



04 IB 002 - Revised

## WYOMING LEGISLATIVE SERVICE OFFICE

# *Issue Brief: Surface Owner Accommodation in Split Estates*

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by:

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### **ISSUE**

Must state legislation designed to accommodate the rights of surface owners in oil and gas operations exclude property owned by the federal government, the state of Wyoming, and Indian tribes?

### **SUMMARY**

There is no federal or state law that explicitly requires the state to exempt federal, state, or tribal property from state legislation designed to accommodate the rights of surface owners in split estates with oil and gas operations. There are numerous federal and state laws, as well as rules and regulations, that govern oil and gas operations. Because of the existence of the federal laws, it could be argued that state law would be preempted to the degree that the federal law sufficiently addressed the concerns promoted by the state law, specifically in the case of federal mineral or surface ownership. At a minimum, inclusion of federal, state, and Indian property in surface owner accommodation laws may result in multiple (and perhaps duplicative) regulations.

Because the surface estate holder has a subordinate right to that of the mineral estate (i.e., in the case of a split estate), oil and gas operations could impact the surface owner when the mineral estate owner exercises his right to access the underlying oil and gas. To deal with federal split estates, the Bureau of Land Management (BLM) promulgated Onshore Oil and Gas Order No. 1-Approval of Operations on Onshore Federal and Indian Oil and Gas Lease (Onshore Order No. 1), 43 CFR 3160 (2003). Onshore Order No. 1 applies to both federal and Indian lands, since the

BLM manages minerals held in trust for tribes or individual Indians. Likewise, the state's Board of Land Commissioners (BLC) has regulations governing the management of the surface estate held by the state, affording certain protections to a surface lessee.

### **BACKGROUND**

A split estate occurs when the ownership of the surface estate (or the possessor thereof) is different from the owner of the mineral estate (or the possessor thereof).<sup>1</sup> Such a situation is known as a split estate. Generally speaking, the owner of the mineral estate holds a preferred right to the owner of the surface estate and may enter the surface land to access the underlying mineral estate. Both the state and federal governments have regulated the right of the mineral estate owner, to some degree, by imposing certain requirements for drilling, operations and reclamation. Matters may become further complicated when the owner of either the surface estate or the mineral estate further conveys an interest in that estate. Thus, anyone with an interest in the mineral estate has some right to access the underlying mineral (including oil and gas), regardless of surface ownership.

In 2004, the Wyoming House of Representatives considered HB 70, the Surface Owners' Accommodation Act (Attachment A). The proposed legislation was designed to provide certain protections for surface owners. The act

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<sup>1</sup> When the same owner holds both the surface estate and the mineral estate, it is known as a unified estate.

defined "surface owner" as "any person who holds an interest of record in the surface estate and any person in possession of the surface who holds an unrecorded interest in the surface estate, excluding adverse claimants without adjudicated title and *also excluding the state of Wyoming, when the state holds record title to the surface estate and all of the underlying mineral estate.*" (emphasis added)

The bill appeared to include just two exclusions—one for those seeking to claim title through adverse possession and one for cases where the state is the *unified* holder of the surface and mineral estates. Neither of these exclusions appears to exempt federal or Indian lands from the surface owner protections provided by the act. The final exclusionary clause, exempting the State of Wyoming when the state holds both the surface estate and the mineral estate, does not appear to apply to split estates where the state owns either the surface estate or the mineral estate.

In its interim committee work on the bill, the Joint Judiciary Committee took testimony from the director of the Office of State Lands and Investments (OSLI), advising that the state is often a unified owner of the surface and mineral interests. The state rules and regulations, the director said, provide procedures in those instances. The director stated that the bill should contain language reflecting the state's unique situation in this matter. In follow-up conversations with LSO staff, the director suggested that the regulations, which are tied to the surface estate, could be read to apply in all situations where the state owns the surface right, though it has not been the practice of the OSLI to do so. The state rule may apply in split estates where a private individual or the federal government is the owner of the mineral estate but has not been applied in this manner.

#### **HB 70: SURFACE OWNERS' ACCOMMODATION ACT**

In the 2004 Budget Session, the Wyoming House of Representatives considered HB 70, the Surface Owners' Accommodation Act. The legislation failed introduction. However, it would have

instituted a number of accommodations for surface owners. The proposed act would have:

- ✓ required oil and gas operators to provide notice to the surface owner of the proposed oil and gas activities;
- ✓ required an oil and gas operator to enter into good faith negotiations with a surface owner regarding potential damages that may be caused by the oil and gas operations;
- ✓ required the oil and gas operator to compensate the surface owner for all reasonable damages resulting from operations on the surface owner's property;
- ✓ required the oil and gas operator to post a bond if no agreement could be reached with the surface owner;
- ✓ required oil and gas operations to be conducted in a manner that would minimize damages to the surface;
- ✓ allowed a surface owner to waive any rights granted under the act;
- ✓ established a two-year statute of limitations for civil action; and
- ✓ allowed the prevailing party to seek reasonable attorney's fees and costs in the event of legal action between the surface owner and the oil and gas operator.

**Notice.** For access to the surface for any *non-surface disturbing activities*, including inspections, surveys, measurements and general evaluation, HB 70 would have required 48-hour advance notice to the surface owner. Before entering upon a site for oil and gas operations that *may disturb the surface*, the act would have required the oil and gas operator to give written notice to the surface owner of its proposed oil and gas operations on the surface owner's property. This notice would have required:

- ✓ a minimum of 60 days advance notice to the surface owner prior to commencement of the initial oil and gas operations, unless waived by the surface owner; and
- ✓ "disclosure, to the extent known, of the proposed plan of work and oil and gas

operations to enable the surface owner to evaluate the effects of the oil and gas operations on the surface owner's use of the property."

Once the 60-day notice of proposed operations had been given to the surface owner, HB 70 would have permitted the oil and gas operator to reasonable access to the surface to conduct inspections, surveys, measurements and general evaluation of proposed routes and sites for oil and gas development, provided that *no material surface disturbance occurred* without approval by the surface owner or compliance with the provisions of the act. In other words, 48-hour notice would be required for non-surface disturbing activities until the notice of proposed operations had been given. Once that had been given, reasonable access would be allowed for non-surface disturbing activities. Oil and gas operations that *disturb the surface* would be allowed to proceed upon compliance with the remaining provisions of HB 70.

**Negotiation.** HB 70 would have required the oil and gas operator to enter into good faith negotiations with the surface owner to reach an agreement regarding:

- ✓ "compensation to the surface owner for damages, if any, that may be caused by the oil and gas operations; and
- ✓ reclamation requirements."

In addition, the parties would have been free to identify and negotiate to their mutual satisfaction:

- ✓ damages;
- ✓ compensation;
- ✓ terms and conditions of payment;
- ✓ mitigation;
- ✓ methods of enforcement; and
- ✓ any other terms material to the parties.

The act also included provisions should the parties fail to reach an agreement.

**Compensation to Surface Owner.** HB 70 would have required an oil and gas operator to

compensate the surface owner for all reasonable damages resulting from its oil and gas operations on the surface owner's property. Factors that may be considered would include, but would not be limited to:

- ✓ loss of agricultural products and income;
- ✓ loss of land value;
- ✓ loss of land use;
- ✓ loss of value to improvements;
- ✓ damage to aquifers and water supplies;
- ✓ costs of surface reclamation; and
- ✓ loss due to inability to implement previously planned uses by the surface owner.

**Certification to WOGCC.** Prior to the Wyoming Oil and Gas Conservation Commission (WOGCC) approval of an application for permit to drill, HB 70 would have required the oil and gas operator to certify to the WOGCC that notice had been provided and that an agreement or waiver had been obtained. If neither an agreement nor a waiver had been obtained, the act would have required the oil and gas operator to provide the WOGCC a bond:

- ✓ in an amount determined by the WOGCC sufficient to pay damages reasonably expected to occur; and
- ✓ at a minimum of \$5,000 per well; or
- ✓ at a minimum of \$500,000 for all oil and gas operations in the state, if required by the WOGCC.

HB 70 would have allowed a surface owner to petition the court with proper jurisdiction to increase the amount of the financial assurance. The act provided that the court could increase the amount upon proof that the bond would not likely be sufficient to cover reasonable damages to the surface owner from the oil and gas operations. Even in the event the bond had been determined to be sufficient, HB 70 would provide that the bond be posted separate from any other form of financial surety required by law.

**Reclamation.** After completion of oil and gas operations, HB 70 would have required the oil and gas operator to complete reclamation of the surface directly affected by the oil and gas operations. The oil and gas operator would have been required to complete reclamation, as reasonably as practicable, to the condition that existed prior to the oil and gas operations. The act would have waived this requirement if the surface owner and the oil and gas operator had agreed to an alternate arrangement.

### EXISTING REGULATIONS

The BLM, the WOGCC and the BLC all have requirements in place to address land entry and reclamation procedures. The WOGCC has bonding requirements to cover operations, drilling, idle well, water pit, plugging, abandonment and location reclamation. The BLC has regulations that allow state surface lessee to share in damage payments resulting from oil and gas operations. The BLM requires proof of a surface use agreement, waiver signed by the surface owner, or agreement for compensation or bond, in lieu thereof, for all federal leases. Oil and gas operators presently post bonds at the state and federal level for various oil and gas related activities. The WOGCC also has a mill levy fund available to use for those situations where an oil and gas operator declares bankruptcy or fails to take responsibility.

### FEDERAL REGULATIONS

As the United States acquired the vast territories across the continent of unoccupied lands, the property, including the minerals underlying the lands, became the property of the federal government. Much of the land was disposed of under various grants to states or private individuals. However, the federal government adopted a practice of retaining some interest in the lands, including the reservation of mineral rights. The Mineral Leasing Act of 1920, as amended, and the Mineral Leasing Act for Acquired Lands of 1947, as amended, give the BLM responsibility for oil and gas leasing on BLM, national forest, and other federal lands, as well as private lands where the underlying mineral rights have been retained by the federal government.

While the BLM provides technical assistance to Indian tribes and individual Indian mineral owners, the BLM does not lease Indian minerals. The Bureau of Indian Affairs (BIA) handles leasing of Indian minerals. However, Onshore Order No. 1 treats Indian lands the same as federal lands for the regulation of split estates. Thus, as part of its trust responsibility, the BLM oversees minerals operations on Indian lands. In sum, the BIA technically leases the minerals, but the BLM provides related management functions.

**Federal Policy.** In April, 2003, the BLM issued Instruction Memorandum No. 2003-131 (Attachment B) to clarify the policy, procedures, and conditions for approving oil and gas operations, e.g., Applications for Permit to Drill (APD) and Sundry Notices (SN), on split estate lands. In short, the provisions of Onshore Order No. 1 govern split estates where the federal government holds the mineral estate and a state or private owner holds the surface estate. When it is a unified federal estate, the BLM negotiates directly with the surface management agency. The federal policy requires oil and gas operators to enter good faith negotiations with surface owners prior to beginning oil and gas operations. If the parties are unable to reach an agreement, the oil and gas operator must post a bond to secure damages.

If there is no agreement between the oil and gas operator and the surface owner, federal regulations require the oil and gas operator to post *two* separate bonds. One bond is required under 43 CFR 3104 for all oil and gas operations developing the federal mineral estate. The second bond is required to satisfy Section 9 of the Stock Raising Homestead Act (SRHA), under 43 CFR 3814 *only if no agreement between the oil and gas operator and the surface owner can be reached*. The BLM will not consider an ADP or SN administratively or technically complete until the federal lessee certifies that either an agreement with the surface owner exists, or that the lessee has complied with the bonding requirements of Onshore Order No. 1.

Patents issued under the SRHA reserve coal and other minerals, including oil and gas, for the federal government. These patents:

- ✓ provide for the right of a mineral entrant to prospect for, mine, and remove reserved minerals, including oil and gas;
- ✓ provide that any qualified mineral entrant has the right to enter upon the lands at any time, provided that no damage is made to permanent improvements;
- ✓ provide that a mineral entrant must compensate the patentee for all damages to crops on the land; and
- ✓ provide that a mineral entrant may use as much of the surface as is reasonably required for all mining purposes as long as an agreement or a waiver has been obtained by the surface owner, or bond is made to protect against the potential harms to the surface owner.

**Onshore Order No. 1.** Onshore Order No. 1 (Attachment C) requires the federal mineral lessee or its operator to enter into good-faith negotiations with the private surface owner to reach an agreement for the protection of surface resources and reclamation of the disturbed areas, or payment in lieu thereof, to compensate the surface owner for loss of crops and damages to tangible improvements, if any. The lessee or its operator shall include as part of the ADP or SN:

- ✓ identification of where surface disturbance will occur on the private surface;
- ✓ the surface owner's name;
- ✓ the surface owner's contact address;
- ✓ the surface owner's telephone number;
- ✓ any other relevant and necessary contact information, if known; and
- ✓ a statement by the federal lessee or its operator that it has obtained an agreement or waiver from the surface owner for access to the leased lands, or has posted a bond to secure payment for loss of damages to crops and tangible improvements.

It is the responsibility of BLM to ensure compliance.

#### STATE REGULATIONS

The OSLI is the Wyoming agency charged with administering state owned lands and interests. Oversight of the OSLI is exercised by the BLC, comprised of the five statewide elected officials as stipulated in Article 18, Sec. 3 of the Wyoming Constitution. W.S. 36-2-107 grants the BLC "the power and authority to promulgate and adopt rules and regulations *not inconsistent* with the laws of the state, as it may from time to time deem necessary in the direction, control, disposition and care of all state lands." (emphasis added) Presently, the OSLI has regulations for both state-owned surface estates and state-owned mineral estates. Table 1 summarizes the BLC regulations.

**Table 1. State Land Regulations Affecting Split Estates.**

Chapter Section	Purpose	Summary
Ch. 4 § 13	Surface impact payments for mineral entrants on state-owned grazing land	Any entrant to state-owned land leased for grazing or agricultural purposes must negotiate a surface impact payment, to be shared between the state and lessee, or submit evidence to the OSLI to establish the surface impact payment.
Ch. 18 § 3	General provisions for state oil and gas leases	The state may condition the issuance of any oil and gas lease upon specific stipulations for the protection of the public or environment.
§ 12	Surface integrity and minimum reclamation for state oil and gas leases	Mineral lessees are required to use proper safeguards to prevent pollution and must reclaim the land upon completion of operations to restore the original condition.
§ 13	Bonding for state oil and gas leases	Oil and gas operators must obtain a bond for each lease or as a corporate surety prior to drilling to indemnify the state.

**Source:** LSO generated from BLC rules and regulations.

Beyond the BLC regulations are regulations specific to oil and gas operations, promulgated by the WOGCC. A person wishing to drill an oil or gas well in Wyoming, whether on public or private land, is required to comply with these rules. WOGCC regulations apply more broadly than just to split estates. They provide for the location of wells, bonding requirements, applications for permit to drill, well completion, reporting, well abandonment, drilling rules, blowout preventers, measurement, and protection of the environment. The WOGCC must issue a permit prior to the commencement of any oil and gas operations.

**State-owned surface estate.** Chapter 4 of the BLC rules and regulations (Attachment D) deals with grazing and agricultural leasing. Section 13 addresses surface impact payments. In contrast with federal requirements, the state regulation protecting the surface is tied to the surface estate. Generally speaking, anyone who has not otherwise obtained permission to enter land owned by the state and leased to a private interest and so desires is required to contact the lessee prior to entry to establish a surface impact payment for the entry upon the premises. Surface impact payments:

- ✓ shall be shared between the lessee and the BLC with the BLC getting 60 to 80 percent of the payment; and
- ✓ may be negotiated by the lessee, provided that any payment is consistent with payments for impacts to adjacent lands; or
- ✓ may be established by the BLC upon recommendation of the OSLI if the person desiring entry upon state lands is unable to reach an agreement with the lessee regarding a surface impact payment after having negotiated with the lessee in good faith for 90 days.

If either party wishes to appeal the director's decision, it will be treated as a contested case under Wyoming law (W.S. 16-3-107 et seq.). The person desiring entry and the lessee shall pay the cost of the contested case hearing in equal shares.

The decision of the BLC establishing the surface impact payment shall constitute final agency action. The person desiring entry may immediately enter the state lands while negotiations with the lessee are proceeding, after providing the OSLI with a deposit for the surface impact payment.

**State-owned mineral estate.** Chapter 18 of the BLC rules and regulations (Attachment E) deals with leasing of oil and gas. There is no mention within this chapter regarding surface owner accommodations. Section 3 allows the BLC to condition the issuance of any oil and gas lease upon "specific stipulations for the protection of the public, the environment, the waters of the state, historical, archeological or paleontological materials, the wildlife resources, or any of the subsurface or surface resources of the state."

Section 12 addresses surface integrity and minimum reclamation. Mineral lessees are held responsible for any damages caused by their operations. Upon completion of operations on state lands, all related disturbances must be reclaimed to leave the land in "as near as practicable to the original condition of the land prior to operations."

Section 13 deals with bonds. Before commencing actual operations, the lessee is required to submit a copy of Oil and Gas Conservation Commission Form 1, Application for Permit to Drill, to the OSLI. Operations shall not commence until an adequate bond has been furnished and approved. The bond must bind the mineral lessee for the payment of all moneys, rents, and royalties accruing to the BLC and for payment of all disturbances to the surface land and improvements.

The lessee is required to advise the OSLI of any change in operations. The OSLI may reduce or increase the amount of the bond as conditions may require. In lieu of individual lease bonds, the lessee may be allowed to file a corporate surety bond of at least \$100,000 to cover all operations in the state. Finally, the director of the OSLI may

require a per well bond instead of allowing bonding per lease.

**Other mineral regulation.** W.S. 30-1-119 provides for the protection of surface proprietors where a mining right exists and is separate from the ownership, or right of occupancy, to the surface. However, it should be noted that this regulation applies to mining activity, not oil and gas operations. In these cases, the surface owner or rightful occupant may demand satisfactory

security from the mine operator, and if such security is refused, they may enjoin the mine operator from working the mine until such security is given. In such a case, the order for the injunction shall fix the amount of the bond.

**POTENTIAL CONCERNS AND CONCLUSION**

Table 2 illustrates the different regulations that would control under different ownership scenarios. It illustrates both current regulations and what would have happened if HB 70 passed.

**Table 2. Regulations Controlling Under Different Surface and Mineral Ownership.**

		Surface Ownership		
		Private	State	Federal (including Indian)
<b>Mineral Ownership</b>	Private	split estate- no regs	BLC regs (never applied)	no regs
		unified estate- no regs		
		<i>HB 70</i>		<i>BLC regs (never applied)</i> <i>HB 70</i>
	State	no regulations	BLC regulations	no regulations
		<i>HB 70</i>	<i>BLC regs (no change)</i>	<i>HB 70</i>
		OO #1	OO #1	Direct negotiations
Federal (including Indian)	OO #1	BLC regs (never applied)		
	<i>OO #1</i> <i>HB 70 (if applicable and not preempted)</i>	<i>OO #1</i> <i>BLC regs (never applied)</i> <i>HB 70 (if applicable and not preempted)</i>	<i>Direct negotiations</i> <i>HB 70 (if applicable and not preempted)</i>	

**Source:** LSO generated.

**Notes:** Regulations printed in regular font in the upper boxes indicate the current status. Regulations printed in *italics* in the lower boxes assume passage of HB 70. Shaded areas indicate a unified estate.

**Key:** BLC regs = Board of Land Commissioners Rules and Regulations; OO #1 = Onshore Order #1

While no federal or state law explicitly requires the state to exempt federal, state, or Indian property from state legislation designed to accommodate the rights of surface owners in oil and gas operations, there are potentially consequences for failing to do so.

- ✓ Federal regulations may preempt state law to the degree that the federal law sufficiently addresses the concerns promoted by the state law.
- ✓ There may be a duplication of requirements for oil and gas operators with existing state and federal regulations.

- ✓ In fulfilling the requirements of all applicable laws, oil and gas operators may be required to post multiple bonds, each regulated under different rules.
- ✓ The procedural and financial complexity may discourage drilling by oil and gas operators.
- ✓ Existing BLC rules may be required to be rewritten, as they may be contradictory to state law, or produce a duplication of requirements.

There are also potential consequences should the state elect to exclude federal, state, and Indian property in state legislation designed to accommodate the rights of surface owners in oil and gas operations.

- ✓ It would be up to the BLM and the BLC to establish sufficient surface owner accommodations.
- ✓ State law applying to non-state and non-federal property may be more or less severe than regulations promulgated by the BLM or the BLC, creating incentives to pursue oil and gas operations based upon property ownership.

Federal regulations governing both the federal and Indian mineral estates will likely continue to exist in their present form regardless of any state legislation. They presently require notice, negotiation or bonding, compensation for damages, and reclamation for surface lands overlying the federal mineral estate. The OSLI has articulated a preference that state property be excluded in the case of a *unified* estate held by the state but has not objected to the inclusion of state owned property in the case of a true split estate. Existing BLC rules regulate both the surface estate and oil and gas operations. There is no current law or regulation to protect private surface owners when the underlying mineral estate is held by another private entity.

#### **CONTACTS FOR MORE INFORMATION**

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