Mineral Rights and Banking

While landscape position and a sound restoration plan are perhaps the most important indicators of future ecological success of wetland banking projects, an equally important consideration is whether the property is compatible with long-term conservation, especially as it relates to future mineral development.

Many parts of the country are experiencing a boom in natural gas and oil production. In some areas of California, abandoned oil wells are being reopened for natural gas exploration and mineral rights are being bought, sold, and exercised by landowners and third-party holders. Therefore, to ensure that mitigation banks and their associated conservation values are protected into perpetuity, interagency review teams (IRTs) need to thoroughly review the ownership of mineral rights prior to bank approval.

The due diligence process for mineral development can be complex and unfamiliar to many regulators. It often involves reviewing lengthy title reports, filtering through mineral leases, and trying to find a solution when mineral rights are severed from the property and owned by a third party. The process to gain control, acquire, or negotiate a mineral rights agreement is costly and can delay the bank approval process. In the paragraphs below, I have attempted to frame the issue and provide some tips and examples for managing mineral rights on mitigation lands.

The basics: in the United States, ownership of mineral resources was originally granted to the individuals or organizations that owned the surface. These property owners had both "surface rights" and "mineral rights," and this complete private ownership is known as "fee simple estate." Fee simple is the most basic type of ownership, where the owner controls the surface, subsurface, and the air above a property.

However, once commercial mineral production became possible, the ways in which people owned property became much more complex. Decades of mineral exploration, leasing, sales, and gifts have produced a landscape where the surface of the land and the mineral rights are not owned by the same party. This is known as a "split estate." With a split estate, the landowner retains the right to restrict the surface estate through a conservation easement, but does not have the right to restrict the mineral estate. In fact, the conservation easement is not legally enforceable against the owner of the mineral estate.

Although the most straightforward approach might be for IRTs to simply limit banking to fee simple estates, in California, where split estates are common, this would severely limit prospective bank proposals. Restoration projects that look promising from an ecological standpoint, but have severed mineral rights, would be passed over for projects where the mineral rights are still intact, but may be less desirable.

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Where to start? The due diligence process for mineral development begins with the submittal of a draft prospectus. While this step is optional in California, it is strongly recommended because it allows the IRT to flag any potential issues with the bank proposal prior to having the sponsor prepare a more detailed prospectus document. As part of the draft prospectus, the banker is required to provide ownership information on interest of surface and sub-surface mineral rights. By providing this information early in the process, the bank sponsor and IRT can propose options to acquire or restrict mineral development on the property when there is a split estate.

In California, bankers are required to submit a preliminary title report at the prospectus stage. While this differs from the 2008 U.S. Army Corps of Engineers/U.S. Environmental Protection Agency Mitigation Rule, a preliminary title report is important because it provides information about the property that is an essential part of the IRT's due diligence process. A preliminary title report should show how title is currently held and what kind of exceptions to title are currently of record (for example, easements, liens, and encumbrances). The onus is on the banker to summarize and explain how each lien or encumbrance on the proposed bank property, may affect the mitigation bank's operation. Just like purchasing a house, the buyer (the IRT) has the right to approve or object to the preliminary title report and back out of the deal unless the seller (the banker) can provide clean title by eliminating certain exceptions to title prior to closing (bank approval).

What are the options for managing mineral interests on mitigation banks? Over the past several years, the Sacramento District IRT has taken several approaches for dealing with split estates and mineral interests.

Minerals Assessment Report: Routinely used by the land trusts to determine wheth-

er a conservation easement will qualify for tax benefits, a minerals assessment report, sometimes called a remoteness opinion, is prepared by a geologist to assess the minerals present on or under the land and to determine the probability, or potential, for future development. While most assessment reports do not entail field sampling, a geologist will review and analyze all available data, including geologic maps, mineral and mining databases, and assessment reports. This information is compiled and the geologist will provide a ranking and opinion on mineral potential based on information inferred from these reports.

It is important to realize that while these reports are useful for helping to understand the likelihood of mineral development, they have somewhat limited value in that they only look at what is feasible at the time the report is prepared. Thus, as technologies and commodity prices change, what becomes commercially feasible also changes. For example, recent advances in hydraulic fracturing, or "fracking," have opened vast areas of the country to new oil and gas drilling.

Surface Use Agreement: Typically negotiated between the landowner and the mineral holder, a surface use agreement restricts mineral exploration and extraction activities that occur on the surface of a site. This can include the number, location, and size of wellpads, access roads, and the depth at which subsurface minerals can be explored or extracted.

In 2009, the Sacramento IRT approved the Cosumnes Floodplain mitigation bank located along the Cosumnes and Mokelumne Rivers in Sacramento County. The bank sponsor signed a surface use agreement with the mineral rights holders that restricted subsurface drilling to below 300 feet and confined all surface activity to five 2.5-acre drilling pads. Three of the pads are located along the perimeter of the bank, while the remaining two are interior. The sponsor designed the project around the drill pads and access roads whose total area was excluded from the bank and conservation easement.

Mineral Deed Acquisition: This is a legal process whereby the mineral rights owner conveys their interest to the owners of the surface estate, which would then be reflected on the property's title. While this method provides the most certainty against any future degradation of conservation values, in many cases current mineral rights holders are reluctant to relinquish or sell their interests to the banker or landowner. It is also sometimes very difficult to locate and establish contact with holders, as often they have moved out of state, or are deceased and the heirs to the estate are difficult to determine.

In 2010, the Sacramento Municipal Utility District (SMUD), a public agency, was unable to locate several of the parties who were shown on the title report to have an interest in the mineral rights under their 1,200-acre proposed bank. After discussing this with the IRT, the SMUD filed a "Complaint in Eminent Domain" in Superior Court requesting that all existing oil and gas and the mineral rights be condemned to SMUD's use for the purpose of establishing a mitigation bank. The court granted the condemnation request.

*Quitclaim Deed***:** A quitclaim deed is a way of transferring all legal rights in the property that the grantor possessed or may have possessed at the time of conveyance. However, unlike a complete mineral deed acquisition, there are no warranties or guarantees of title being offered to the grantee. Bank owners may request the title company to contact mineral rights holders and ask that they sign a quitclaim deed that conveys oil and minerals to the landowner. If signed, the deed is recorded, and can be presented to the IRT; however, it will not be recorded on the title.

Lease Agreements: In some cases, the landowner or the mineral rights holder may have entered into lease agreements with a third party. It is important to carefully examine and read the terms and conditions of each existing lease to understand exactly what activities and facilities will and will not be permitted on the property, where they will be located, when they can be developed, and how and when reclamation will occur. The presence of a mineral lease does not automatically disqualify a prospective bank site as long as the conservation values are protected from the short- and long-term impacts of mineral development.

The owners of the Santa Paula Creek Mitigation Bank in Ventura County set up a limited liability company (LLC) to which they transferred the subsurface mineral rights to their mitigation bank prior to bank approval. The LLC then entered into a lease agreement with a petroleum company that allows the lessees the ability to drill and extract oil below the 500-feet level from a location outside the bank property. All minerals above the 500-feet level, as well as all surface rights, are protected by the bank's conservation easement.

*Property Assessment and Warranty***:** In addition to providing the preliminary title report at the prospectus stage, in California, bankers are asked to sign and submit a property assessment and warranty (PAW) with the draft banking enabling instrument. The purpose of the PAW is to specifically explain each lien, encumbrance, or other exception to the title and the manner in which it may affect the conservation easement to be recorded against the bank property. By signing the PAW, the banker is certifying the accuracy of the property assessment and that they have no knowledge of any legal restrictions placed against the bank. The PAW serves as an added layer of protection to ensure that all leases, options, or other matters have been fully disclosed and evaluated against the conservation easement.

Although examining title reports and mineral leases may be unfamiliar and outside the standard skill set of agency staff who serve on the IRT, it is very important to ensure that the long-term conservation values of a mitigation bank are upheld into perpetuity. Because each proposed mitigation bank is different from the next, there is no one-size-fits-all approach for managing mineral interests. In some areas, the probability and likelihood of subsurface mineral extraction is very low, whereas others may be sited close or adjacent to active oil and gas fields. Therefore, it is important to evaluate each proposal on a case-by-case basis and to work with the landowner to resolve all outstanding concerns and issues. ■

-Eric Raffini

References

Mineral Development and Land Conservation: A Handbook for Conservation Professionals (Colorado Coalition of Land Trusts 2008).