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## FISCAL IMPACT REPORT

**ORIGINAL  
DATE LAST**

**SPONSOR** HAGC **UPDATED** 2-10-06 **HB** 437/HAGCS

**SHORT TITLE** Surface Owners Protection Act **SB** \_\_\_\_\_

**ANALYST** Woods

### APPROPRIATION (dollars in thousands)

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

(Parenthesis ( ) Indicate Expenditure Decreases)

### 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

House Agriculture and Water Resources Committee substitute for House Bill 437, 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:

- It makes the Surface Owner’s Protection Act (the “Act”) applicable to private surface fee land only. It no longer requires operators of oil and gas operations to compensate surface owners for the use of the surface owners’ property. It 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, without setting forth what factors

may be included to calculate damages. It imposes a duty on the operator to reclaim all surface directly affected by the operator's oil and gas operations.

- It 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) contact information for the operator and the operator's representative, and (3) a proposed surface compensation agreement. The proposed surface compensation agreement must at a minimum address the issues delineated in the Act. In the absence of a surface use and compensation agreement, oil and gas operators are 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 and in an amount equal to the greater of (1) the compensation, as estimated by the operator, for damages, or (2) \$2,500 per well site.
- It no longer expressly 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 now simply states that in an action brought pursuant to the Act, a court may award to a prevailing party attorney fees (no longer compensatory or punitive damages) if the court finds that (a) the operator failed to provide notice as required by Section 5.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 6, (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.
- It deletes the 6-year Statute of Limitations provision contained in the original HB 437 and removes venue in Santa Fe.
- It creates an exception for the notice, surface compensation agreement, or bond requirements of the Act for operations to protect health, safety or the environment in emergency situations.

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:

The substitute bill, like the original HB 437, changes existing law in favor of allowing surface owners greater rights. 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 operator is liable only for damages to the surface caused by its negligence, or by unreasonable or excessive use of the surface. The substitute bill provides that the oil and gas operator is liable for damages to the surface owner but does not specify what damages.

State law does not presently require prior notice of oil and gas 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 that 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. The substitute bill would require prior notice to the surface owner and would require that the operator either obtain a surface use agreement or post a bond for protection of the surface owner prior to commencement of operations.

The substitute HB 437 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. Some of the bill's provisions are similar to those statutes.

The substitute bill, like the original bill, requires operators to submit a proposal prior to commencement of operations that includes detailed operational plans. In practice, the plans for initial operations should be known thirty 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.

#### *New Issues Raised by the Substitute Bill*

The original bill contained a detailed list of the elements of damage for which a surface owner would be entitled to compensation, including specifically loss of use of the land, diminished market value, damage to water resources and cost of reclamation. The substitute bill removes this detailed list and simply provides that the operator shall compensate the surface owner for "damages caused as a direct result of the operator's oil and gas operations." This change leaves the question of the elements of compensation that a surface owner can recover to be resolved by the courts, thus introducing a number of uncertainties. For example:

- (a) The original bill provided that a surface owner could recover compensation for loss of use of the portion of the surface used for oil and gas operations in addition to any physical damage to the land. A surface owner could not recover for such loss of use under present law. It is unclear what a surface owner could recover for loss of use under the substitute bill.
- (b) The original bill allowed the surface owner to recover compensation for damage to water resources without limiting such recovery to the surface owner's water rights. The sub-

stitute bill contains no reference to water resources. Hence it is unclear what right a surface owner would have to compensation for water, even if the surface owner had a water right.

(c) The original bill specifically provided that, in the event of an operator's failure to restore the surface, the surface owner could recover the cost of such restoration even if it exceeded the value of the land as restored. The substitute bill is silent on this subject. Under common law, recovery for damages to land is usually limited to the land's fair market value.

The substitute bill deletes the word, "gathering" from the definition of "oil and gas operations." This may not be a substantive change, since "gathering" is an activity "associated with production" and therefore may be included in the substitute bill's definition of "oil and gas operations." However, if the alteration in language from the original bill is intended to make a substantive change, it may exclude recovery of damages resulting from the operation of "gathering" pipelines running from wells to field collection points or processing facilities.

The Office of the Attorney General (OAG) perspective:

The legislation is not clear as to what statute of limitations would apply for bringing an action under the Act; there is no definition or criteria as to what may qualify as an emergency situation under Section 8; and it is unclear whether to provide these protections to surface owners to help protect their property rights.

New Mexico Oil and Gas Association (NMOGA) perspective:

The House Agriculture and Water Resources Committee Substitute for HB 437 retains the Cattle Growers' priority issues from the original bill which are:

- require notice by the oil and gas operator to the surface owner;
- require agreement & compensation by the oil and gas operator to the surface owner; or in lieu of that;
- financial assurance.

The committee substitute has cleared up several NMOGA legal concerns and ambiguities that were in the original bill and CS/HB 437 no longer

- abrogates common law or New Mexico property law;
- does not subjugate the property right of the mineral estate;
- does not void New Mexico constitutional provisions; nor
- does not void a long history of judicial decisions;
- clarifies the relationship between surface owner/oil & gas operator and the tenant;

- does not harm the mineral estate relationship between New Mexico and the federal government; and
- clarifies that the Act only applies to private fee surface land.

CS/HB 437 still contains a list of items in Section 3.B and some of those items are regulated by either the Oil Conservation Division, who has statutory authority under the Oil and Gas Act, or the Bureau of Land Management and are considered a part of the permit to drill process and third party transactions covered under the statutory authority of the Oil and Gas Gathering Act or Pipeline Act, which industry feels can be clarified in the negotiation process with the surface owner.

The New Mexico Department of Agriculture (NMDA) perspective:

This legislation addresses the ranching industry's potential loss of resources during oil or gas exploration and extraction, and the differences between the House Agriculture and Water Resources Committee substitute for HB 437 and HB 437 include the following:

- Applies to private fee surface land only.
- Definition of “reclaim” is changed to “make reasonable effort to restore surface directly affected” . . . . . rather than as closely as reasonably practicable.
- The oil or gas operator shall compensate the surface owner for damages caused as a direct result of operations.
- The oil or gas operator shall not be responsible for allocating compensation between the surface owner and any tenant.
- Provisions for lost income from diminished land value, loss of use, loss of improvement value, harm to environment, and costs of reclamation are removed in the substitute bill.
- The oil or gas operator has a duty to reclaim all surface directly affected by their operation, however, loss of use liability is removed.
- The oil or gas operator shall give the surface owner notice of the planned operations which will include terms of ingress and egress and a definite offer of compensation for damages resulting from the operations 30 days, rather than 40 days, prior to first entering the surface to conduct oil or gas operations. Many references to aesthetics and responsibility/liability requirements in the original bill are stricken from the substitute.
- Notices required by the act shall be deemed to have been received 5 days after mailing by certified mail or immediately upon hand delivery. This change allows the oil or gas operation to proceed without delay if the surface owner fails to accept certified mail and without a definitive agreement.
- In lieu of a written agreement between the oil or gas operator and the surface

owner, pursuant to rules of the Oil Conservation Commission, the operator must post a bond or other surety for the benefit of the surface owner in the greater of the compensation estimated by the operator or \$2,500 per well site. This differs in the requirement per well rather than a set rate of \$25,000 or the estimated compensation.

The legislation will affect farms and ranches in New Mexico as well as help compensate for disruptions to their operations or to reclaim damages to the surface estate. The disruptions have the potential to increase costs of farming/ranching operations affecting returns to that operation directly related to the amount of surface disturbance. However, the oil and gas industry, besides owning the right to develop the mineral estate, provides economic and fiscal benefits to the state and local economies.

### **ADMINISTRATIVE IMPLICATIONS**

EMNRD suggests that the Act requires OCD 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 provisions for notice to the surface owner to be sent to the address "shown by the records of the county clerk" [Page 4, lines 21 through 23, and Page 5, lines 1 through 3] 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.

### **OTHER SUBSTANTIVE ISSUES**

NMDA suggests that House Agriculture and Water Resources Committee substitute for HB 437 applies only to private fee surface land thereby excluding federal and state land ownership. The act also provides for the court to award attorney fees to the prevailing party (surface estate) if public notice and other procedures outlined in the act are not followed.

### **WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

EMNRD indicates that the oil and gas industry liability to surface owners will continue to be determined by private negotiations and under the common law as developed by the New Mexico courts.

OAG notes that surface owners have no claim for compensation for the use of the surface property and no recourse for damages caused to the surface property as a direct result of operators' oil and gas operations.

NMDA adds that the exploration for oil and gas resources will continue under current conditions regardless of bill passage.