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STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION

THE MATTER OF THE APPLICATION OF THE NEW MEXICO OIL CONSERVATION DIVISION FOR REPEAL OF EXISTING RULE 50 CONCERNING PITS AND BELOW GRADE TANKS AND ADOPTION OF A NEW RULE GOVERNING PITS, BELOW GRADE TANKS, CLOSED LOOP SYSTEMS AND OTHER ALTERNATIVE METHODS TO THE FOREGOING, AND AMENDING OTHER RULES TO CONFORMING CHANGES STATEWIDE.

Case No. 14015

LEGAL BRIEFING BY THE INDEPENDENT PETROLEUM ASSOCIATION OF NEW MEXICO

Pursuant to Order number R-12819-B issued by Mr. Fesmire, Chairman of the Oil Conservation Commission on November 1, 2007, the Independent Petroleum Association of New Mexico (IPANM) hereby submits this brief in response to the Commission's order regarding the question of the legality of surface owners approval in Section 19.15.17(F)(1)(c) of proposed rule 17, or the 'Pit rule'.

Point One

The proposed NMOCD regulation requiring Surface Owner approval for oil and gas operators to bury products from operations on site violates established law in New Mexico

The NMOCD proposed Rule 19.15.17.13(F)(1)(c) requires an oil and gas operator to obtain a 'written consent' from a surface owner prior to burial of pit constituents on site – either in a current reserve pit or in a deep trench as defined in the rule. While there is no requirement in the regulation as to how parties are to achieve this written agreement, exchange of money is the most foreseeable result. IPANM does not believe that the NMOCD has the jurisdiction, by regulation, to grant a surface owner the unfettered right to impact a mineral rights owner's disposal of byproducts of oil and gas production on location. Moreover, while the Surface Owner's Protection Act states that an operator "shall reclaim all the surface affected by the operator's oil and gas operations" §70-12-4(C). This statutory requirement does not grant the NMOCD the jurisdiction to grant a surface owner additional rights with respect to the dominant versus servient estate. In addition, several legal issues arise in this discussion: First, who is the

surface owner including a discussion of the split estate issue on both the state and federal levels; Second, the NMOCD's position seems to imply that a surface owner should have the right to refuse an operator the right to leave drilling constituents on site due to 'potential damage', however, this is not legally 'damage' under established caselaw. Finally, the NMOCD proposed regulation impermissibly expands the Surface Owner's Protection Act granting rights to a surface owner which were not mandated by the Legislature.

Who the surface owner and the split estate issue

In the proposed rule 17, there is no definition for 'surface owner' and as such, IPANM would urge the Oil Conservation Commission to define 'surface owner' in a manner that is consistent with current statute in definition and applicability. As currently undefined in the proposed rule, written approval from any surface owner, private, State or Federal would be required prior to onsite or deep trench burial. As defined in the Surface Owner's protection Act,§ 70-12-1 to 10 NMSA 1978, a "surface owner means a person who holds legal or equitable title, as shown in the records of the county clerk, to the surface of the real property on which the operator has the legal right to conduct oil and gas operations." §70-12-3(D). Legal title is "cognizable and enforceable in a court of law but who carried no beneficial interest thereto" as defined in Blacks Law Dictionary. Equitable title is based on rights to the property based on fairness in contrast to strictly formulated rules of common law. As an example, at the time of sale of property, the buyer gets the equitable title at the time of handing over the money, but the legal title is not transferred until the sale is legally recorded. In trust situations the trustee has the legal title to the property, but the beneficiary has the equitable title. Thus, equity owners are not generally listed at the county clerk's office, but they will be listed jointly as responsible parties with the tax department. At a minimum while tax appraisal records may not be perfect, the party responsible for administering the surface property will more likely than not receive prompt notification. Without a very clear definition of surface owner, grazing allotments and permanent tenancies and the rights attached thereto which are allegedly similar to equitable ownership, could result in legal challenges as equitable surface owners.

Note that the statutory definition of 'surface owner' in the Surface Owners Protection Act does not exclude a political subdivision or the State or Federal Government. However, section 2

of the act states that "the Surface Owners Protection act applies to: A. private fee surface land; and B. leasehold interests in any land on which oil and gas operations are conducted when the tenant incurs damages to leasehold improvements as a result of oil and gas operations" §70-12-2(A, B) NMSA 1978. This applicability section narrows Surface Owner's Protection Act to only private fee lands, and further clarifies that a leasehold interest or tenant is not included in the definition of 'surface owner'.

The term Split-Estate refers to subsurface mineral rights owned by an owner other than the owner of the surface lands. Federal split estate lands are lands granted under patent with minerals reserved to the Federal Government. On private surface split estate lands over either private or State minerals, Amoco Production v. Carter Farms Co., is the seminal case in New Mexico that requires "unreasonable, excessive or negligent use of the surface estate" to prove surface damages against a mineral estate owner. Under current New Mexico law, if a rancher denies access to the surface over either private or state minerals, the rightful owner of the subsurface mineral estate has legal recourse for access to the land for exploration or oil and gas operations. "A general principle of oil and gas law that when an oil and gas lease grants to the lessee a particular tract of land for the purpose of exploring, drilling, mining and producing oil and gas, the lessee gains by implication the right to enter upon and use as much of the surface as may be necessary for the lessee's operations." *Kysar v. Amoco Production Co.,* 2004-NMSC-025, 135 N.M. 767, 93 P.3d 1272 *citing 1 Earl A. Brown, The Law of Oil and Gas Leases* , § 3.06, at 3-45 to -51 (2d ed. 2003). The basis for this rule is that "'when a thing is granted all the means to obtain it and all the fruits and effects of it are also granted.'" Id. at 3-51 (quoting *Squires v. Lafferty* , 121 S.E. 90, 91 (W. Va. 1924)). New Mexico case law is consistent with this principle. *Kysar, Id.*, See also, *Carter Farms* , 103 N.M. at 119, 703 P.2d at 896 (noting that a mineral lessee "is entitled to use as much of the surface area as is reasonably necessary for its drilling and production operations"). The Restatement (Third) of Prop.: Servitudes § 2.15 (2000) characterizes the rights of a mineral owner, when those rights have been severed from the surface, as implied servitudes, or easements, "created by necessity". The *Kysar* court further states, "It seems appropriate to characterize the implied right of the lessee to which *Carter Farms* refers as an implied easement by necessity". See Restatement of Prop., § 2.15 cmt. b ("For analytical purposes, implied rights necessary to reasonable enjoyment of profits are treated

as implied servitudes covered by the rule stated in this section.) Note that the principle of an implied right generally has been limited to use of the surface of the premises under which the mineral estate lies. "[W]here a person purchases the oil and mineral rights in a specific tract of land, the surface area of such lands may be subjected only to such burdens as are reasonably necessary to the full enjoyment of the mineral estate in such particular specific parcels and the surface area may not be burdened by installations or surface fixtures designed to serve oil producing facilities located without the parcels." Kysar, supra, citing *Wall v. Shell Oil Co.* 25 Cal. Rptr. 908, 913 (Cal. Ct. App. 1962). A lessee that holds the right to exploit the minerals underlying a tract of land generally "will not be permitted to use the surface thereof in aid of mining operations on adjacent, adjoining, or other tracts of land." *Annotation, Right of Owner of Title to or Interest in Minerals Under One Tract to Use Surface, or Underground Passages, in Connection with Mining Other Tract* , 83 A.L.R.2d 665, 670 (1962). New Mexico cases also are consistent with this principle. Thus, if there is no agreement between the parties for the use of the surface, if the surface owner can prove the *Carter Farms* standard, then he will be afforded legal remedies. However, it is questionable whether the NMOCD can grant a surface owner the right to either refuse access or demand compensation for allowing burial of pit contents on his property since this is not defined as "damage" to the land.

In New Mexico, of the 9.4 million acres owned by the state, 8.9 million acres, or 95 percent, are state trust lands. These lands, granted to New Mexico at statehood, must be managed to generate income for schools and other designated institutions. By contrast, of the 77.77 million acres of surface land in the state, the Federal Government retained 36 million acres of mineral rights, 26.5 million acres of federal surface; 9.5 million split estate acreage; 13.3 million acres managed by the BLM a public lands and 8.4 million acres of Indian trust minerals. *BLM Public Land Statistics*, 2006, Part 1A. Federal Surface Lands include both the public domain and acquired lands of all Federal agencies. With the exception of an estimated 4 million acres of the acquired lands, Federal mineral rights exist in all Federal lands. The gas production from all onshore Federal gas leases amounted to approximately 2.0 Tcf, or about 10 percent of national gas production. New Mexico public lands produced about 5.5 percent of all U.S. gas production in 2000. "*A Brief Examination of the Adequacy of Future U.S. Natural Gas Infrastructure and*

Resources and The Role of Public Lands in U.S. Natural Gas Production" A Report to the Wilderness Society By Lookout Mountain Analysis, W. Thomas Goerold, Ph.D., June 18, 2001.

In this case, the question of private surface over Federal minerals is also one that must be resolved since currently, the NMOCD and the BLM have an agreement for consistent closure standards. Under the Gold Book, which is the BLM's policy manual on closure and remediation standards, an operator is allowed to leave pit constituents onsite with a four foot top soil cover – as defined in the present proposed Rule 17 hearing, this process has been described as a 'taco'. There is no mandate in the BLM guidelines to remove drilling wastes to a secondary pit in a 'burrito' nor is there a requirement for an additional liner under the four foot of topsoil.

Following is a brief discussion of established caselaw and statutes with regards to surface owner's rights over federal minerals. Note that proposed rule 17 is in direct conflict as to granting economic benefit to rights to surface owners. The 'most important … land grant statute [impacting federal split estates] enacted in the early 1900's' was the Stock-Raising Homestead Act of 1916 (SRHA) 39 Stat. 862, 43 U.S.C. §291 et seq. *Watt v. Western Nuclear, Inc.*, 462 U.S. 36 (1983). The Act applied to 'any public lands' the US Secretary of the Interior designated as '*stock raising lands*'(emphasis added)" 43 U.S.C. §291 (1976 ed.)(repealed by Pub. L. 94-579, 90 Stat. 2787). The SRHA requires that on lands granted under patent that "any person qualified to locate and enter the coal or other mineral deposits… shall have the right at all times to enter upon the lands … for the purpose of prospecting." 43 USC §299(a). To reenter the land the operator must (1) obtain consent or waiver of the homestead entryman or patentee; (2) pay for damages to crops or other tangible improvements to the owner, provided an agreement may be had as to the amount thereof; (3) in lieu of the above provisions, the operator may execute a bond to the benefit of the entryman or owner of the land; finally (4) all patents issues for coal or other mineral deposits shall contain notations[1] declaring them to be subject to the provisions of this subchapter. Id.

In 1932[2], Congress added stipulations to the Stock-raising Homestead Act and created a new Notice to surface owner section. The new section required that an operator notify a surface

1 The notations provision is very important since it is a clear legislative showing that the aforementioned protections apply. It is also conceivable that land could have been granted without this notation which will be easy to find today since it must be attached to the title.
2 43 USC §299 was amended in 1993 as Pub L. 103-23.

owner, as listed in the local tax roles by certified mail, of the filing of a notice of intention to locate a mining claim. Id. at (b)(3). The notice had to be given at least 30 days before entering such lands and required consent of the surface owner unless the operator posted a bond to cover permanent loss of income3. Id. The SHRA required that the Secretary consider the potential loss of value due to the estimated *permanent*[4] reduction in utilization of the land. See Id. at (f)(1)(A).

Looking further into the US Code, Title 43 USC. § 178 [5] (hereinafter referred to as the New Mexico Land Act of 1932), the New Mexico Land Act states that the mineral lessees, permittees and grantees "*may enter upon the lands for the purpose of prospecting for and mining such deposits* (emphasis added)" 43 USC §178. There is no mandate or requirement under the Act to notify or pay surface owners for any type of damage or use of the land. There is no notation on the deed as required in the SRHA to apply the additional economic and protective benefits for the large working ranch parcels granted under SRHA. Congressional intent at the time of the granting of patents in the state of New Mexico was to reserve mineral leasing to the United States and to confer no benefits to the surface owner other than the receipt of title to 160 acres at $1.25 per acre.

It is clearly established law that when an agency or court requires statutory interpretation of an Act, the interpreter must consider the ordinary meaning of the language of the act at the time Congress enacted it. *Amaco Production Co. v. Southern Ute Tribe*, 526 U.S. 865 (1999). Thus, as held in *Leo Sheep Co. v. United States,* 440 U.S. 668, 682 (1979), land grant statutes applicable to federal lands and split estates in New Mexico should be interpreted in light of 'the condition of the country when the acts were passed'. Accordingly, for a location on federal split estate lands, to grant any economic benefits and protections to a surface owner, a regulatory agency must comply with the provisions of the specific Act that land was patented[6].

3 Note that IPANM does not oppose notification of surface owners prior to commencement of operations. Moreover, IPANM will adhere to the legislative mandated in the Surface Owner's Protection Act to propose a compensation amount based on the list enumerated in §70-12-4 for items that can be quantified. Since future permanent damage is not calculable, giving a surface owner the right to impact the mineral right is outside the purview of either existing statute or caselaw.

4 The word permanent with reference to reduced value should mean that the value of the bond should be minimal given the vast number of regulations on reclamation.

5 Feb. 23, 1932, ch. 52, 47 Stat. 53.

6 However, a very important point to make is that surface owners should be made fully aware of all subsurface ownership – this is the responsibility of the title company and the realtors and should not become a burden for operators who lease minerals from the BLM.

Further, under the proposed rule if the NMOCD treats the BLM as a surface owner, the Taylor Grazing Act which applies to only the federal surface, becomes relevant and further binds any position the BLM may take pursuant to the proposed rule. In *Blancett v. BLM*, 04-2153 (DC. District Court, 3/20/06), the court completed a very substantive review of The Taylor Grazing Act of 1934, 43 USC §315e. The Act authorizes the Secretary "to issue or cause to be issued permits to graze livestock," and further provides that "the creation of a grazing district or the issuance of a permit . . . shall not create any right, title, interest, or estate in or to the lands." *Blanchett* at 2 citing 43 U.S.C. § 315b. At the same time, the Act provides that "*nothing contained in this subchapter shall restrict prospecting, locating, developing, mining, entering, leasing, or patenting the mineral resources of such districts under law applicable thereto.*(emphasis added)" id. citing 43 U.S.C. § 315e. Under this provision, the BLM must not only consider mineral interests as the dominant estate, but must give them priority over grazing privileges. *See Hinton v. Udall*, 364 F.2d 676, 678-79 (D.C. Cir. 1966) (noting that the interests of Taylor Grazing Act permit holders "were expressly made subordinate to mineral interests by Section 6 of the Taylor Act, 43 U.S.C. § 315e"). Similarly, if the BLM is asked to grant the written waiver to burial in place, under the provisions of established statutes, the BLM must grant the mineral estate as the dominant estate.

The question of foreseeable damages:

Second, the NMOCD's proposed rule allows a surface owner the right to refuse an operator the right to leave drilling constituents on site due to 'potential damage', however, this is not legally 'damage' under established caselaw; 'damages' is the cause of action based on the temporal nature of the damage and ease of remediation. As to the question of 'damage' to subsurface which is where the pit constituents would be buried, the NMOCD recent report on Carbon Dioxide Sequestration is an excellent source for statutory and common law on the issue of subsurface trespass. *"A Blueprint for the Regulation of Geological Sequestration of Carbon Dioxide in New Mexico"* by Mark E. Fesmire PE, JD, Nov. 17, 2007. The report cites several cases for the proposition that "direct physical infringement of subsurface property occurs only when physical evidence supports the claim". *Schwartzman Inc. v. Atchison, Topeka & S.F. Ry.,*

857 F.Supp. 838, 845 (D.N.M.1994)(trespass for pollution of groundwater). In *Schwartzman*, the plaintiffs relied solely on opinions of experts to establish trespass, nor was soil or groundwater testing completed to demonstrate contamination due to the activities of defendant railway company. *Schwartzman*, 857 F. Supp. at 845. Likewise in *Snyder Ranches, Inc. v. Oil Conservation Comm'n of New Mexico,* 110 NM 637, 798 P.2d 587(NM 1990), the plaintiff's reliance on the fact that survey maps showed his property boundary merging with a "sealing fault" that would block the flow of injected salt water as "proof positive that the fault line must include part of their land," was insufficient to establish that salt water injected by defendants on the adjoining property must have infringed on their property. *Snyder Ranches, Inc.*, 798 P.2d at 589, 590. A similar analogy to the case at hand would be that burial by an oil and gas operator of oil field byproducts in a reserve pit by itself is not conclusive proof of 'damage', rather proof of contamination to the ground water or direct harm to the environment or human health must be proven.

Indeed, similar to the disposal of produced water on lease, under existing law, the oil or gas producer has implied authorization to bury in place his drill cuttings and contents of the reserve, drilling and workover pits on lease. "New Mexico further appears to hold that there is no claim for subsurface trespass for the injection of salt water produced on site in the production of oil and gas due to an implied authorization for disposal by injection because such practice is a necessary part of the purpose of the lease; though the same is not true for the injection of salt water produced off site, unless, perhaps, an instrument or contract specifies otherwise." NMOCD report, p. 28 citing *McNeill v. Rice Engineering andOperating, Inc.*, 133 N.M. 804, 70 P.3d 794, 798, 801 (NM Ct. App. 2003). In addition to McNeill, cited above, the NMOCD report cites several cases from multiple jurisdictions for the premises that "[t]he right to inject salt water produced onsite from oil and gas wells stems from the theory that such production "is a necessary and unavoidable" result of the production of oil and gas that has been explicitly authorized by the original mineral conveyance." citing *Colburn v. Parker and Parsley Development Co.*, 17 Kan.App.2d 638, 842 P.2d 321, 326 (Ct. App. Kansas 1992) ("We hold the granting clause in an oil and gas lease includes an implied covenant to dispose of the salt water produced during operations by utilizing a saltwater disposal well drilled on the leased premises without additional compensation to the lessor. We hold that such a right is required in order for

the production of oil and gas to be accomplished"). Based on testimony at the NMOCD taskforce meetings and both the Surface Waste Management Rule 36 hearing and the Rule 17 Pit hearings, the major concern for contamination is from produced water which has chloride content. Testimony from even the Oil and Gas Accountability project expert, Dr. Theo Colborn conceded that harm was correlated to dosage and exposure to a contaminant which must involve migration of a contaminant to contact an organism. In place burial which effectively encapsulates the wastes poses little or no risk to any organisms – in fact a breach of one small pit location would case less 'damage' or harm to the environment than a breach of a landfill facility. If the law currently allows for disposal on site of the produced water, there is little or no support for the forced hauling of drill cuttings which are no more than ground rock and earth from the wellhead to an off site location. Moreover, under established caselaw, cited by the NMOCD in support of its 'Blueprint for the regulation of geologic sequestration' it is clear that by analogy to the salt water disposal discussion, that on lease disposal of pit constituents is proper in all respects under established New Mexico caselaw.

The most recent case on the issue of damages is *McNeil v. Burlington Resources Oil and Gas Co.,* which creates a distinction between temporary damage which will require payment of the cost of repair, so long as this cost is less than diminution in fair market value. Id.(141 NM 212, 153 P.3d 46, 54 (N.M. Ct. App. 2007)) Temporary damages are defined as "damage that can be remedied, removed or abated within a reasonable period of time at a reasonable expense" *Morsey v. Chevron, USA, Inc.,* 94 F.3d 1470, 1476 (10th Cir. 1996). In contrast, permanent damages are defined as those damages caused by an injury that is fixed and where the property will always remain subject to that injury. Id. "Permanent damages are damages for the entire injury done—past, present, and prospective—and generally speaking those which are practically irremediable." Id. Moreover, in this case, the 'damages' alleged were not simply the burial of oil field wastes on site, but the claimed failure of the Defendant to properly close the associated pit resulted in subsurface contamination of their property. Plaintiffs also asserted that the contamination affected the water supply in the area and that, as a result, Plaintiffs' cattle will not drink the water.

Therefore, proposed Rule 17, giving the surface owner the right to prevent burial on site or to receive financial benefit, assumes 'damage' to the subsurface which is not within the rights

of a surface owner prior to the determination of the temporal nature and remediation capabilities of the alleged 'damage'. Moreover, by statute, the Oil Conservation Commission was created by the Legislature under the Oil and Gas Act, and is empowered to 'prevent waste ... and protect correlative rights' *See Section 70-2-11(A).* No where in either the Oil and Gas Act, §70 NMSA 1978 or in the Surface Owner's protection Act, §70-12 NMSA 1978, is the NMOCD given the right to increase the bundle of rights for surface owners of the State of New Mexico.

The Surface Owner Protection Act

The Surface Owners Protection Act, which was passed by the New Mexico Legislature during the 2007 session, requires an operator to estimate a list of items to arrive at an offer of compensation before even stepping foot on the property. The operator must estimate the following, *as applicable*, for: a) Loss of Agricultural production and income; b) Lost land value; c) Lost use of the surface owner's land; d) Lost access to the land; e) Lost value of improvements caused by oil and gas operations. §70-12-4(A) NMSA 1978. Calculation of compensation for this list begs the question: How can an operator estimate "land value" over an unspecified period of time? Clearly, an operator does not have a crystal ball, nor will he estimate failure in his operations to cause permanent non-remediable damage. Even as a starting point, whether an estimation should begin with actual appraisal or based on information from the tax assessor, without time value of money analysis is relevant to the amounts offered as potential compensation. How can an operator estimate lost use and access? Technically, if the rancher still uses that road, he can not be paid for lost use or access and the operator could charge a toll. Finally, if a rancher maintains that he improved his surface by sage-brush eradication and oil and gas operations will now affect his improvements, arriving at a compensation amount may be impossible. If the NMOCD assumes that burial of pit contents on location will cause lost land value, we would urge a review of the *McNeil* analysis which clearly differentiates between compensation for temporary 'damage' and permanent 'damage'. Again, the payment for 'damage' analysis is related to the cost of repair, if the damage is remediable and therefore temporary supra. In contrast, permanent damages are defined as those damages caused by an injury that is fixed and where the property will always remain subject to that injury . supra. In essence, calculation for negotiations with the surface owner for the purpose of getting written consent for on site burial can not, and should not be considered. Finally, an issue which is very

relevant to the Surface Protection Act is the availability of bonding over a surface owner who refuses to cooperate with an offered compensation amount. Proposed rule 17 grants no alternative to an operator if a surface owner refuses to grant permission to exercise mineral rights on the land in question. Rather, the rule gives the surface owner standing to impact both the operations decisions and economics of drilling in the state of New Mexico.

In conclusion, IPANM would urge the NMOCD to withdraw the surface owner approval provision currently stated in proposed rule 19.15.17.13 section (F)(1)(c). Without a clear definition of 'surface owner' and the similar applicability rule in the Surface owners Protection statute, §70-12 NMSA 1978, the party with economic benefit as a result of the proposed NMOCD rule could be expanded from that in statute. Moreover, the proposed rule gives a surface owner unfettered standing to how an operator intends to conduct operations on the dominant mineral estate. Finally, whether disposal on site of pit drill cuttings and contents, which are a direct result of operations on location is proper and within the bundle of rights given to a mineral owner under established caselaw.

RESPECTFULLY SUBMITTED,

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