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Memorandum

To: HB 790 Subcommittee Members

From: Krista Lee Evans, Research Analyst
Legislative Services Division

Date: July 15, 2005

RE: Split Estates related to oil and gas production in Montana

At your first subcommittee in August we will be having a brief discussion on split estates and how they work in Montana. In an effort to help get you up to speed more quickly, I have summarized a few issues below. Our meeting time is going to be fairly limited so it is important to read the information and be prepared to discuss questions and issues at the meeting, if necessary.

SPLIT ESTATE

Split estate general information

53A Am Jur 2d Section 176 provides that "the owner of mineral land may, if he or she desires, convey the land as an entirety, or he may sever the minerals or his rights therein from the remainder of the estate in the property and sell each separately from the other. The owner can accomplish this either by granting his or her general estate, with an or by reserving the mineral rights, or by granting the minerals or the surface alone. It may also be accomplished by lease of the mineral interest." There are more than 20 citations from around the United States that affirm this statement, one is from Montana, Rist v. Toole County, 117 Mont. 426, 159 P.2d 340 (1945).

A grantee of the minerals underlying the land becomes the owner of them; his or her interest is not a mere mining privilege. The minerals thus severed become a separate corporeal hereditament. The fact that, subsequently to the severance of the minerals from the surface estate, a conveyance of the land is made in which no reservations or exceptions of the minerals are set forth neither extinguishes the rights of the mineral owner nor vests any of the mineral rights in the grantee of such a conveyance. 53 Am Jur 2d Section 177.

With regard to the relationship between surface and mineral estate owners 53A Am Jur 2d section 331 provides "since the owner of the surface of the land and the owner of the minerals when they are severed from the surface estate have separate and distinct titles, each must exercise, with due regard for the rights of the other, the rights which go with such titles. So far as it is possible, these respective rights should be adjusted to each other, so as to conduce to the full enjoyment of the property."

What is a split estate?

The title that landowners hold to their property can exist in many forms. Many, unless they have had experience with mineral development in the past, do not realize that the ownership of the minerals that lie under the surface property may be held by a different person, company, or government agency. Section 82-10-502, MCA, provides the following definitions:

- ▶ "oil and gas estate" means an estate in or ownership of all or part of the oil and gas underlying a specified tract of land.
- ▶ "surface owner" means the person who hold records title to or has a purchaser's interest in the surface of the land.

A portion of the land that was developed in the Western United States was done so under numerous Homestead Acts. Title 43, Chapter 7, Subchapter X Stock Raising Homestead specifically requires that "All entries made and patents issued under the provisions of this subchapter shall be subject to and contain a reservation to the United States of all the coal and other minerals in the lands so entered and patented, together with the right to prospect for, mine, and remove the same." Therefore, there are large portions of surface property where the underlying minerals are owned by the federal government. Split estates do not only occur with the federal government. There are numerous scenarios.

- ▶ Federal mineral/private surface
- ▶ Private mineral/federal surface
- ▶ State mineral/private surface
- ▶ Private mineral/state surface
- ▶ Private mineral/private surface -- (2 different owners)

In Montana, the Bureau of Land Management (BLM) administers 93.27 million acres of mineral and surface acres. 11.7 million acres of that total are split estate with the minerals being federally owned. I've attached Table 1-3 that was developed by the BLM that provides more detailed information regarding the acreage they manage.

Statutory provisions

Throughout the Montana Code Annotated there are multiple references to the mineral estate, mineral rights, and oil and gas estate.

Eminent Domain

Section 70-30-102(44), MCA provides that "projects to mine and extract ores, metals, or minerals owned by the condemnor located beneath or upon the surface of property where the title to the surface vests in others" is a public use, except for strip mining. In other words, the legislature has determined through this statute that it is a public use to condemn surface property to gain access to a mineral right.

Property Ownership Right

Pursuant to 70-16-101, MCA, the owner of land in fee has the right to the surface and to everything permanently situated beneath or above it. It is explicit in statute that there is a right of ownership. Therefore, if a property owner chooses to sell part of that ownership - the mineral rights for example - it is simply the property owner exercising their right to sell a portion of their fee simple ownership.

State Land Restrictions

The sale of state owned land is restricted in 77-2-303(1), MCA and provides the following: ". . . land that is in state ownership that in the judgement of the department of natural resources and conservation is likely to contain valuable deposits of coal, oil, oil shale, phosphate, metals, sodium, or other valuable mineral deposits is not subject to sale of either the surface land or any of the mineral deposits.

Section 77-2-304, MCA states that "all coal, oil, oil shale, gas, phosphate, sodium, and other mineral deposits in state land, except sand, gravel, building stone, and brick clay, which were not reserved by the United States before July 1, 1927, are reserved to the state." "The state also reserves for itself and its lessees the right to enter upon state land to prospect for, develop, mine, and remove mineral deposits and to occupy and use so much of the surface of the land as may be required for all purposes . . ."

Section 77-2-327(1) provides that a certificate of purchase with regard to improvements on state lands must contain the reservations in favor of the state provided in 77-2-304 relating to coal, oil, and mineral rights in the land.

Summary

Even though it is not expressly stated in statute that there are multiple rights there are numerous other statutes that reference two property rights -- the surface right and the mineral right.

Case law regarding split estates

Case law regarding split estates generally addresses which of the two estates is dominant -- the surface or the mineral estate.

Dominant estate

As between the two estates, it is generally held that the mineral estate is the dominant estate and the surface estate is the servient estate. 53A Am Jur 2d Sec. 331 Hunter v. Rosebud County, 240 Mont 194, 783 P.2d 927 (1989)

There are multiple decisions that relate directly to whether the mineral estate or the surface estate is dominant when discussing access to surface property when exercising a right as a mineral owner. Some of the access issues are related directly to the document that reserved the mineral rights and are case specific. Others are more broad and excerpts from the Montana Supreme Court decisions are provided below.

Western Energy Co. v. Genie Land Co. 195 Mont 202, 635 P.2d 1297 (1982)

"The principal issue involved is whether the mineral reservation set forth . . . gives Western Energy the right to conduct its resource inventory operations on Genie's surface."

The court discussed the specific issues related to the mineral reservation in this particular case and went on to say " Our resolution of this controversy is based upon our conclusion that the proposed resource inventory operations are necessarily implied in the language reserving the minerals, including coal, 'together with the use of such of the surface as may be necessary for exploring and for mining or otherwise extracting and carrying away the same . . . ' "

The court also referred to three other cases applying Montana law "that have established that a reasonable use of the surface by the owner of a severed mineral estate for the enjoyment of the mineral reservation may be implied from the terms of the mineral reservation, though not expressly stated therein. In Hurley v. Northern Pacific Railway Company, 153 Mont. 199, 455 P.2d 321 (1969) (reversed on other grounds) this court affirmed that a mineral owner had the right to reasonable use of the surface area under mineral reservations similar to the one here involved."

The Court also made two other statements that are relevant to the discussion regarding split estates. The first addresses implied rights and states: "It was certainly the understanding of the parties at the time of the deeds of conveyance that Northern Pacific Railway Company withheld the mineral ownership, and reserved the right to do what was necessary to extract the minerals. For us to hold otherwise with respect to such implied rights, in the light of newer regulatory adoption would be to put the mineral estate beyond the reach of its owner. In justice, that cannot be." The second statement made reference to the adoption of regulations, "It is clear that the adoption of the regulations by the state for the protection of the environment is a reasonable exercise of its police power. The necessity for mine operators to meet those requirements in exploring for or extracting minerals is accordingly a reasonable use of the surface for the purpose of mining operations."

Western Energy Co. v. Genie Land Co., 227 Mont. 74, 737 P.2d 478 (1987)

This decision had the same parties as the decision that is outlined above with the addition of the Montana Department of State Lands as an additional defendant. In the above stated case the issue was whether or not the company could have access to conduct investigative studies, etc. to determine if strip mining was feasible. This case resulted when Western Energy Co was unable to get land owner consent to strip mine the property.

The "owner consent statute" provided the following: "Consent or waiver by surface owner. In those instances in which the surface owner is not the owner of the mineral estate proposed to be mined by strip -mining operations, the application for a permit shall include the written consent or a waiver by the owner or owners of the surface lands involved to enter and commence stripmining operations on such land, except that nothing in this section applies when the mineral estate is owned by the federal government in fee or in trust for an Indian tribe."

The decision explained the issue as follows: "Relying on section 82-4-224, MCA, the owner consent statute, Genie refused Western the right to enter the land for the purpose of stripmining, thus foreclosing the possibility of Western's obtaining a permit to mine from the Montana Department of State Lands." The Montana Supreme Court went on to state that "The constitutionality of Section 82-4-224, MCA, is dispositive of this case notwithstanding various errors Western claims were committed by the District Court. **We find the statute unconstitutional.**" (emphasis added)

The Court states that "It is incorrect to argue Western does not have a property interest in its leased mineral estate which is protected by the due process clauses. It has long been established that the holder of an unexpired leasehold interest in land is entitled, under the Fifth Amendment, to just compensation for the value of that interest when it is taken upon condemnation by the United States." (citations omitted)

While the principles of eminent domain require just compensation when private property is taken for public use, constitutional due process requirements may be met without just compensation when the state exercises its inherent police power to regulate the health, safety, and general welfare of the people. The Court provided that "the statute must serve a public, rather than a private interest and the means chosen to advance the interest must be reasonable."

Hunter v. Rosebud County, 240 Mont. 194, 783 P.2d 927 (1989)

One of the issues that was addressed on appeal by the Supreme Court in this decision was whether or not there was a merger of the mineral estate and the remaining estate. The plaintiff in the case argued that "once the mineral estate was severed from the remaining interest they could not merge into a unitary estate. According to the Hunters, mineral estates and the remaining estate are of equal dignity . . ." The Court offered this opinion, "We disagree with Hunters' argument. Their assertion that the mineral estate and the remaining estate are of equal dignity is not correct. The general rule is

that the owner of the mineral estate enjoys the dominant estate and the surface owner of the remaining estate holds the subservient estate. This theory is based upon the realities that accompany mineral exploration and development. Obviously, in order to fully utilize a mineral estate, one usually must have access to the surface."