

PRODUCED WATER GUIDANCE:

Recent State Legislation

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Management and use of the produced water¹ resource has become an increasingly important part of oil and gas development and operations. As the industry has evolved and production rates have increased, the correlated increase for the amount of water that is associated with that production has shifted how the industry uses and manages the produced water resource. An emerging consensus appears to be that utilizing recycling and re-use technology with produced water may be the best option for handling these large volumes moving forward.

Texas and New Mexico passed legislation in 2019 that provided guidance for the use and management of produced water. In 2020, Oklahoma did the same. Operators in these states rely on groundwater for hydraulic fracturing but must also handle the water that is produced as a byproduct of the production zone. This reliance on water, in conjunction with the corresponding need for efficient and beneficial management of the resource, has opened the door for these states to legislatively respond to the rapidly adapting industry.

All three states have taken steps to distinguish and classify produced water as a separate, distinct entity from the groundwater estate. The new laws enacted in Texas, New Mexico and Oklahoma focus specifically on the produced water resource and are targeted at managing the resource while also providing incentives and guidance for the beneficial re-use and recycling of industry water.

Water in the Permian Basin

Texas and New Mexico, like other energy producing states, view the water resource as an integral commodity for both the landowner and the operator. Both states have a high demand for water resources while they face diminishing supplies. The union of high demand and lack of supply have become driving forces for additional water management options. Drought and drainage are the main concerns for the Permian and Delaware basins. Located in the Chihuahuan desert, this area receives approximately less than ten (10) inches of precipitation each year. Thus, water sources in both states are highly valued, regardless of the elements and minerals contained within.

The Permian Basin encompasses a large swath of land in West Texas. In this area, oil and gas development is embedded in the community and culture. By 2023, Permian Basin production is expected to reach approximately 5.4 million barrels of oil per day. In June of 2019, Texas alone produced approximately 94 million barrels of crude. Accordingly, one can estimate the produced water associated with that production will reach approximately 5 times that amount. For an area that is in need of water, yet also plagued by drought conditions, understanding and transacting with the produced water resource may provide some relief.

Texas

The Texas Legislature has labeled produced water as “waste,” recognizing a clear distinction between the groundwater estate and produced water. In doing so, the legislation focused on produced water as an oil field waste issue and not as a water ownership issue.

Texas addressed the produced water resource by passing Texas House Bill 3246 (“HB 3246”). HB 3246, which became effective September 1, 2019, provided the industry with guidance regarding produced water, and placed a special emphasis on recycling and reusing produced water. HB 3246 further established that when a person takes possession of fluid oil and gas waste (produced water) to treat it for a subsequent beneficial use, the produced water becomes that person’s property and can be transferred and conveyed to third parties for disposal or use in treated or untreated form. In essence, the Texas Legislature created a possession-based standard, allowing the possessor of the water to transact with more confidence and security.

HB 3246 begins with an “unless clause,” stating that “[u]nless otherwise expressly provided by an oil or gas lease, a surface use agreement, a contract, a bill of sale, or another legally binding document,” the possessor of the produced water essentially becomes the legal owner. This language was included in the bill to protect existing contracts, recognizing that a landowner may still transact with the water supply, separate and apart from this new law.

¹ “Produced Water is the water naturally occurring in the targeted hydrocarbon formation that also flows to the surface through the wellbore during oil and gas exploration and production.” Adam Friedman, Recycling Flowback and Produced Water: Can Texas Do More to Throw Away Less?, The State Bar of Texas Oil, Gas and Energy Section (Fall 2016).



Texas presents significant challenges and corresponding opportunities when it comes to water management due to the differing landscape and high producing basins. New Mexico faces many of the same water driven challenges. Due to their similar demographics and shared basins, there is overlap when it comes to water use and management, creating a cooperative environment to help both states overcome their hurdles.

New Mexico

The New Mexico Legislature passed House Bill 546, also known as the Produced Water Act (“PWA”), effective as of January 1, 2020. This bipartisan effort was intended to encourage and facilitate the recycling and re-use of produced water by oil and gas producers, and also provide legal certainty for those who transact with the resource within New Mexico borders. As with Texas, the New Mexico PWA provides that the ownership of produced water is in the person or entity in possession of that water.

As found in Texas HB 3246, the New Mexico PWA also contains a similar “unless clause,” stating that “unless otherwise provided by law, a contract, bill of sale or other legally binding document,” the PWA may govern the ownership of the water.

The PWA also granted authority over the produced water resource to the New Mexico Environment Department. With the passing of the New Mexico Produced Water Act, many believe that most of the obstacles faced in the past with recycling produced water, i.e. concerns with liability and questions of ownership and authority, have been successfully addressed.

Oklahoma

While Texas and New Mexico face drought concerns, Oklahoma has faced disposal concerns accompanied by seismic activity in parts of the state. In addition to guidance for seismic activity, operators may now also find guidance for water management through Senate Bill No. 1875. The Oil and Gas Produced Water and Waste Recycling and Reuse Act was enacted in 2020 and becomes effective on November 1, 2020 and should provide an additional resource for those handling produced water.

Oklahoma’s new law is complimentary to the produced water legislation in the neighboring states of Texas and New Mexico and also contains a similar “unless” clause, giving priority to existing contracts. In many ways, the new laws in all three states can be viewed as complimentary laws. When viewed together, it would appear that the states have responded to their overall needs in their individual ways, while also finding common ground for efforts across state lines.

Practical Guidance

What do these new laws mean for those who work hands-on with the various transactions? What issues will follow these new laws that may have not been foreseen during their drafting and enactments? With new laws, there is always a bit of uncertainty: words on paper are one thing, but what do the words mean when they are put into action? Gaining an understanding of not only the intent and language used within these laws, but also how the laws will be applied, is critical for transacting with produced water going forward.

All three state's new laws recognize the possessor of the produced water as the owner. When the goal is to quickly move and transfer the resource to third parties and subsequent transferees, these new laws may do exactly what they are intended to do. However, because the new laws contain specific language, i.e. "unless clauses," recognizing the existence of prior contracts, the following guidelines are suggested to better understand how these laws impact this particular resource:

1. The future may be one where water title examination for contracts, purchases, mergers, and acquisitions is a more common practice. The laws in these three states contain language where existing instruments that burden the water resource are in place, those instruments will be capable of trumping or superseding the legislative guidelines. Produced water handlers will need to have notice and understanding of what, if any, documents exist that might impede their rights to the resource.
2. If the goal is to maintain control over the produced water resource, operators and water handlers may consider contracting outside of the new laws. Moreover, for some landowners, continuing to contract privately allows not only provisions for the water but may also provide for additional protections to other portions of the surface estate. The statutes do not prohibit parties from privately contracting; instead, they work as a fail-safe, or safety net, when contracts are not in place.
3. It will be important for those that draft or examine transactions in this area to pay close attention to any future legal changes or rulemakings. The laws surrounding produced water in Texas, New Mexico and Oklahoma are still new. Attention and focus will be necessary as the laws are gradually placed into practical application, used with operations, and further regulated. It will be equally important to understand how each new law creates regulatory guidance for transfers not only within the respective state's borders, but also transfers across other state borders.
4. Due diligence is recommended for transactions where the produced water resource is being transferred. With various business models, novelty of the laws, and a fast-paced industry, disputes are likely to arise, not only with landowners, but with operators alike, that will require court involvement, additional regulatory guidance or further legislation. Diligence with record keeping and comprehensive communications regarding transactions is suggested to assist with proper insulation for any such disputes.
5. The statutes do not address the relationship of produced water and recycling and re-use alone; disposal is also

addressed. Thus, water handlers should consider tracking the ownership of injection wells, not only for liability and regulatory purposes, but ownership purposes as well. If recycling and re-use is the future, there may come a time where one may want to pull injected water back up and attempt to treat it.

While the new legislation in the three states has provided some security and clarity for those transacting with this resource, the fact remains that some issues will still need to be fleshed out. For example, the three states now permit the liability that comes with the resource to transfer to the possessor. Is liability then limited to only the current possessor? Or is there risk remaining for all of those in the chain of possession? It is likely that issues such as these will be raised and decided through either case law or subsequent amendments, thus making it critical for this part of the industry to respond and adjust to the continually changing legal atmosphere.

Conclusion

The new produced water laws in Texas, New Mexico and Oklahoma allow both states to explore their options with recycling and re-use, permit operators to work with the resource at various levels, and provide guidance for the industry as a whole for an understanding of what can and cannot be done with this resource. Some believe that the only economical and efficient use for produced water is re-use for future operations inside of the industry. Others say that we have only just begun to understand the full potential of produced water. Regardless of the position, all agree that handling and managing this resource is a necessity, and one that will continue to impact our industry. Sustainable options lie ahead and efficiently treating produced water for re-use and recycled purposes may soon be an obtainable goal for our industry.²

Disclaimer:

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² For additional resources and information, see also Kimberly A. Wurtz, *Watering the Forest for the Trees: An Examination of Basin Groundwater Use and Management in Energy Producing States*, 5 OIL & GAS, NAT. RESOURCES & ENERGY J. 459 (2020), <https://digitalcommons.law.ou.edu/onej/vol5/iss3/4>.