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Surface Use Agreement: Representation of the Surface Owner

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THE SPLIT ESTATE

Prior to explaining specifics as to typical terms and conditions of a Surface Use Agreement ("SUA"), it is important to first understand the unique nature of the split estate as it exists in Colorado and, indeed, throughout most of the western United States.

Initially, it is important to understand some basic terminology. There exists in law what is referred to as the dominant estate and that of the subservient estate. As one might guess, the dominant estate takes priority over the subservient estate.

It is this general characteristic of dominant and subservient estates that at first confuses many people as it pertains to mineral rights. Colorado, and again most of the western United States, permits the severance of estates. For the purposes of this discussion, the two estates are referred to as those involving surface rights and mineral rights. It is important to understand that the owner of property can sell the surface rights to his property, but retain or otherwise convey to another third party the rights to the minerals. This type of transaction causes what initially is described as a unified estate to become severed. The mineral estate is said to be severed from the surface estate. These mineral rights include, when properly drafted, the rights to oil, natural gas, and many minerals, including, but not limited to coal, copper, etc.

It is the nature of these split estates that creates the dominant and subservient estate. Because both federal and state laws have always encouraged mineral and natural resource exploration since Colorado statehood in 1876, it is the mineral estate that is deemed to be dominant over the

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subservient surface rights. This means, in the simplest terms, that is the owner of the mineral rights that has reasonable access to the surface of the property so as to explore and develop mineral rights. Accordingly, the owner of the mineral rights has an absolute right to reasonable use of the surface to explore and develop said mineral rights, even in the event that the surface right owner has no interest in the development of such mineral rights or objects to exploration or development of the same.

Sometimes, it can be a bit confusing as to whether or not the mineral rights have been severed from that of the surface rights. Like many real property rights, this severance of mineral rights cannot be done by oral agreement alone. If you believe that the property that you own or may purchase does not itself include mineral rights, the first place to look would be the Title Insurance purchased at the most recent time the property was conveyed. Unfortunately, in many instances title companies were not used at the time the property was conveyed and there was never title insurance secured as to that given property. Hence, no Title Commitment is available. In other instances, property rights were so long ago acquired that the underlying title abstracts are no longer available for common examination. As such, it might be necessary to secure the services of legal counsel or landsmen to conduct a title search as to the mineral interests. This title search can be conducted at the Clerk and Recorder's office of your local county government. Always be certain that you are in possession of accurate information as to the mineral rights before beginning to negotiate any SUA.

It is also important to understand that merely because the mineral rights are dominant to the surface rights does not mean that the beneficiary of such mineral rights has unfettered and unilateral discretion to impose upon the surface in any way they see fit so as to explore and develop mineral resources. While it is true that the mineral owners have a right to access, this right must be seen as collaborative in nature and customarily is subject to negotiation. The result of successful negotiation between the surface owner and operator as to these rights is the SUA.

Included is a copy of "Tension Beneath the Surface: The Evolving Relationship Between Surface and Mineral Estates" by Robert E. Witwer as published in the December, 2001 edition of the Colorado Lawyer. Some of the information is outdated, but the article provides a thoughtful treatment of legal issues involving surface use and mineral estates.

THE SURFACE USE AGREEMENT

The SUA is also sometimes referred to as a Surface Damage Agreement ("SDA") or Surface Use and Damage Agreement ("SUDA"). These differences as to the name of the document are more semantic than substantive in nature and each are typically negotiated by the surface owner and a company representative, often a landman. No matter the name, SUA's in practice are an evolving document. An SUA that was negotiated ten years ago often will not adequately address

all the issues currently being presently considered.

As an aside, never be shy to discuss the terms and conditions of any proposed SUA with your neighbors, your local conservation district representative, or even representatives of your local oil and gas conservation commission. If nothing else, you will quickly learn that which is reasonable and customary in your area. Please also recall that the by-word of this entire process is "negotiation". It is important not to be shy when you negotiate. This is not to suggest that it is appropriate to be overly aggressive in setting forth suggested terms and conditions. On the other hand, those experienced in these negotiations realize that it is important to stand your ground. Some landsmen and other company representatives, although certainly a vast minority, rely upon intimidation tactics and threats in an attempt to pressure individuals or entities to execute an agreement that is not favorable to their interests. Never take such an approach personally if you experience that tactic.

The following is a preliminary outline of issues to consider when negotiating an SUA:

1. Make sure that you are working with an experienced individual with knowledge as to important issues and preparing SUA's. While it not always necessary to retain an attorney, make sure that you are, at a minimum, working with an experienced landman or other individual that understands and is conversant as to SUA's.

2. Make certain in advance of starting negotiations that surface water rights (including reservoirs and diversion systems) and ground water rights (including springs and wells) are documented by appropriate permits or other legal decrees so that there is no dispute as to ownership of the surface water rights in question are yours. Without digressing too substantially, water rights in Colorado are essentially that of appropriation, not riparian nature. This means that merely because water is located on your property or runs through your land does not mean that you possess any rights to these waters.

3. Make sure that the entity that will be actually drilling on your property has a Water Management Plan ("WMP") and, as appropriate, access to a Water Shed Management Plan (addressing drainage on your property, not necessarily drainage of the entire drainage basin). These documents will permit for a better understanding of water related issues that might impact your property.

4. When negotiating access rights, make certain that you are not merely addressing access to the property in question as a whole, but rather access to each potential well specifically. While it is common that only a single well will ever be drilled on your property, concerns in the event that multiple wells are drilled need to be

thought out thoroughly in advance.

5. Address trans-boundary issues (i.e. impacts experienced on other properties resulting from development which occurs first on your property) that include, by way of illustration, water trespass, dust, noise, artificial light, and the like that may effect not only yourself, but your immediate neighbors. There exist a wide array of exploration and development activities that occur on your property first. It is necessary, particularly in the event that the surface owner does not actually reside upon or actively utilize their property, that they consider a "good neighbor" policy considering the rights of others, particularly those that are down stream or down wind of exploration activities.

6. As alluded to above, never hesitate to visit with your neighbors to determine the current and customary SUA terms and conditions being utilized in your area. You may find that what you believe to be customary is anything but the case.

7. Always keep in mind that some of the impacts from exploration and development do not become apparent for several years; sometimes many, many years. Make certain that your SUA provides significant latitude in addressing such future issues. For instance, the impact on water wells might not be experienced for years. Make sure to address testing as to the quality and quantity of water. Please also be aware that in the event producing quantities of oil and gas are located your property, the producer will not be expected to be responsible for the normal aging and wear and tear on facilities.

8. Understand in advance that the SUA is not "magic wand" so that every conceivable future problem of the exploration and development of oil and gas on your property will be addressed. Unfortunately, such simply is not possible. This is especially true with the impressive advancement of technology. That being said, a good SUA will address a wide variety of issues that typically arise between the producer of oil and gas and the surface owner.

9. Lastly, retain a good professional to assist you with all these considerations.

Please recall that these recommendations are not in any fashion meant to be comprehensive. No mention is made of perhaps the key issue, financial compensation for use of the surface or damages if the property is injured. Additional areas of concern include, <u>but are not limited to</u>, those involving surveyors, seismic activities, debris and trash, operations in mud and snow, water protection, soil protection, noise pollution, light pollution, air pollution, protection of view corridors, protection of vegetation resources, protection of wildlife resources, lost to livestock, cooperation with others as to roads and water storage, drilling operations and details thereof,

impacts upon recreational uses, issues pertaining to reclamation, parking of equipment off-road, access points into areas of development, time of operations, limitations on operations, cooperation with other companies, changes in locations of roads, electric lines, and wells, cooperation and coordination with other governmental agencies, legal concerns, allocation of attorneys fees and costs in the event of breach, financial issues, damages, introduction of pipelines, compressor stations, above ground electrical lines, below ground electrical lines, service access points, and road maintenance. Those familiar with negotiating SUA's will be able to readily determine which issues impact your property.

BENEFITS OF NEGOTIATING A SURFACE USE AGREEMENT

The main benefit of entering into an SUA is that such provides an executed legal document setting forth with specificity issues and agreements thereupon. In advance, both the surface user and the development company know that if the company does not adhere to the terms and conditions of the agreement, they can be taken to court and if the surface owner prevails, the development company will typically will have to compensate the surface owner for attorneys fees and costs reasonably incurred in enforcement of the SUA.

Without an SUA, the operator still has the right to post a bond and unilaterally decide what is reasonable and necessary use of the surface. Under those circumstances, the remedies of the surface owner include litigation which is no doubt lucrative for your legal counsel, but not profitable to the surface user. Recovery of attorneys fees under these circumstances can be very difficult.

Furthermore, the negotiation of an SUA is an opportunity to focus upon issues that are important to any given property. By way of example, a surface use owner recently represented by this firm was involved in guide and outfitting operations on his property during each fall. During those weeks, it was essential that the oil and gas developer was not on the property. Because this was a priority to that surface owner, it was identified as an issue. A compromise was reached that allowed oil and gas development to advance, on the one hand, but that successful guide and outfitting could also occur.

DRAW BACKS OF ENTERING INTO AN SURFACE USE AGREEMENT

It is almost universal that the right to claim damages for trespass upon unreasonable use of the surface is waived as a term and condition of an SUA. There are also instances where the amount of money being paid by the development company to the surface owner to enter into an SUA *vis a vis* the written concessions allowed the land user as so small that the surface user might benefit from refusing to execute an SUA.

Lastly, as referenced above, SUA's simply are not perfect written documents. No matter how

much time and effort is spent in negotiating the same, it is very frequently the case that it is impossible to foresee each and every potential contingency that may occur in the future, particularly when it is sometimes the case that problems arise years after the SUA is entered into. Particularly with expanding and improving technology, many issues might exist that simply could not have been foreseen at the time the SUA was entered into.

LEGAL RIGHTS UNDER COLORADO LAW WHERE A SURFACE USE AGREEMENT IS NOT SUCCESSFULLY NEGOTIATED WITH THE OPERATOR

Generally speaking, it is the Colorado Oil and Gas Conservation Commission ("COGCC") who is responsible for implementation of regulations as to oil and gas exploration, development, and operations. An objective of the COGCC Regulations is to attempt to minimize surface damage and expedite a complete and satisfactory reclamation. Unfortunately, there currently exists no requirement that a Surface Use Agreement must be entered into with oil and gas operators.

Oil and gas operators are required to first consult with surface owners, although not necessarily their tenants, about such matters as establishing access roads, siting well pads, and attending to details of final site reclamation. However, absent an SUA no compensation is due as a legal matter to the surface owner for the reasonable use of the surface.

That being said, agreements are frequently reached regarding the location of oil and gas facilities and the timing of operations so as to avoid disputes between surface owners and industry, with an eye specifically towards minimizing litigation. In most instances, operators voluntarily negotiate agreements with landowners for use of the surface in the drilling, completion, and, if successful, production of wells. In order to address the circumstances where surface owners incur significant damages to crops or their the surface as a result of oil and gas exploration, development, or operations, COGCC regulations require that oil and gas operators post a bond to cover the cost of remediation.

Operators are required to first provide to the COGCC financial assurance prior to commencing any operations involving heavy equipment. This is to allow surface owners that are not parties to the lease to be compensated for unreasonable crop loss or land damage caused by such operations. COGCC Rule 703 discusses this matter.

More recently, the Colorado Supreme Court in *Gerrity Oil & Gas Corp. v. Magness,* 946 P.2d 926 (Colo. 1997) established guidelines pertaining to the competing interests and rights of the split estate. The Court emphasized that there exists no absolute right held by the surface use owner to exclude another from use of the surface. The Supreme Court further held that resolution of split estate conflicts should be guided by the principle of "due regard" underscoring that the holder of mineral rights must "accommodate surface owners to the fullest extent possible consisting with the right to develop the mineral estate". The Colorado Supreme Court stated that

in instances where alternative methods of mineral resource extraction are available, those possessing oil and gas rights had an obligation as a consequence of the Doctrine of Reasonable Surface Use to avoid methods that "preclude or impair uses by the surface owner". A copy of that case is attached hereto for your review. As set forth above, COGCC Rule 703 specifically requires that operators are required to provide financial assurance to COGCC of $2,000.00 per well on non-irrigated land and $5,000.00 per well on irrigated land before any drilling operations with heavy equipment commences. This is to protect surface owners against unreasonable crop loss or land damages. In addition, operators can instead elect to provide a statewide, blanket financial assurance to COGCC for $25,000.00. As you can imagine, this low threshold of financial requirement does not provide much assurance for those that have not entered into an SUA. In the absence of a SUA or in the event that reasonable and necessary surface damage results for oil and gas exploration or development, surface owners are not entitled to any compensation.

According to current state regulations, and as set forth in COGCC Rules 305 and 306, operators must first notify surface owners before drilling a well. This notice must be mailed or hand delivered as well as be posted at the drill site. Operators must further notify surface owners if future operations are planned at the existing well that will result in significant surface disturbances and again notify such individuals before final reclamation of the well site and access roads is completed. Important guidelines include a thirty (30) day notice prior to drilling, seven (7) day notice as to future well operations, and thirty (30) day notice for final reclamation. The COGCC Rules set forth the specifics as to these notice requirements.

All that is required of the operator is to attempt good faith consultation with surface owners regarding well locations and access roads. The operator must also inquire of the surface owner if they want to be further consulted about the timing of the operations and location of the well site and access road as well as final reclamation activities. The operator is required to provide a description of the proposed drilling site, dimensions of the well site, and, if known, the location of associated production or injection facilities, pipelines, roads, and any other areas to be used for oil and gas operations. Again, if there is a surface tenant who does not actually own the surface rights, the operator has no obligation whatsoever to consult with them unless the surface owner appoints his tenant for consultation.

What constitutes a reasonable use by an operator will depend upon a case by case analysis, but will generally include the right to make entry upon the property as well as the right to engage in timber cutting, to utilize water on the property, and to install necessary equipment and, where appropriate, employee housing. Although any of these may constitute reasonable use, if excesses occur with respect to any one or all of these liability for damages to the landowner exists.

In addition to the possibility of litigation seeking damages by the landowner as a consequence of express contract breach relating to unreasonable use of the surface resulting in damages, there

exist an additional two theories of law upon which damage recovery is often sought. Under the legal theory of nuisance, recovery is extremely questionable because of the standard of proof required in such a case. Instead, suit predicated upon negligence is preferred under most circumstances. Essentially, the standard of care required of an operator is that they acted consistent with the duty of care that would be normally exercised under the standards of the industry. In addition, it is noted that there exist restrictions as to noise (COGCC Rule 802), lighting (COGCC Rule 803) as well as visual obstruction and degrigation (COGCC Rule 804).

RECENT DEVELOPMENTS AS TO SURFACE USE AGREEMENTS

As of February 15, 2005, property owners who do not execute a lease are not a party to an SUA will have ten (10) business days to request on site meeting about a proposed drilling site with state and local officials as well as representatives of the mineral owners. The Director of the COGCC is now required to conduct an on site inspection prior to issuing any approval to an Application for Permit to Drill ("APD") at the request of the surface owner of lands under three (3) conditions:

1. A surface owner did not execute a lease or was not party to a subsurface use or other similar agreement for a proposed well;

2. The surface owner contends that the impacts of the proposed well may not be otherwise adequately addressed by the rules and regulations of the COGCC; and

3. The request for this on site inspection is made by the surface owner within ten (10) business days of the good faith consultation as required in COGCC Rule 306.

The objective of this inspection shall be to determine whether additional, technical, or operational conditions of approval should be added to the ADP so as to:

1. Avoid potential and unreasonable crop loss or land damage;

2. Address potential health, safety, and welfare or other significant adverse environmental impacts within the COGCC jurisdiction regarding the proposed surface location that may not be otherwise adequately addressed by other COGCC rules or orders; or

3. Otherwise ensure compliance with COGCC rules relating to advance notice and good faith consultation with respect to the timing of operations and locations of facilities.

Importantly, the on site inspection is not to address matters of surface owner compensation,

diminution of property value, future use of the demised property, or any other private party contractual issues between the operator and the surface owner.

Prior to the surface owner requesting an on site inspection, the surface owner must have participated in a good faith consultation in a timely manner with the operator in accordance with COGCC Rule 306. The operator shall first set forth a specific date on which this COGCC Rule 306 consultation occurred on the ADP submittal itself. If appropriate, the operator may include on the ADP that the surface owner executed a lease.

If the COGCC Rule 306 good faith consultation does not resolve operational issues, it is then that the surface owner may request a COGCC site inspection. This request must be made within ten (10) business days (not calendar days) following the first day of the consultation all as set forth with greater specificity in COGCC Rule 306. This request for inspection must be in writing. Attached hereto is the official form approved by the COGCC.

Please note, the request for on site inspection must be received within ten (10) business days of the COGCC Rule 306 consultation date as set forth in the APD. The surface owner shall also include in this request the following information:

1. Two dates in which the surface owner is available to meet on the location with such dates being within thirty (30) days of requesting such on site inspection;

2. The surface owners preference for having the local designee invited to participate in the on site inspection; and

3. A brief description of the unresolved issue(s) related to the proposed well.

Please note, any request by a surface owner for an on site inspection made prior to the formal submittal of the ADP by an operator shall not be accepted by COGCC.

Upon receipt of a timely "On Site Inspection Request Form", the Director of COGCC shall withhold approval of all ADP's until the expiration of the ten (10) period provided as set forth above, except under the following circumstances:

1. That the surface owner has executed a lease;

2. That an SUA has been executed; or

3. The COGCC Rule 306 consultation was waived by the surface owner.

When the Director of the COGCC conducts this on site inspection, the Director must invite the representatives of the surface owner as well as those of the operator. If either the operator or the surface owner has requested that the local governmental designee ("LGD") be invited, the

Director must also then invite the LGD to this on site inspection. The Director must attempt to select an acceptable time for the representatives to attend this on site inspection which shall be conducted to the extent practicable, on one of the two dates that the surface owner requested of the Director.

After this on site inspection, the Director may apply site specific drilling conditions as appropriate to avoid potential unreasonable crop loss or land damage or to prevent or mitigate health, safety and welfare concerns, including potential significant adverse environmental impacts. Such conditions must, among other things, take into account cost effectiveness, technical feasability, protection of correlative rights, and prevention of waste. The Director is not authorized to, among other things, require the operator to compromise reasonable geologic and petroleum engineering considerations. By way of illustration and limitation, the Director as necessary may consider visual or esthetic impacts, surface impacts, noise impacts, dust impacts, ground water impacts, safety impacts, and wildlife impacts.

If the operator objects to any of the conditions of approval applied by the Director at the time of the on site inspection, the Director shall withhold the issuance of the ADP and set the matter for hearing by the COGCC at its next regular scheduled hearing at which time the commission may determine the conditions of the drilling permit approval.

CONCLUSION

Although imperfect, it is almost universally the position from the point of view of both surface owners and those in the oil and gas industry that it is better to attempt to meaningfully address issues in advance and successfully negotiate an SUA than to “fly blind” and hope for the best. Enforcement of legal rights is more expensive and time consuming than negotiating contract terms and, in the even of default, enforcement can be very costly. It is almost always the case that entry into an SUA is far more beneficial than no such agreement.

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