SURFACE USE AGREEMENTS[1]

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It has long been a truism of natural resources law that a severed mineral estate is dominant over the surface estate in the same tract. The reasons are well known and documented.[2] Mineral owners and lessees have for decades relied on this analysis to gain access to their mineral estate, and many have given little thought to the idea that it could be otherwise. However, things are changing in the West, where most split estates conflicts arise, particularly where new residential development is competing with oil and gas drilling and other mineral development. New patterns of development, both on the surface and in the subsurface, are sharpening the conflicts between mineral owners and surface owners. New waves of in-migration to rural areas, which in the past were sparsely populated and might have been primarily valuable for grazing or raising forage crops, have filled the landscape with new surface owners, many of whom were either not aware of or not concerned about the implications of buying surface ownership in a split estate. Many of these new owners are not the type to take things lying down, and can be aroused when told that their piece of paradise is subject to an

[1] "Negotiating a Surface Use Agreement for Private Lands," by David Patton (Rocky Mtn. Min'l L. Fundtn. Special Institute, Nov. 4-5, 2004) was an indispensable resource in drafting this paper.

[2] The generally accepted reason is that the subsurface estate can be rendered worthless if its owner cannot access it. *Moser v. U.S. Steel Corp.*, 676 SW.2d 99 (Tex. 1984); *Magness v. Gerrity*, 946 P.2d 913 (Colo. 1997). Most courts have held that mineral rights owners have an easement to use as much of the surface as is reasonably necessary to enjoy the mineral estate. *See* Am Jur 2d Gas and Oil §§ 115-141 (2004) (citing numerous cases). *See also*, Donald Zillman, "The Common Law of Access and Surface Use in Oil, Gas and Mining," *Severed Minerals, Split Estates, Rights of Access, and Surface Use in Mineral Extraction Operations 1A-2* (Rocky Mtn. Min'l L. Fundtn. 2005).

implied easement to facilitate mineral development.

As a result, the old ways are changing, and surface owners now have much more to say about where and when mineral development can occur, particularly where the mineral interests are privately owned.3 Surface use agreements are one way to deal with this conflict.

Background

The fundamental problem of any surface use agreement is balancing the mineral owner's (or lessee's) right to develop its mineral interests, which necessarily entails a right of access, right of reasonable use of the surface for temporary and permanent installations, right to alienate and right to receive economic rents, against the surface owner's rights to use the land for agriculture, to develop the surface for other economic uses, to subdivide and sell the surface, to control ingress and egress, and to receive whatever economic rents she may legally obtain from the surface estate. Resorting to the classic formulation of the mineral estate as the dominant interest and the surface estate as servient, does not solve the problem; it merely frames it. Neither party's rights are absolute4, and the problem is always to protect as much of your client's interest as possible, without overreaching. When we add society's increasing interest in regulating and controlling mineral and surface development activity through zoning, land use regulation, pollution and conservation regulation, and local government

[3] In the past year, Wyoming has enacted a Surface Entry Act, W.S. 30-5-401 *et. seq.*, effective July 1, 2005, that imposes new requirements of notice, good faith negotiation toward a surface use agreement or, in the alternative, posting of financial assurance, and that provides for compensation to surface owners in split estates. This brings to ten the number of states having such statutes. The Colorado legislature is debating a split estates bill, HB 1185, as of the writing of this article. If enacted, it will require similar concessions to surface owners. New Mexico's "Surface Owner Protection Act" legislation, HB 437, died before the end of the 2005 legislative session. All of these bills legislatively modify (or would if enacted) the common law dominance of the mineral estate over the surface estate, and shift substantial power to the surface owner.

[4] For example, in *Gerrity Oil & Gas Corp. v. Magness*, 946 P.2d 913 (Colo. 1997), the Colorado Supreme Court imposed a duty of due regard on mineral owners, and characterized the

permit and special review processes, we have the potential for a significant degree of conflict.

Surface use agreements are one piece of the solution. Through negotiation and contract rather than confrontation and litigation, parties can resolve competing interests in a way that apportions benefits and burdens voluntarily; surface owners and mineral owners can each come away with a sense that they have gotten most of what they need at an acceptable cost.

I. The Essential Elements

The following elements must be identified and present for a surface use agreement to be formed and enforceable.

A. Parties

The correct necessary parties must be identified and joined in the agreement. Without all of them, the purposes of the agreement may be frustrated. The parties may vary, depending on the facts of ownership of a given parcel. The following examples are intended to show how surface use agreements' effectiveness may vary depending on which parties are joined.

i. Surface Owner owns fee simple: Where, the surface owner is also the mineral owner, the mineral lessee is dealing with the owner or owners of the unified estate. The lessee/operator needs to be sure he or she is negotiating with all interest owners. An undivided fee simple estate may have many fractional interest owners, and they should all be included in any agreement. Ideally the surface use issues are dealt with in the lease negotiations; this is the logical and appropriate time to address them because the fee owner shares in the benefits of mineral development while bearing the burden of surface damages.

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surface estate and mineral estate as "mutually servient."

ii. Surface and minerals are severed:

a. No mineral lease: Where there are unleased severed minerals, only the mineral owner and surface owner are involved, and no other parties are required. The mineral owner deals directly with the surface owner, and can reach an agreement that binds both parties and their successors and assigns. A potential lessee can deal with the mineral owner only, and later try to deal with the surface owner, or he can try to wrap up both owners at the same time. Any agreement should be transferable with the signatories' interest, and should bind future lessees or assignees. If that is not the case, then one or both parties to an agreement may find its purpose frustrated by a subsequent transfer of interest and failure of the new owner to enter into an agreement.

b. Existing mineral lease: If the mineral estate has been severed and leased, then a surface owner faces the problem of whether to include both the lessee and the mineral owner in a surface use agreement, or deal only with one or the other. In most cases its best to obtain the signature of both mineral owners and lessees if possible. If the mineral owner does not participate in an agreement, then only the lessee is bound, and the agreement will last only as long as that lease exists. As a result, the surface owner may face the same problem repeatedly with successive lessees. On the other hand, it may not be realistic to try to future lessees by committing the mineral owner to

terms in perpetuity.

c. Severed executive rights: Not all mineral interest owners have the right to execute leases,[5] but surface use agreements may affect their interests. Where there are significant non-executive royalty interests in a tract, it is a good idea to try to get royalty owners as well as executive rights holders to ratify any agreement with the surface owner if the agreement significantly affects the mineral owners' or lessees' ability to develop its estate. Although the non-executive rights owner lacks the legal right to bind the owner of the executive interest to a surface use agreement, the holder of the executive right may have duties of diligent development that may be abrogated by a restrictive surface use agreement. Depending on the facts of the situation, the executive rights holder may want to consider obtaining the concurrence of the non-executive owner in any agreement that may restrict its freedom to develop.

iii. Separate surface lessee:

Normally a surface lease that comes into existence after the severance of minerals will be subject to the same implied easements as the surface ownership. However, when the surface lease predates the severance, then the surface lessee's interest may not be burdened by the implied easement in favor of mineral development. In that circumstance, it may be necessary to include the holder of a pre-severance surface lease as a party to any agreement, to ensure that everyone's

[5] 2 H. Williams & C. Meyers, Oil and Gas Law § 338 (2004).

competing rights and interests are reconciled and protected.

B. Description of Lands Covered

After identification of the parties, proper description of the affected lands in a key consideration. The lands covered by the agreement must be described in particular, in a way that will allow third parties to find the described lands. The agreement, or a memorandum, should be recorded. This is essential to have any agreement run with the land, to bind successors and assigns, and to put strangers to the agreement on notice. Obviously, recording the agreement itself may disclose its terms; in highly competitive plays, where disclosure of terms can rapidly drive up lease costs, operators may want to impose a confidentiality provision and record a memorandum instead.

C. Delineation of Restricted Areas and Activities

If operations are to be barred from, or restricted to, certain areas on the lands, those inside boundaries should be described as carefully as the outside boundaries overall lands covered by the agreement. Prohibited activities must be clearly stated. Restricted hours of operation must be set forth clearly. In this area of any surface use agreement, clarity is essential to avoid later misunderstanding.

D. Notification and Consultation

This is often an extremely difficult issue. If the prospective agreement will require the operator to notify the surface owner in advance of certain activities, then the parties must specify what will be subject to notice, and how notice will be provided. Surface owners may need to notify operators of activities that could interfere or conflict with oil and gas operations, such as plowing, irrigation, and harvesting. Most parties will be able to work out a practical system; one warning sign of potential trouble is an insistence on unreasonable notice and consultation requirements on either

side, or overly detailed documentation demands.

Activities for which notice and consultation may reasonably be expected include:

1. Seismic work
2. Use of access points
3. Construction or modification of locations for wells, tank batteries, meter and processing equipment
4. Construction or modification of roads, flowlines, gathering lines and power lines
5. Compressor siting
6. Cutting of fences or trees
7. Moving in/drilling and workover operations/ moving off
8. Core drilling
9. Trenching/bulk sampling
10. Blasting
11. Stripping/Excavation

E. Life of the Agreement

Any surface use agreement should clearly express the parties' mutual intent concerning the life of the agreement. If an agreement is not to be in perpetuity, it should clearly state the conditions under which it will end. If it is to be perpetual, then it must be made binding on all heirs, successors and assigns, and should include the mineral owner (not only the lessee) and be filed in the record as a covenant running with the land.

F. Exclusivity/Non-exclusivity

Parties must clearly address the question of whether the rights granted and reserved are exclusive. The surface owner may lease his property or otherwise allow third parties to use it, but may not grant others a greater right to interfere with mineral operations than he enjoys himself. Operators should pay close attention to the possibility that the surface owner may allow others to use the surface in a way that may interfere with operations, and attempt to address that issue in the agreement.

G. Payments

1. Damages

As stated earlier, the classic formulation holds that mineral owners may make reasonable use of the surface, without having to pay for access or for damages that are reasonable (unless payment for damages is provided for in the lease agreement). True as that statement may be, damage payments are often an important consideration in any surface use agreement. They offer something to each party. The surface owner gets compensation where none might have been due; the operator gets a settled, liquidated amount, rather than a festering controversy. In addition, the operator will get clearly defined rights that may be greater in scope than under the implied easement. Both parties get an agreement that spells out explicitly what their relative rights and responsibilities are in the context of a specific piece of property.

2. Easements

All mineral operations require easements providing access for exploration, development and production. Although such easements are implied covenants in any lease, operators and surface owners often find it useful to define them, and settle on a fee for them. Fees may include payments for use of road, flowline and gathering line easements, use of easements to support off-premises production activities (for which an implied easement may not exist); rental of property for other facilities that serve off-premises operations: payment for loss of crops or loss of use of agricultural land, and general consideration for concluding an easement agreement.

Fees are appropriate when a mineral operator is obtaining easements for facilities to support off-premises production, since this is generally outside the scope of the implied easement for access to the minerals on premises.

Any fee agreement should spell out clearly what is being granted, what is being compensated for, what property is being burdened and what appurtenant estate, if any, is being benefited.

H. Prescribed Locations of Facilities and Drillsites

The location of the operator's facilities and operations are usually a significant concern of the surface owner. The operator is often able to accommodate the surface owner's needs, but a number of issues can arise.

1. Location of access roads/flowlines/gathering lines. Surface owners may request an access route that protects them from having oilfield traffic pass through their yard, through a planted field, or through some other favored place. Often their preferred route will be longer, or more difficult to engineer and construct, or may even be on their neighbor's property. This can present a difficult problem for the operator, as accommodation can be expensive, difficult or impossible. In particular, the request to have an access road located on another surface owner's property can present a difficult negotiation problem. Such requests can be honored if the neighbor is willing to grant an easement, but more often the operator has to refuse. In these cases, the surface owner should be prepared to negotiate the easement with its neighbors.

   While flowlines don't present the same traffic problem, surface owners often prefer to have them located similarly.

2. Location of Drillsites. Drillsites often are initially staked somewhere that horrifies the surface owner. Lessees may have considerable latitude to move

the location.[6] The bottom-hole location will usually be dictated by geology, engineering, and spacing requirements. However, it is usually possible to move the surface location and drill directionally. This increases the time and expense of drilling, which affects the economics of any project. Therefore, operators usually request that surface owners bear some or all of the additional cost of drilling directionally. This can lead to hard feelings during consultations, as many surface owners are not familiar with the technical limitations on directional drilling, and may not appreciate the way increases in capital cost can profoundly affect the economics of a project.

3. Location of Wellhead Facilities. Tanks, treaters, separators and meters will normally be located close to the well head; surface owners and producers may agree to specified locations that reduce their visibility, or that do not interfere with the surface owner's use of his property. Again, cost may be a factor, and should be subject to negotiation.

4. Clarity and Specificity. In all of these issues, it is best for operator and surface owner to meet onsite, agree on locations of wellheads, facilities and access ways, survey in the agreed-on-locations, and then reduce them to an agreement and a plat.[7]

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[6]On the other hand, state spacing regulations may restrict the bottom hole location to a narrow window, *see* COGCC Regulation 318A, and will generally prohibit drilling too close to a property line, *see* COGCC Regulation 603.

[7]Colorado's regulations require that an operator have an on-site meeting with the surface owner, although the surface owner may waive it by a signed document. *See* COGCC Regulation 305. Rules recently adopted by the Colorado Oil & Gas Conservation Commission have broadened

II. Other Issues

1. Scope of damages covered by the agreement

This is a key area that must be given careful consideration. The scope of settled damages should be specified, and (from the operator's perspective) everything not specified should be excluded, to avoid open-ended claims. From the point of view of the surface owner, a mechanism to recover for unspecified, unanticipated damages should be provided.

2. Construction standards for roads, bridges, culverts, fences, cattle guards

In those instances where an operator agrees to move, construct or reconstruct culverts, fences, cattle guards and similar structures, the parties should specify the standards that are mutually acceptable. Often county standards can be used.

3. Prohibition against hunting, fishing, firearms

Many surface owners seek assurance that employees, agents, contractors and others on the site will not hunt, fish, or bring firearms onto the site. A related requirement is a prohibition against trespassing generally; the surface owner and the mineral operator should agree on the scope of use of the surface, and that no expansion of that use will occur without further agreement.

4. Pollution

Pollution is regulated by federal and state laws, regulations and enforcement agencies. Surface owners may attempt to obtain commitments from operators to comply with higher standards

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the right to an on-site consultation, by providing that the surface owner may request the Commission to make an on-site inspection in advance of approving an application for a permit to drill. The on-site inspection is to determine whether the Commission should attach additional protective conditions to the permit, but it may also address "unresolved issues related to the proposed well." The Commission may require an operator to make additional efforts to mitigate surface, noise, visual, dust, ground water or other impacts. *See* OGCC Order No. IR-96, Jan. 10, 2005.

or agree to contractual enforcement mechanisms. Operators will want to affirm that they are obligated to comply with applicable laws and regulations. Operators should avoid granting surface owners a contractual right to enforce laws and regulations, as the potential for confusion and double penalties can be quite high.

5. Restoration/reclamation

Similarly, most reclamation and restoration standards are prescribed by regulatory agencies. While operators and surface owners may agree to more stringent requirements, operators should not do so without careful consideration. As with environmental standards, operators should try to avoid granting the surface owner a contractual right to enforce state reclamation standards.

6. Use of surface water, well water, produced water

Water is a difficult issue in the oil patch, made much more so by the complex interplay of water law and water quality regulation. Coalbed methane development, for example, requires the pumping and discharge of large amounts of formation water as part of the production process. While produced water may sometimes be a boon to the surface owner, it often is not, either because it is too salty or because the water chemistry interacts negatively with soil chemistry. If the operator intends to use surface water or well water in its drilling operation, it is important to spell this out in the agreement, because water quantity represents an important property interest.

Similarly, the operator who wants to discharge produced water should satisfy itself that it has the blessing not only of any permitting agency with jurisdiction, but the owner of the surface whose property will be affected. Significant damages claims can arise from a misunderstanding, or from assuming that surface owners will want produced water.

III. Financial Sureties

The issue of financial surety is distinct from the payment to the surface owner for a surface use agreement. Usually termed "bonding," financial sureties are the operator's promise to pay a certain amount to ensure the performance of its statutory duties, or to compensate surface owners for damage that may occur, even if the parties do not enter into a surface use agreement. Many states require operators to post financial assurances as a requirement of being permitted to operate; the federal government requires their posting as a condition of obtaining access to federal minerals under split estates.[8]

A. State Requirements

A number of states require that operators post surety as a condition of obtaining any permit to operate.[9] A few also require that operators post bonds to compensate surface owners for damages, or as a condition of gaining access to severed minerals.[10] Operators may post bonds for individual well permits, or may post a larger statewide bond to cover all their operations.

B. Federal Requirements

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[8] *See, for example,* the Stock Raising Homestead Act, 43 U.S.C. § 299.

[9] Colorado: COGCC Regulations Part 700 govern the posting of bonds as part of the overall permitting process.

[10] *See* Alaska Admin. Code tit. 11, §§ 83, 158, 83.160 (Loislaw.com through 2004 Legis. Sess); Alaska Stat. § 38.05.130 (Loislaw.com through 2004 Legis. Sess); 756 Ill. Comp. Stat. 530/1 to 530/7 (Loislaw.com through 2004 Legis. Sess); Ind. Code §§ 32-23-7-1 to 32-23-7-6 (Loislaw.com through 2004 Legis. Sess); Ky. Rev. Stat. Ann. § 353.595 (Loislaw.com through 2004 Legis. Sess); Mont. Code Ann. §§ 82-10-501 to 82-10-511 (Loislaw.com through 2004 Legis. Sess); N.D. Cent. Code §§ 38-11.1-01 to 38-11.1-10 (Loislaw.com through 2004 Legis. Sess); 52 Okla. Stat. Ann. §§ 318.1 to 318.9 (Loislaw.com through 2004 Legis. Sess); 58 Pa. Stat. §§ 601.102 to 601.401 (Loislaw.com through 2004 Legis. Sess); 25 Pa. Code §§ 78.21, 78.51, 78.65 (Loislaw.com through 4002 Legis. Sess); S.D. Codified Laws § 45-5A-1 to 45-5A-11 (Loislaw.com through 2004 Legis. Sess); Tenn. Code Ann. §§ 60-1-601 to 60-1-608 (Loislaw.com through 2004 Legis. Sess); W.Va. Code Ann. §§ 22-7-1 to 22-7-8 (Loislaw.com through 2004 Legis. Sess); Wyoming Stat. Ann. § 30-5-401 *et. seq.* (2005).

The Federal Stock-Raising Homestead Act also requires that prospective operators post bonds to protect the interests of surface owners as a condition of access to the surface.[11]

IV. Current Developments

As noted above, Wyoming law has recently adopted legislation requiring mineral owners and surface owners negotiate and reach agreement as a condition of the mineral owner's ability to develop its property.[12] Colorado and New Mexico are considering comparable legislation. Others have had such requirements for decades.[13] The broad outlines of all are similar. Where private surface estates exist, mineral operators must attempt to negotiate a surface use agreement before they may develop their property. If the parties are unable to reach agreement, the mineral owner may post a bond or surety with the state, as a condition of being able to drill. The purpose of the bond is to compensate the surface owner in the event the operator fails to reclaim or otherwise unreasonably uses the surface. Mineral operators must provide varying degrees of notice and disclosure to the surface

[11] 43 U.S.C. § 299(a) provides that a "person who has acquired from the United States the coal or other mineral deposits in such land, . . . may occupy so much of the surface . . . [as may be reasonably required]. . . ." However, the mineral leasee must either (1) obtain the written consent of the surface owner, (2) pay for damages to crops and tangible improvements, or (3) post a bond with the United states sufficient to compensate the surface owner for damages. The surface owner must bring an action on the bond to get compensated. This "bonding on" provision is the source of a great deal of resentment in the coalbed methane play in the Powder River Basin.

[12] *See* Wyoming - "Split Estates - Procedures for Oil and Gas Operations," W.S. 30-5-401 through 410. The Wyoming bill adopts an approach analytically similar to that of the Federal Stock Raising Homestead Act. However, it abrogates the implied easement by requiring payment for all loss of use and diminution of market value. In addition, it codifies notice and consultation requirements and gives the surface owner a right of action if the mineral owner does not comply. Colorado's bill mandates that the parties reach an agreement, or in the absence of an agreement, appraisal and arbitration will follow. The bill provides that operators may be required to pay for all damages, including loss of property value. This provision for payment of damages due to market value diminution, if enacted, would be a significant change from prior practice in Colorado.

[13] *See* footnote 8.

owner before starting any activity, and surface owners are given greater access to the administrative process for reviewing and approving applications for permits to drill.

V. Conclusions

The operator's rights under the implied easement for development are gradually being replaced with a codified form of the accommodation doctrine. Surface use agreements are another piece of the ever-more-complicated puzzle that operators must assemble when putting together a play. The benefits to be gained from them are substantial, if the parties deal fairly and openly toward resolving real issues.