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

SPONSOR Egolf **ORIGINAL DATE** 01/28/09 **LAST UPDATED** 02/17/09 **HB** 219

SHORT TITLE Free Market Energy Restoration Act **SB**

ANALYST White/Woods

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	**FY10**	**FY11**		
	Indeterminate		Recurring	Land Trust 09800

(Parenthesis ( ) Indicate Revenue Decreases)

*See Fiscal Impact Statement

SOURCES OF INFORMATION

LFC Files

Responses Received From
State Land Office (SLO)
Energy, Minerals and Natural Resources Department (EMNRD)
New Mexico Oil and Gas Association (NMOGA)
New Mexico Environmental Law Center

No Response Received From
Taxation and Revenue Department[1] (TRD)

SUMMARY

Synopsis of Bill

House Bill 219 applies to split estates: a form of real property ownership common in New Mexico in which the surface and the mineral interests have been separated and are owned by different persons. The legislation would require a person seeking to enter into an oil and gas development agreement with a mineral owner to give 30-days notice to the private surface owner before entering into the agreement. The notice must include a statement that the surface owner may be able to avoid or minimize oil and gas operations by entering into a separate agreement with the mineral owner. Notice is not necessary if the surface owner is the state or the federal government, or if the private surface owner had been given notice in the past 12 months

[1] FIR will be updated upon receipt of TRD response.

regarding the same property and the same mineral interest owner. The legislation additionally proposes:

- Oil and gas development agreements entered into without the required notice, or entered into during the 30-day waiting period, will be void and unenforceable, and any entry onto the surface owner's land in reliance on the agreement will be a criminal and civil trespass.

- An operator seeking a permit to drill or other permit to conduct operations from the Oil Conservation Division (OCD) will be required to certify that the oil and gas development agreement under which it is conducting operations was entered into in compliance with the notice requirements of HB 219, or that the provisions of HB 219 do not apply to the agreement. Knowingly filing a false certificate will be a violation of the Oil and Gas Act.

- When the commissioner of public lands holds a public sale of oil and gas leases on a split estate, the commissioner must notify the surface owner of the public sale.

FISCAL IMPLICATIONS

There is no appropriation attached to this legislation.

Comments regarding the bill's impact have been received from the following respondents:

The New Mexico Environmental Law Center advises:[2]

> I am writing to express my concern about the amended fiscal impact report that was issued on HB 219, the Free Market Energy Restoration Act, on February 12 ("February 12 FIR"). I have two concerns with the February 12 FIR.
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> I believe the State Land Office's ("SLO") estimate of the cost of implementing HB 219 is both overstated and unsubstantiated. It is unsubstantiated because the SLO offers no data to support its assertion that HB 219 will result in state mineral leases being completely discontinued (rather than the process being changed or slowed) with the attendant revenue declines.
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> The SLO's position is also overstated. The SLO position assumes that state mineral leasing will stop completely. This is an unreasonable assumption. While HB 219 may change or even slow the SLO's mineral leasing process, it is unlikely that state mineral leasing will discontinue altogether. Generally, it is much easier to locate surface owners (for example, the person who pays property taxes on a piece of property is often the surface owner) than mineral owners, so the burden on the SLO would be minimal. Additionally, if HB 219 becomes law, the SLO could require the person winning the bid on a lease or the person nominating land for lease to notify the surface owner, relieving the SLO of that responsibility. Moreover, I understand that a representative from the SLO conceded in testimony before the House Energy and Natural Resources Department that the information that it would be required to disclose under HB 219 is already available at the SLO.

[2] The New Mexico Environmental Law Center response was received on 2-15-09.

The concerns of the New Mexico Oil and Gas Association ("NMOGA") are also misplaced. NMOGA claims that HB 219 could cost its members as much as $200.00 per acre for complex title searches. However, oil and gas operators are already required to notify surface owners under the Surface Owner Protection Act, NMSA 1978, §§ 70-12-1 *et. seq.* HB 219 would merely change the timing for which notification is required. It would not place any additional burdens on oil and gas operators.

Because of the above reasons, I suggest that the February 12 FIR be amended further to reflect more realistic costs to the SLO and oil and gas operators.

SLO states:

HB219 which is presently being considered in the House Energy and Natural Resources Committee would have a very negative impact on State Land Office revenues. The major source of funding at the Land Office comes from oil and gas revenue, typically over 90% each year. There are two main sources of oil and gas revenue, bonuses when leases are sold each month and royalty from production when oil and gas are actually produced from state leases.

The Land Office has about 30% of its land in a split estate situation (SLO owns 13 million mineral acres and 9 million surface acres so there are about 4 million acres of split surface and minerals). HB219 would have the effect of eliminating any split minerals from being offered up for oil and gas leasing at the monthly sale. The Land office does not have the records on hand in-house to determine surface ownership of split surface estate and does not have the budget or personnel to conduct title searches in county records to verify surface ownership so as to provide the notice set out in the bill. In the last several years lease bonuses have been running in the $45 million range and if forced to eliminate spilt estate minerals from the sales that would reduce our available acreage by approximately 30% (SLO presently has about 3 million mineral acres leased for oil and gas and approximately 775,000 acres of that are split estate minerals). Using the bonus revenue from the last few years the annual reduction in bonus money is estimated to be in the $10 to $15 million dollar range.

On the production side royalty is the largest single contributor to Land Office revenues - last year was a record at approximately $459 million dollars. HB 219 would not affect the oil and gas leases already in the system but if spilt estate minerals are no longer able to be leased then the same percentage impact on Land Office revenues that would be felt on the bonus side would also work it way in to the royalty side. Using the $459 revenue number could result in a negative impact to the Land Office beneficiaries estimated to be in the range of $100 to $140 million dollars.

The effect of eliminating Land Office split mineral estate would also have a corresponding negative impact on severance and other production type taxes that are assessed on production from Land Office leases. The SLO does not have an estimate of the tax revenue loss but it could easily be in the millions of dollars.

NMOGA offers the following comment:

> Differences in title searches will vary by the ownership of mineral title. Federal and/or state minerals are easier to search; private of course is more difficult. It is not unknown for a landman, depending on the amount of research involved in determining mineral ownership, to charge $30,000 - $40,000 for "two weeks out" on a mineral search.
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> A mineral title search on as much as 1320 acres per day with little or no problem for less than $1.00 per acre or you can have had as many as 93 minerals owners in a 40 acre tract that has taken several weeks resulting in $200 per acre or more. It all depends on the title level, county records, title plant and area that you are researching. If you wanted to run title on a smaller area, the cost may or may not be reduced as you still have to run the same title on a larger tract to get to point in time where the smaller tracts were created out of the larger tract.
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> An estimate for a mineral search of the El Dorado Subdivision for example, taking out the known 17,500 acres federal/state mineral, for the private and land grant mineral titles in the remaining 28,620 acres in the area ran over $700,000.

EMNRD notes that there will be only minor costs for the Oil Conservation Division, which will need to change its permit forms to require the certification required by HB 219. The Oil Conservation Division may also need to take enforcement actions against operators who knowingly file false certifications.

SIGNIFICANT ISSUES

EMNRD indicates that the focus of HB219 is on giving notice to the surface owner of a split estate before the operator and the mineral interest owner enter into an agreement on oil and gas development. The intent of HB219 is to give the surface owner time to negotiate an agreement with the mineral interest owner, or perhaps purchase the mineral rights. Nothing in HB 219 mandates that the mineral interest owner enter into an agreement with the surface owner. Further, HB219 goes beyond the existing Surface Owner's Protection Act, NMSA 1978, Sections 70-12-1 through 70-12-10, which requires notice to the surface owner only after the operator and mineral interest owner have entered into their agreement, and operations are about to begin. HB 19 also builds in enforcement mechanisms that are not present in the Surface Owner's Protection Act, requiring the operator to certify that it has complied with its requirements before obtaining permits from the OCD, making any agreement entered into in violation of HB 219's requirements void and unenforceable, and making entry onto the surface owner's land in reliance on the agreement a civil and criminal trespass.

PERFORMANCE IMPLICATIONS

SLO states that the legislation. "…might put the SLO at a competitive disadvantage *vis a vis* the federal government because the notice provisions in the bill do not apply to the issuance of oil and gas leases by the federal government." There is no performance issues associated with EMNRD.

ADMINISTRATIVE IMPLICATIONS

SLO states, "Not only would this bill add significantly to the SLO's time and expense in issuing oil and gas leases, but it likely would add significantly to the number and types of disputes arising from oil and gas exploration and production under SLO oil and gas leases." EMNRD advises that the Oil Conservation Division will need to change its permit forms to require the certification required by HB219.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SLO advises that this bill overlaps to some extent with the Surface Owner Protection Act, NMSA 1978, § 70-12-1 (2007) *et seq.*, which pertains to surface damages caused by oil and gas exploration or production and requires notice to surface owners prior to entry for purposes of oil and gas exploration or development. Existing statutes and regulations, including the statutory form of oil and gas lease issued by the Commissioner of Public Lands, contains provisions related to damages caused to the surface and surface improvements. *See, e.g.*, NMSA §§ 19-10-4.1 to 19-10-4.3 (statutory oil and gas lease forms); NSMA 1978, § 19-10-26 (requiring surface damages bond or waiver where there is a split estate); NMAC § 19.2.100.23.

TECHNICAL ISSUES

SLO advises that while the FMERA portion of the bill states that non-complying oil and gas development agreements are void and that entry under a void oil and gas development agreement constitutes criminal and civil trespass, the amendment to NMSA 1978, § 19-10-17 does not address these issues in any way, and thus leaves ambiguity as to the consequences of non-compliance with respect to SLO oil and gas leases.

OTHER SUBSTANTIVE ISSUES

SLO indicates that while the bill states that one of its purposes is to "provide mineral estate owners with an alternative, competitive option from mineral estate ownership," nothing in existing law prohibits a mineral estate owner from seeking to maximize the value of the mineral estate by bargaining with the surface owner. Thus, the bill would burden the mineral estate owner without providing any additional benefits. NMSA 1978, § 19-10-17 already provides that the Commissioner of Public Lands must hold a public auction with notice when issuing an oil and gas lease. *See also* NMAC § 19.2.100.25. Thus, surface owners affected by State leases already are in a position to participate in the process that results in the issuance of a State oil and gas lease. It is unclear whether a surface owner's ability to participate in the process by which oil and gas development agreements are entered into constitutes a legitimate state interest, and thus the proposed legislation may give rise to litigation concerning its constitutionality.

ALTERNATIVES

SLO suggests that the bill could exempt oil and gas leases issued by the Commissioner of Public Lands by deleting Section 7. The bill could be structured as an amendment to the Surface Owner Protection Act.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

EMNRD states that, currently, operators are not required to notify surface owners of split estates prior to entering into oil and gas development agreements, and surface owners are often unaware that a lease has been entered into and development is going to occur until after the agreements have been made, and development is about to start.

AMENDMENTS

SLO states: "If the bill is amended by deleting Section 7, the effect of the bill on the Commissioner of Public Lands or the State Land Office would largely be eliminated. The remaining question would be whether the bill affects the ability to unitize state trust lands with affected private lands."

BW/mc:svb