act does not presently define "produced water,"

Section 70-2-12B NMSA 1978 confers on OCD the authority "to regulate the disposition of water produced or used in connection with the drilling for or producing of oil or gas or both." The legislature may wish to consider changing the definition of produced water to the definition found in existing statute.

TRD comments that the legislature may wish to clarify how the credit would be apportioned, be it per taxpayer, per power plant, or for the program as a whole. The legislature may wish to require the taxpayer to hold a FERC license to sell electricity on the electric grid as a precondition to being eligible for the credit. The legislature alternatively or in addition may wish to require the taxpayer to show off-site sales of a certain number of megawatt hours of electricity in order to be eligible for the credit. The legislature may wish to add a condition that the taxpayer must show that the produced water disposal claimed for the tax credit is proportional to reasonable and prudent use of the water for the megawatt hours of generation demonstrated by the taxpayer.

OTHER SUBSTANTIVE ISSUES

HB 153 is the consensus product of discussions among representatives of the oil and gas industry, the utility industry, the State Engineer, and the Oil Conservation Division regarding the disposal of produced water from oil and gas drilling and production. The tax credit proposed in the bill would provide an incentive to make additional water available in water short areas of the state for disposition through productive projects subject to OCD regulation, without requiring a permit from the State Engineer or disrupting existing state water law.

Currently, deep aquifer injection is one of the few cost-effective means of disposal of produced water. The bill would make it more economically attractive to dispose of produced water in various construction or industrial processes, and this could promote the conservation of potable water that might otherwise be used in those processes.

SLO notes that there are no apparent enforcement provisions in the bill. A provision for penalties (i.e. the loss of the credit and the need to amend past tax returns accordingly) if the certification proved false could make the Act properly enforceable.

PA/prr:dm:lg