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## FISCAL IMPACT REPORT

ORIGINAL DATE 2-7-06

SPONSOR McSorley LAST UPDATED \_\_\_\_\_ HB \_\_\_\_\_

SHORT TITLE Surface Owners Protection Act SB 631

ANALYST Woods

### APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY06	FY07		
NFI	NFI		

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicate of HB437

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Energy, Minerals and Natural Resources Department (EMNRD)  
 Office of the Attorney General (OAG)  
 New Mexico State Land Office (SLO)  
 New Mexico Department of Agriculture (NMDA)  
 New Mexico Oil and Gas Association (NMOGA)

### SUMMARY

#### Synopsis of Bill

Senate Bill 631, Relating to the Production of Oil and Gas; Enacting the Surface Owners Protection Act; Stating Certain Duties Owed by Oil and Gas Operators to Surface Owners; Requiring Notice to the Surface Owners of Oil and Gas Operations; Requiring a Bond or Other Surety in Certain Circumstances; Providing a Cause of Action, seeks to enact the Surface Owners Protection Act (the Act), which addresses the following general factors:

- The Act requires oil and gas operators to compensate surface owners of real property for the use of the surface owner's property and to pay for any damages to the land resulting from oil and gas operations. In addition, the Bill requires oil and gas operators to restore the surface of lands disturbed by their operations to original condition, except to the extent otherwise agreed between an operator and the surface owner. Oil and gas operators are required to give notice to the surface

owner five business days prior to initially entering the property for non-surface-disturbing activities. At least forty days prior to commencement of surface-disturbing operations, the operator would be required to give notice to the surface owner and to propose a detailed surface use and damage agreement.

- If the parties do not reach a mutually acceptable surface damage agreement within forty days after the surface owner's receipt of the operator's notice and initial proposal, the operator may commence operations upon filing of a bond or other security with the Oil Conservation Division (OCD) in the amount of the greater of \$25,000 or the operator's good faith estimate of probable surface damages. If the operator does not exercise good faith in making the estimate, the surface owner, in a subsequent suit against the operator, can be awarded attorneys fees and punitive damages.
- If an operator commences operations without a surface use agreement, the surface owner may recover the damages in a civil action in district court, brought, at the election of the surface owner, in Santa Fe County, the county where operations occur, or the county where the surface owner resides. If the operator commences operations without giving the notice or without filing security, or if the operator fails to exercise good faith in estimating probable damages, the court may award the surface owner attorneys' fees and punitive damages.

There is no appropriation attached to this legislation.

## **SIGNIFICANT ISSUES**

There are a number of differing legal opinions, interpretations, and observations associated with this legislation. Accordingly, they will be presented without prejudice:

### The Energy, Minerals and Natural Resources Department (EMNRD) perspective:

- Under common law (accustomed practice), an owner or lessee of oil and gas has a right to use as much of the surface of the land as is necessary to explore for and produce minerals. The surface owner, absent a contrary agreement, is not entitled to compensation for loss of use of the portion of the surface reasonably necessary for mineral operations, nor for any diminution in the value of the surface due to such operations. The oil and gas producer is liable only for damages to the surface caused by its negligence, or by unreasonable or excessive use of the surface.
- State law does not presently require prior notice of operations to the surface owner, or require security from the operator for damages that may accrue to the surface owner. Where, however, the mineral estate is owned by the federal government, the United States Bureau of Land Management requires oil and gas producers give notice to the surface owner and either obtain a surface use agreement or post security prior to commencement of operations. BLM requires that an oil and gas operator file a statement that it has an agreement with the surface owner, or a bond, with BLM at the time the operator files its application for permit to drill. The bond amount is determined by BLM on a case by case basis and

is usually from \$1,000 to \$5,000 per well location. Oil and gas producers in New Mexico typically pay surface damage settlements to surface owners prior to operations. There is, however, no legal requirement to do so.

- SB 631 would put New Mexico in company with nine other states (Illinois, Kentucky, Montana, North Dakota, Oklahoma, South Dakota, Tennessee, West Virginia and Wyoming) that have modified the common law concerning an oil and gas operator's liability to surface owners by statute. Many of the bill's provisions are similar to those of statutes in North Dakota, South Dakota and Montana and it follows the pattern of other states by allowing oil and gas operators access on prescribed conditions. Under the Act, this would be the posting of a bond or other security in the amount provided, if the surface owner does not respond to the operator's proposal, or if negotiations are not successful.
- The bill requires operators submit a proposal prior to commencement of operations that includes detailed operational plans. In practice, the plans for initial operations should be known forty days prior to commencement of operations, but plans for later operations on the property, in most cases, would not be known at commencement. This issue could be addressed by requiring the operator to give notice of additional or revised operational plans.
- SB 631 also provides that a surface owner may recover, among other elements of damage, "harm to the watershed, aquifers or water supplies on or underneath the property." Under New Mexico Water Law, surface ownership does not bring with it water rights. It would be more precise for the Act to allow a right to recover for diminution, as a result of oil and gas operations, in the availability of water supply that a surface or ground water user has a right to divert by permit or adjudication.
- SB 631 further provides that the surface owner may recover cost of reclamation if the operator fails to reclaim the property, even if that cost exceeds the fair market value of property. [Page 3, Lines 14-15] No requirement exists for a surface owner recovering such an award to apply it to actual reclamation. An alternative would be to require that any award of damages would be applied first to remediation of the property pursuant to OCD requirements.

The Office of the Attorney General (OAG) perspective:

- SB 631 requires operators of oil and gas operations to compensate surface owners for the use of the surface owners' property. It also makes oil and gas operators liable to surface owners for any damages sustained by the surface owner as a direct result of the operator's oil and gas operations, including the costs of reclamation if the operator fails to reclaim the surface properly.
- SB 631 requires operators of oil and gas operations to provide notice to the surface owners of the planned oil and gas operations prior to entering the surface property. The notice shall include (1) sufficient disclosure of the planned oil and gas operations to enable the surface owner to evaluate the effect of the operations on the property, (2) a copy of the Surface Owners Protection Act, (3) contact in-

formation for the operator and the operator's representative, (4) a proposed surface compensation agreement, and (5) an offer to discuss and negotiate in good faith any changes to the proposed operations, the proposed surface use and compensation agreement, or mitigation actions that the surface owner might request. In the absence of a surface use and compensation agreement, oil and gas operators to post a bond or other surety for the benefit of the surface owner with the Oil Conservation Division of New Mexico Energy, Minerals and Natural Resources Department.

- SB 631 creates a private right of action by surface owners against operators who conduct oil and gas operations without a surface use and compensation agreement or outside the scope of an existing agreement. It authorizes a court to award to a surface owner compensation, attorney fees and punitive damages if the court finds that (a) the operator failed to provide notice as required by Section 4.B of the act, (b) the operator conducted oil and gas operations without a surface use and compensation agreement and without posting bond, as required by Section 5, (c) in posting bond, the operator failed to estimate in good faith the compensation that would be owed to the surface owner for damages, or (d) the operator conducted oil and gas operations outside the scope of a surface use and compensation agreement

New Mexico Oil and Gas Association (NMOGA) perspective:

- NM property law and other legal systems have established the rights of both parties when the surface is separated from the mineral, and gives the mineral owner the right to reasonable use of the surface. In absence of such authorization, the mineral estate is valueless. The test should be whether the surface owner has suffered damages because of unreasonable activities by the operator. *Gerrity Oil & Gas Corp. v. Magness; Amoco Production Co. v. Carter Farms Co.*
- Current case law requires “due regard” for/or “accommodation of” competing surface uses so long as the technical and economic feasibility of mineral development is not compromised. *Hunt Oil Co. v Kerbaugh; Getty Oil Co v. Jones*
- Where actions of mineral lessee cause temporary damage to surface estate, but such damage can be repaired, damages owed to owner of surface estate equal the cost of repair or restoration, if such cost does not exceed property's value. *Amoco Production Co. v. Carter Farms Co.*
- When actions of mineral lessee have rendered surface totally unusable for period of time, damages owed to owner of surface estate are determined by land's rental value for that same period. Where temporary damage results to the surface estate, but it can be repaired, then the damages are the cost of repair or restoration if the cost of restoration does not exceed the value of the property. *Ellison v. Walker*
- SB 631 attempts to change venue when law specifies that actions concerning real property are brought in the county in which the property is located.

- SB 631 violates the New Mexico Constitution, Article II, Section 19 by impairing the obligation of contracts.
- The definition of surface owner does not exclude federal, state or tribal surface ownership or the owner of both the surface and mineral estate.
- The definition of “reclaim” overrules various NM Supreme Court cases (Amoco v. Carter Farms, etc.)
- Does not establish a procedure to determine the “tenant’s share” of damages. If the land is reclaimed would the tenant then get 100% of the compensation? Loss of use only effects operations.
- As written, the legislation does not prevent current surface owner from entering into an agreement that will bind future surface owners.
- SB 631 requires the operator to examine title to surface, when it should be the tax records.
- SB 631 is aimed at oil and gas operators and protecting surface owners but it does not take into consideration, nor does it protect, the rights of the mineral owner. Surface owners purchase their property interest subject to the burden of development of the mineral estate. Oil and gas mineral property rights owners would have their property rights devalued for the private benefit of surface owners, and the reversal of the dominance of the mineral estate could be construed as a “taking” by the mineral owners.
- The required agreement in SB 631 does not “specify rights and obligations” but rather mandates a contract to control activities; NM property law based on NM statutes, property conveyances, historical practices, and court decisions, specifies and defines the rights and obligations of the parties. (See Legal Issues)
- SB 631 is not in the best interest of New Mexico as it 1) Restricts and delays the development of NM’s natural resources; 2) unnecessarily raises costs of oil and gas operations without benefit; 3) attempts to control private negotiations and voids NM property law.

The New Mexico Department of Agriculture (NMDA) perspective:

- This act addresses the ranching industry’s potential loss of resources during oil and gas exploration and extraction caused by the split ownership of mineral and surface rights in which the traditional priority is given to mineral rights.
- This act may affect many ranchers in New Mexico, but the effects on the economics of on the oil and gas industry are not calculated. Variables include the growth of the oil and gas industry, the number and intensity of surface rights affected, and the success of restoration practiced by the oil and gas industry.

The New Mexico State Land Office (SLO) perspective:

- The Act is to be interpreted to benefit surface owners regardless of whether the mineral estate was severed from the surface estate.
- The Act would raise legal issues relating to surface use and the development of the mineral estates.
- The Act may conflict with existing SLO rules, regulations and current state oil and gas leases regarding surface use for oil and gas operations
- The Act would establish different legal requirements for state leases entered after July 1, 2006.

**ADMINISTRATIVE IMPLICATIONS**

EMNRD indicates that the Act requires the department's Oil Conservation Division to approve, maintain on file, and, when necessary, collect bonds and other security furnished for the benefit of surface owners. This would require one additional FTE.

**TECHNICAL ISSUES**

EMNRD notes that the provision for notice to the surface owner to be sent to the address "shown by the records of the county clerk" [Page 7, lines 4 and 5] should be changed to the records of the county tax assessor, since the tax office would ordinarily have more current and complete information regarding surface owner addresses. Further that, under the bill, if the operator becomes insolvent, the surface owner can collect the proceeds of the bond provided pursuant to the bill, and is not obligated to apply those proceeds to reclamation. OCD would recommend that the bill be amended to require the proceeds of the bond to be applied to reclamation of the property.

**OTHER SUBSTANTIVE ISSUES**

EMNRD suggests that the legislation would allow oil and gas operators to file security and proceed with operation if a surface use agreement is not concluded within forty days after the surface owner's receipt of the operator's notice of intent and proposal. [Page 5, lines 18, et seq.] This might create uncertainty where a surface owner cannot be located or does not call for or accept certified mail. This could be resolved by a provision that the notice would be deemed received a specified time after mailing to the prescribed address.

BW/mt