

Greetings Section Members,

This issue of the Section Newsletter complements the May 19 seminar on "Water for Energy in the Southwest: Where Will It Be Found?" co-sponsored by our Section and the UNM School of Law Utton Center. In addition, this issue contains another look at a topic from the last issue. Attorney Gene Gallegos provides further discussion of *Creson v. Amoco Production*, with a different perspective of the meaning of "at the well" in natural gas royalty cases. We thank Mr. Gallegos for preparing this response, and hope this and future Newsletter issues stimulate continued input from Section members.

Thank you members for your support of this Section and the Newsletter. Please feel free to contact me or other Board members with your ideas and wishes about how your Section dues are spent – we are here to make the Section work for you.

Jennifer J. Pruett, Editor

The Promise of Recycled Water and the Return Flow Woes

Joshua Mann

As the American West struggles to supply its rapidly expanding population with blue gold, policy makers in the arid region must look in new directions. The Southwestern states are suffering from a nearly decade-long drought, shown by the recent drop in the Lake Powell and Lake Mead reservoirs to their lowest levels.¹ Meeting this growing demand for municipal, residential, agricultural, commercial and environmental needs has resulted in an upsurge in reuse of wastewater, aided by stricter water quality standards and improved treatment technology. In Texas, reuse of water is expected to provide 12 percent of the total water demand by 2050.² Arizona has altered its water law to encourage reuse and has a reputation as having the leading role in adopting policies and programs to further the use of reclaimed water.³ In New Mexico, state and local governments are emphasizing the potential of reused water as an opportunity to increase water supply as evidenced in the state, regional and municipal water plans. However, widespread reuse of effluent has its challenges, and New Mexico's water law may not support great expectations.

There are benefits and drawbacks to using recycled water. One advantage over conventional water sources is that it is the only source of water that automatically increases with economic and population growth, even in time of drought.⁴ In addition, reuse of effluent presents cost savings because of the proximity of urban treatment plants to end-users. On the other hand, wastewater treatment facilities often require large up-front costs and costs for acquisition, treatment, storage and distribution as opposed to groundwater pumping. Moreover, municipal wastewater represents only a small portion of total supply, whereas agricultural use accounts for approximately 80% of total water consumption nationally; therefore, the benefit of recycling water is limited.⁵

Another concern regarding use of reclaimed water is the potential health risks associated and

water quality issues. However, general health studies have found that uses of reclaimed water, even for indirect potable use, can be safe with appropriate pretreatment.⁶ Further, it is important to acknowledge that conventional water sources often have impaired water quality. Public opinion can act as a barrier to reuse of reclaimed water. In Los Angeles, public opposition halted a recent plan to reuse effluent when a journalist dubbed the proposal "toilet to tap."⁷

In New Mexico, the State Water Plan and The Regional Water Plan Template identify reclaimed water as an alternate water source that localities should consider.

Local governments should consider the advantages offered by community wastewater treatment systems, including the potential to use treated effluent to augment stream flows or to provide water for non-potable community reuses such as landscaping.⁸

The Regional Water Plan Template calls on localities to formulate and analyze alternative actions for water management including analysis of reusing wastewater. The Middle Rio Grande Water Plan's Alternatives section states that the region must promote reuse of gray water and wastewater. "The treated wastewater can be reused once or several times before it is returned to the river or lost to evaporation."⁹

Three legal issues are central to the use of recycled water: 1) regulations for effluent quality; 2) regulation of effluent reuses; and 3) legal rights to effluent. EPA is generally responsible for regulating various aspects of wastewater treatment and a majority of states have set permitting guidelines for the beneficial use of reclaimed water. In New Mexico, NMED is the government agency responsible for issuing Ground Water Discharge Permits for domestic wastewater, and has several categories of "reclaimed wastewater," the

continued on page 2

Recycled Water

continued from page 1

approved uses of which are based on public exposure. The highest quality may be for all but direct consumption and the lowest quality may only be used for irrigation of fodder, fiber, and seed crops for non-milk-producing animals or forest trees. New Mexico's water law, the doctrine of prior appropriation, governs rights to effluent.

Despite near consensus among policy makers and communities on the promise of recycling water, New Mexico water law is not friendly towards effluent reuse.¹⁰ To understand why, one must consider the dual aspects of a water right.

There is the diversion right, which equals the total amount withdrawn from the stream system, and the consumptive right, which is the portion that is consumed. Any remaining amount that returns to a watercourse or underground reservoir is a return flow and cannot be recaptured because it has returned to the public source.¹¹ For example, the city of Albuquerque receives credit for return flows to the Rio Grande, which are metered outflows from the sewage treatment plant. Therefore, the city may purchase fewer water rights in exchange for the amount it returns to the river, reducing the cost of expensive transfers from other uses.¹² An appropriator must demonstrate return flow before the OSE will allow the offset. As a practical issue, in New Mexico, where all water is appropriated, many downstream users depend on return flow some would get cut off without it.¹³

The legal issue is whether a water user, such as a municipality, has a right to reuse wastewater it treats. If the State Engineer (OSE) has conditioned a permit to return all measurable return flow, including sewage effluent, to a river, then a user may not use more than its consumptive use right.¹⁴ However, it could reuse some or all of its effluent if it reduced its pumping correspondingly, so that total consumptive use did not increase.

"In other words, by limiting diversions under a permit to the consumptive right and replacing any consequent shortfall in municipal supply with effluent, [a] municipality could make use of its return flows within its legal authority."¹⁵

In *City of Roswell*,¹⁶ the court held that the OSE, in granting a permit to change the place of use of a water right, could not impose return flow conditions, unless it found that the change of the place of use would impair existing rights of downstream users. "No appropriator can compel any other appropriator to continue the waste of water which benefits the former. If the

senior appropriator by a different method of irrigation can so utilize his water that it is all consumed in transpiration and consumptive use and no waste water returns by seepage or percolation to the river, no other appropriator can complain."¹⁷

New Mexico's neighbor, Arizona, relied on *City of Roswell in Public Service Co. v. Long*.¹⁸ That case modified Arizona's version of the doctrine of prior appropriation by according rights to effluent treated by municipalities.¹⁹ Arizona water law holds that a downstream user may appropriate, or



acquire a right to, the sewage effluent component of a water source.²⁰ In *Long*, however, the court held that treated effluent is a separate source of water from surface and ground water, and municipalities may acquire a right to use the effluent and market it, over the objections of downstream water rights holders, subject only to the beneficial use requirement. *Long* cites *City of Roswell* several times but the holding in the former broadens the ruling in the latter significantly. Whereas *City of Roswell* held that the OSE could not condition a permit to require the discharge of effluent, except to prevent impairment to downstream users, *Long* holds that a municipality can cease effluent discharge into a water source regardless of impact on downstream users so long as the beneficial use requirement is met. In New Mexico, once an upstream discharger loses control of his water it returns to the public source and is no longer his property. The *Long* holding seems to say that even though the historic supply of water for any downstream water right holder includes return flow from upstream, an upstream discharger maintains his interest in the discharge even when it returns to the public source. The ruling in *Long*

has contributed substantially to Arizona's reputation as a "progressive" in the area of promoting effluent reuse.²¹

New Mexico has some distance to travel before it earns such a superlative. The best intentions of state and local policy makers are the beginning. They must overcome economic, water quality and public acceptance hurdles that all communities throughout the nation face. In addition, legal uncertainties involving effluent reuse must be dealt with, in a way that contemplates the current usage by downstream users of effluent, before its promise as a water source becomes a reality.

Endnotes

¹ Ginette Chapman, *From Toilet to Tap: The Growing Use of Reclaimed Water and the Legal System's Response*, 47 ARIZ. L. REV. 773 (Fall 2005).

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ *Id.* at 784.

⁸ State Water Plan and Regional Water Plan Template.

⁹ Middle Rio Grande Regional Water Plan, A-27.

¹⁰ William M. Flemming & G. Emlen Hall, *Water Conservation Incentives For New Mexico: Policy And Legislative Alternatives*, 40 NAT. RESOURCES J. 69 (Winter 2000).

¹¹ *Reynolds v. City of Roswell*, 99 N.M. 84, 654 P.2d 537 (1982).

¹² *Flemming, supra* note 10.

¹³ Conversation with Lisa Robert, freelance writer, on March 23, 2006 at UNM School of Law.

¹⁴ Susan C. Kery, et. al, *Legal Issues Specific to the Middle Rio Grande Water Planning Region*, available at <http://www.mrcog-nm.gov/images/Documents/Legal%20Issues%20in%20MRG%20Water%20Planning%20Region.pdf> (last visited April 21, 2006).

¹⁵ *Id.*

¹⁶ *Reynolds v. City of Roswell*

¹⁷ *Id.* at 541, 88.

¹⁸ 160 Ariz. 429, 773 P.2d 988 (Ariz. 1989).

¹⁹ *Chapman, supra* note 1.

²⁰ *Long* at 996, 437; A.R.S. § 45-141(A).

²¹ *Chapman supra* note 1 at 793.

Well, “At The Well” Is Not The Answer

J.E. (Gene) Gallegos

This article is written in response to the article in the Winter 2005 edition of *Vista* entitled “At the Well” in New Mexico – Current Court Interpretation of the Definition of “At the Well” in Natural Gas Royalty Clauses. That article paints an erroneous portrait of New Mexico law for post-production deductions permitted by an oil and gas lessee in calculating royalty and overriding royalty. The premise of “At the Well” in New Mexico rests on a reading of *Creson v. Amoco Production*¹ that fails to appreciate (a) Bravo Dome Unit carbon dioxide (CO₂) is neither marketable nor marketed at the wellhead but (b) the plaintiffs in that case nonetheless stipulated that the CO₂ was marketable at the well.

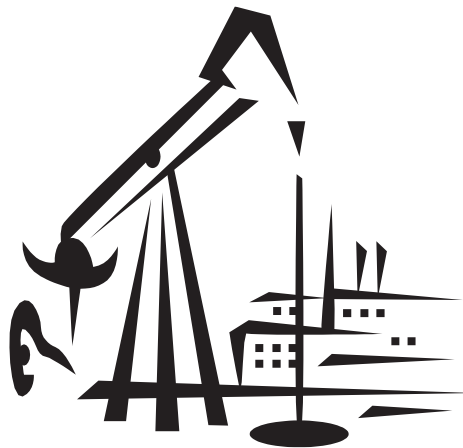
The duty to market is generally accepted as an implied covenant that attaches to all oil and gas leases. 5 *Williams & Meyers Oil and Gas Law* §§ 853-856; 5 *Kuntz, A Treatise on the Law of Oil and Gas* § 60.2. Beyond that traditional recognition of the implied duty, however, there is disagreement between jurisdictions and law review writers when dealing with specific royalty disputes. The question in all the cases boils down to: what costs after the oil or gas comes to the surface does the oil and gas lessee bear alone and what costs can the lessee impose on lessors and override owners to reduce the royalty payment?

Texas and Louisiana courts in recent years have been resistive to the position of royalty owners. Decisions in those states stand for the view that a royalty clause using the words “at the well” means all expenses after production should be shared by the lessor in a “net-back” calculation.² Even in those states the lessee can only deduct actual costs and costs that are reasonable.³

Colorado, Oklahoma, Kansas and Arkansas courts have seen the marketing duty as creating responsibility on the lessee beyond simply production – more than just getting hydrocarbons to the surface. Decisions from those states have held that a lessee’s implied duty to market requires the lessee to bear some, or most, post-production costs necessary to sell the gas. These states adopt the “marketable condition” rule; that is, the duty to market includes putting the gas into marketable condition.⁴ The lessee thereby has to absorb expenses necessary to put the product into a truly saleable or useable condition.

The article in question would place New Mexico in the Texas and Louisiana camp, stating that the words “at the well” in a royalty clause “allows for the deduction of post-production, value enhancing costs from gas sold downstream.” *Vista*, p. 5. That is the reading of *Creson* that lessees prefer to espouse out of self-interest. It is wrong. The decision is understandably confusing because at the trial level plaintiffs attempted to make their case solely on an inapplicable “Unit Expense”

provision in the Bravo Dome Unit Agreement. That provision, contained in Article 14.3 of the Unit Agreement, concerns production, not post-production, costs.



The confusion created by the *Creson* decision follows from the faulty trial strategy adopted by the royalty owners. The *Creson* plaintiffs did not rely on the duty to market to challenge the lessors’ royalty calculation that deducted expenses to gather, dehydrate and compress the CO₂. The *Creson* plaintiffs conceded that the carbon dioxide (CO₂) was marketable at the well: “It is undisputed . . . that the carbon dioxide gas is marketable in its unprocessed state at the wellheads.” 2000 NMCA 81 [8]. “In this appeal, plaintiffs have conceded that the carbon dioxide gas was marketable at the wellhead. . . .” *Id.* [22] “[I]t is undisputed that the carbon dioxide gas was marketable and was actually marketed at the wellhead.” *Id.* [24]. Because the plaintiffs did not raise any fact issue concerning marketability the case cannot stand for a holding rejecting the marketable condition rule.

The Tenth Circuit Court of Appeals in *Elliott Industries v. BP America Production*⁵ recognized that the plaintiffs in *Creson* stipulated themselves out of court by not questioning whether CO₂ gathering, dehydration and compression services were properly post-production costs and whether the gas is in fact marketable at the wellhead, stating, “[i]n *Creson*, these issues were not disputed.”⁶

In fact the Bravo Dome CO₂ at issue in *Creson* is not a marketable product until it has been transported from the wells to a plant where water is removed and it has been subjected to such high compression (from an inlet psi of 100 pounds up to 1,800 – 2,000 psi at the tailgate) that it is transformed from a gas into a liquid, “supercritical” state. The compressed CO₂ is not a commercially

saleable commodity until it has reached the plant tailgate or more typically when it has arrived at distant EOR fields. In compressed, supercritical state, the CO₂ is injectable and is “miscible” with oil when introduced into enhanced oil recovery reservoirs. The CO mobilizes the oil so that otherwise unrecoverable crude oil moves to the production wells.⁷

The trend of New Mexico oil and gas decisions has been decidedly more friendly to royalty owners than Texas and Louisiana. New Mexico jurisprudence for half a century has recognized that even though a lease speaks expressly to the computation of royalty there are nonetheless implied duties that work directly to the fulfillment of the lessor’s royalty rights. In *Libby v. DeBaca*,⁸ the oil and gas lease to develop CO₂ contained an express rental and royalty provision, yet the implied covenant of development required the lessee to build a dry ice plant to market the gas or lose the lease. In *Darr v. Eldridge*,⁹ the royalty provision called for payment of specified cents per gallon of mineral water produced from the well. Our Supreme Court compared that to oil and gas leases, relied on oil and gas lease law and quoted Merrill, *Covenants Implied in Oil and Gas Leases*, 464 (2d Ed. 1940) for the principle,

“We have seen that the courts in varying language, base the doctrine of implied covenants, other than that for protection, upon the ground that the lessor’s chief remuneration is to be derived from the royalties resultant from development and operation, that this remuneration constitutes his chief inducement for executing the lease, that, therefore, the lease in all respects, must be construed as having written into it this duty of diligently promoting the productivity of the premises.”¹⁰

The Supreme Court in *Darr* held that the lessor could enforce an implied covenant “to make diligent efforts to market in order that the lessor may realize on his royalty interest”¹¹ citing *Libby* and *Wolfe v. Texas Co.*¹² *Greer v. Salmon*,¹³ held that “production is equated to producing and paying a royalty.” “Production” means that minerals have been ‘produced, saved and sold’ or ‘produced, saved and consumed.’”¹⁴ See also *Duwall v. Stone*:¹⁵ “[R]oyalty” is a fractional share “of all of the oil and gas produced, saved and marketed . . . free and clear of all development and operating expenses.”

Bravo Dome CO₂ is produced in gaseous state from a network of over 300 wells operated by Oxy USA. It is *not* marketable at the well. The

continued on page 6

The Clean Air Mercury Rule, Coal-burning Power Plants and New Mexico's Water: What's the Connection?

Jennifer Hower



Introduction

Like any environmental or natural resource issue, few things can be placed only in a general category. The Clean Air Mercury Rule, recently passed by the U.S. Environmental Protection Agency ("EPA"), is an attempt to keep a hazardous pollutant, mercury, out of the air. At the same time, the rule assists in promoting clean water because of the connection between airborne mercury emissions and significant contamination issues within state-wide water habitats that can harm both New Mexico's natural environment and overall public health. Therefore, flawed implementation of a mercury rule could have a negative effect on both air and water quality.

Mercury Background

Mercury enters our lives in several different forms, but only one is the focus of the current regulation. While elemental mercury and inorganic mercury can cause significant damage, organic mercury produces the most contamination. Organic mercury occurs when mercury combines with carbon. The most common form of organic mercury is methylmercury, which bioaccumulates in fish in mercury-contaminated waters.¹ In 1999, there were 1,782 mercury advisories in 41 states restricting the consumption of fish. The state of New Mexico currently has 36 water bodies with fish consumption advisories.²

Organic mercury ends up in water after being emitted into the atmosphere, often by the burning of fossil fuels and mining. The Center for Disease Control has found that 80% of human-derived sources of mercury are emissions into air from fossil fuel combustion, smelting, mining and solid waste combustion.³ Further, electric utility boilers account for 22% of the total atmospheric mercury emissions in the United States, at 48.5 megagrams per year.⁴ By far one of the largest emitters of mercury in New Mexico is the

San Juan Power Plant, which emits 751 pounds of mercury a year.⁵ These emissions significantly affect the surrounding area, as a monitoring station at Mesa Verde National Monument registered the third highest mercury reading ever in the United States.⁶

In humans, mercury is a neurotoxin, with its primary effect being on fetuses, infants and children. Human mercury exposure can occur through inhalation or consumption of fish from contaminated waters.⁷ Mercury exposure in pregnant women is of significant concern, due to the developmental effects it can have on a fetus. In 1999, 10% of women in the U.S. had mercury levels close to or at hazardous levels.⁸

The Clean Air Mercury Rule

EPA proposed the Clean Air Mercury Rule ("CAMR") on December 15, 2003, issuing the final rule on March 15, 2005, published in the Federal Register on May 18, 2005.⁹ The CAMR was created to act in tandem with the Clean Air Interstate Rule ("CAIR")¹⁰, and focuses on controlling mercury emissions through the implementation of a cap and trade program. The difference between the two trading programs is that the CAMR would be the first time that a pollutant categorized as a Hazardous Air Pollutant by the EPA will be traded on an open market. The cap and trade program would be implemented on a State level, and each State would be assigned an annual mercury budget to allocate to mercury emitters within its boundaries. For Phase I of the implementation of the CAMR (2010-2017), New Mexico would have an annual mercury budget of .299 tons. Phase II of the CAMR implementation would reduce New Mexico's budget to 0.118 tons annually.¹¹

Flexibility in the rule comes from the manner in which States may opt to allocate their annual budgets. EPA provides an allocation methodology within the model rule that can be adopted by states, or a state can create its own allocation methodology that must be approved by the EPA. Allocation flexibility can come from cost allowance distribution, the frequency of allocations, the basis for distributing the allowances, and the use of allowance set-asides (i.e. banking) and the size of such set-asides.¹²

The CAMR, as written, only applies to coal-fired utility units. To be classified as a utility unit, the entity must a) sell more than 25 Megawatt (MW) to any utility power generation system, b) be capable of combusting more than 73 MW heat input for any individual boiler, or c) if the unit is a cogeneration unit, it must sell more than one-third of its potential electric output capacity.¹³

Controversy

There has been significant controversy surrounding the passage of the CAMR. In February 2005, the U.S. Government Accountability Office (GAO) issued a report questioning EPA's cost-benefit methodology in creating the CAMR. The report listed three main problems with EPA's cost-benefit analysis: 1) EPA did not consistently analyze the costs and benefits of each option; 2) EPA did not document some of its analyses, specifically in relation to technology-based options; and 3) EPA did not estimate the health benefits of each option.¹⁴

Subsequently, eleven states including New Mexico, filed a lawsuit regarding the CAMR on May 18, 2005.¹⁵ The participating states argued that the CAMR would create hot spots and jeopardize public health. At the same time, fourteen states¹⁶ including New Mexico, and various environmental organizations¹⁷ also petitioned the EPA to reconsider and modify the rule to more substantially eliminate current mercury emissions issues and provide increased safeguards for at-risk populations. In late October 2005, EPA agreed to reconsider the following portions of the Clean Air Mercury Rule: 1) the method used to apportion state mercury caps; 2) the definition of "designated pollutant;" 3) new sub-bituminous coal-fired plants designation in New Source Performance Standards; 4) the statistical analysis used for New Source Performance Standards; 5) the highest annual average mercury content used to derive New Source Performance Standards; and 6) the definition of covered units.¹⁸

Current Status

The verdict is still out on the Clean Air Mercury Rule. The comment period set by the EPA for the reconsideration of the CAMR ended December 19, 2005. To date, EPA has not taken any public action on the matter. Until administrative and judicial avenues are completed, the fate of the CAMR is unknown. However, the conflicts that have arisen in the implementation process of a federal regulation that would require coal-fired utilities to remedy hazardous mercury emissions through a trading program is a lesson in the interconnectedness of major environmental issues. The outcome will have a significant impact on both the air and water quality of New Mexico.

Endnotes

¹ U.S. Department of Health and Human Services, Toxicological Profile for Mercury, at 21 (March, 1999) [hereinafter *Tox. Profile*].

continued on page 8

Three Card Monte or Bad Law¹

Alex Beattie

Cultures and governments have collided in a 17-year battle over use of groundwater to mine New Mexico's large uranium deposits in McKinley County. Experts estimate that there are millions of pounds of uranium, enough to run nuclear power plants for decades, creating a billion dollar industry. The dispute is whether the mine site is Indian country; which will determine whether New Mexico or the Navajo Nation has authority to issue necessary approval to use the underground aquifer. Until this dispute is resolved, EPA will manage the aquifer.

As a general rule, the Safe Drinking Water Act (SDWA)² prohibits contamination of an underground source of drinking water. The SDWA establishes overall minimum standards for drinking water across the country and directs EPA to establish requirements for control of underground injection processes in order to protect sources of drinking water. But because certain aquifers will never be used for drinking water,³ EPA adopted criteria for exempting them from SDWA requirements.⁴ Additionally, section 300h-1 provides for state primacy in enforcing UIC programs; New Mexico received approval in 1983.

Congress amended the SDWA in 1986, specifically authorizing EPA to treat Indian tribes as states (TAS) under the SDWA;⁵ the Navajo Nation received this EPA approval in 1994. This approval covered "all lands located within the exterior boundaries of the Navajo Reservation ... [and] within the Eastern Navajo Agency: all Navajo tribal trust lands, all Navajo allotments, and all tribal fee lands and federal lands previously determined to be part of Indian country."⁶

This dispute began in 1989 when the New Mexico Environment Department (NMED) approved a discharge plan for underground injection by Hydro Resources, Inc. (HRI) for its mine sites in Churchrock, N.M. (Section 8 mine),⁷ and applied for an aquifer exemption from EPA. EPA approved this request in 1989. In 1992 HRI requested an extension of its permit to a neighboring mine site (Section 17 mine).⁸ After a hearing and comment period, EPA denied the extension request stating that the Section 17 site was Indian country. In 1995 NMED again sought an extension of the aquifer exemption to the Section 17 site, which EPA also denied. After a failed attempt to resolve the jurisdiction dispute through joint-permitting between NMED and the Navajo Nation, EPA notified NMED and HRI in 1997 that both Section 8 and Section 17 would be treated as disputed Indian country requiring federal permits. HRI and NMED sought review of EPA's decision.

Addressing the 'disputed status' of the Section 8 mine site, the 10th Circuit, in *HRI, Inc. v. EPA*,⁹ affirmed EPA's decision to administer the UIC program until a determination could be

made as to whether the site is Indian country. In affirming EPA's position, the 10th Circuit rejected HRI's argument that EPA had unlawfully withdrawn this authority from New Mexico, stating EPA had initiated a program revision.¹⁰ "If Section 8 is indeed Indian country, then New Mexico's program could not extend to it in the first instance."¹¹ The court also found that EPA had not reached a final decision whether the Section 8 mine site was Indian country, and remanded to EPA for a final determination as to whether the Section 8 mine site is Indian country as a "dependent Indian community."¹²

On November 2, 2005, EPA issued a notice in the Federal Register seeking comments and information from the public regarding possible Indian country status of the Section 8 mine site. "This determination is necessary to establish whether EPA or the New Mexico Environment Department is the appropriate agency to consider a particular underground injection control permit application under the Safe Drinking Water Act."¹³ EPA specifically limited its comment request to the subject of whether the mine site was a "dependent Indian community."¹⁴

Opponents to a finding of Indian country state that the Section 8 site is privately owned in fee simple and fails to meet the test for a dependent Indian community stated in *Alaska v. Native Village of Venetie Tribal Government*.¹⁵ *Venetie* held that a dependent Indian community is a limited category of Indian lands that are neither reservations nor allotments, set aside by the federal government as Indian lands for use of Indians under superintendence of the federal government. Prior to *Venetie*, the 10th Circuit examined a number of factors to determine whether an area was a dependent Indian community, including establishing the proper community of reference.¹⁶ "Because *Venetie* does not speak directly to the issue, barring en banc review by this court, *Watchman*, continues to require a 'community of reference' analysis prior to determining whether land qualifies as a dependent Indian community under the set-aside and supervision requirements of 18 U.S.C. § 1151(b)."¹⁷ *Watchman* held that the lower court erred when it used a mine site itself in isolation from the surrounding community, as the community of reference. This is the decision that EPA is facing in considering whether the checkerboard area surrounding Churchrock constitutes a dependent Indian community. Should EPA determine that Section 8 is Indian country, this could allow the Navajo Nation to enforce its ban on uranium mining to protect its citizens.

The McKinley County Attorney stated: "Any attempt to expand Navajo jurisdiction in the Checkerboard Area of McKinley County is taken very seriously by the County."¹⁸ According to Gamercio Associates, LTD: "In the past few

years, the Navajo Nation has made it very plain that they want to extend their sovereignty beyond the borders of the reservation."¹⁹ The Northwest New Mexico Council of Governments²⁰, N.M. Representative Donald L. Whitaker²¹ and N.M. Senator Lidio G. Rainaldi²² expressed concerns that New Mexico would miss an opportunity to raise revenue through its severance tax on uranium²³ and the effect this might have on providing public services. The New Mexico State Engineer stated that "all groundwater located under the proposed site falls within the sole and exclusive administrative jurisdiction" of his office; and that a finding of Indian country would "create confusion and uncertainty...."²⁴ Strathmore Minerals Corp. stated: "An Indian Country determination by EPA would effectively constitute a taking without just compensation ..."²⁵ The New Mexico Oil & Gas Association stated: "NMOGA continues to stand opposed to a regulatory agency making a decision on the definition of 'Indian country' which we feel is clearly defined by federal law and the U.S. Supreme Court."²⁶

Submitting a comment in favor of a finding of Indian country, Eliot Gould²⁷ noted "A formal designation of Indian lands as a 'reservation' is not required for them to have Indian country status."²⁸ Gould cited *U.S. v. McGowan*, in which the Supreme Court held that the Reno Indian Colony was to be treated as the functional equivalent of a reservation, because it was on land set aside by the federal government for the benefit of the Indians.²⁹ The Navajo Nation Department of Justice stated that the drafters of the Indian country statute relied on *McGowan* and codified as the dependent Indian community subsection.³⁰ *Venetie* discussed and relied upon *McGowan*.

The dispute over which government has authority to set quality standards for the groundwater under the Section 8 mine has drawn deep lines in the sand. The 10th Circuit noted that HRI was free to pursue a UIC permit from EPA, but had not done so.³¹ Such actions have lead supporters of an Indian country finding to suggest that HRI (and the uranium industry) is playing a Three Card Monte version of forum shopping, using the state as the mark. Opponents to a finding of Indian country state that this is just an example of bad law.

Endnotes

¹ **Three Card Monte** is a confidence game in which the victim, or mark, is tricked into betting a sum of money that he can find the money card among three face-down playing cards. Three Card Monte, which is never played straight, is an example of a classic short con in which the outside man pretends to

continued on page 6

Three Card Monte

continued from page 5

conspire with the mark to cheat the inside man, while in fact conspiring with the inside man to cheat the mark.

² 42 U.S.C. §§ 300f thru 300j-26

³ 40 CFR 144.3

⁴ 40 CFR 146.4

⁵ 42 U.S.C. § 300j-11

⁶ *HRI, Inc. v. EPA*, 198 F.3d 1224, 1232 (10th Cir. 2000) (The EPA withheld TAS approval with respect to private fee land within the Eastern Agency, stating that the Navajo Nation had not demonstrated jurisdiction over these lands).

⁷ Hydro Resources Inc. is a New Mexico based subsidiary of Uranium Resources, Inc., 650 S. Edmonds Lane, Suite 105, Lewisville, Texas 75067. The Section 8 mine is owned in fee simple by HRI.

⁸ The Section 17 mine is a split estate. The surface is owned by the U.S. and held in trust for the Navajo Nation; while HRI holds the mineral rights and certain surface rights to enable mining.

⁹ *HRI, Inc. v. EPA*, 198 F.3d 1224 (10th Cir. 2000); the court held that the Section 17 mine site was Indian country.

¹⁰ 40 C.F.R. 145.32(a)

¹¹ *HRI, Inc. v. EPA*, 198 F.3d 1224, 1241 (10th Cir. 2000).

¹² 18 U.S.C. § 1151; “the term “Indian country”,

... means (a) all land within the limits of any Indian reservation under the jurisdiction of the United States Government, notwithstanding the issuance of any patent, and, including rights-of-way running through the reservation, (b) all dependent Indian communities within the borders of the United States whether within the original or subsequently acquired territory thereof, and whether within or without the limits of a state, and (c) all Indian allotments, the Indian titles to which have not been extinguished, including rights-of-way running through the same.”

¹³ <http://www.epa.gov/region09/water/groundwater/permit-determination.html> (last visited April 25, 2006)

¹⁴ All of the comments can be viewed at: <http://www.epa.gov/region09/water/groundwater/permit-determination.html> (last visited April 25, 2006).

¹⁵ 522 U.S. 520 (1998).

¹⁶ *Pittsburg & Midway Coal Mining Co. v. Watchman*, 52 F.3d 1531, 1542 (10th Cir. 1995)

¹⁷ *HRI, Inc. v. EPA*, 198 F.3d 1224, 1249 (10th Cir. 2000)

¹⁸ Comments submitted to the EPA, December 15, 2005; <http://www.epa.gov/region09/water/groundwater/permit-determination.html> (last visited April 1, 2006).

¹⁹ Comments submitted to the EPA, (undated).

²⁰ Comments submitted to the EPA, (undated).

²¹ Comments submitted to the EPA, December 8, 2005.

²² Comments submitted to the EPA, January 24, 2006.

²³ N.M. Stat. Ann. § 7-26-7 (2006).

²⁴ Comments submitted to the EPA, December 15, 2006.

²⁵ Comments submitted to the EPA, January 30, 2006.

²⁶ Comments submitted to the EPA, January 03, 2006.

²⁷ Mr. Gould submitted his comments personally and not on behalf of any organization.

²⁸ Comments submitted to the EPA, February 4, 2006.

²⁹ *United States v. McGowan*, 302 U.S. 535, 538-539 (1938)

³⁰ Comments submitted to the EPA, January 30, 2006.

³¹ *HRI, Inc. v. EPA*, 198 F.3d 1224, 1249 (10th Cir. 2000)

“At the Well”

continued from page 3

CO₂ is only marketable after it has been gathered (transported by field pipelines to the plant), dehydrated and compressed. Ironically, in *Amoco Production Co. v. New Mexico Taxation and Revenue Dept.*,¹⁶ the analogue of making Bravo Dome CO₂ marketable is presented where removing the CO₂ from San Juan Basin coalbed natural gas was necessary to make it marketable. “Case law holds that for purposes of the NGPT [Natural Gas Processor’s Tax] ‘processing’ is that which takes place in order for the gas to be marketable or acceptable to interstate pipelines.”¹⁷

The unbroken line of New Mexico cases recognizing the implied covenant to market rule are not addressed in *Creson* for the reason previously stated. The words in a royalty clause “at the well” do not answer the question under New Mexico law about what post-production expenses can be used in making a royalty calculation. Nor does *Creson* “illustrate the current legal trend in New Mexico regarding the definition of “at the well” in natural gas royalty clauses.” *Vista*, 5. Moreover, *Elliott* cannot properly be coupled with *Creson* as joining such “trend.” Indeed, *Elliott* is the antithesis of *Creson* by expressly limiting *Creson* due to the concession in that case of wellhead marketability. *Elliott* instead states that an “at

the well” royalty obligation is circumscribed by fact issues about whether certain expenses are for production rather than post-production; whether post-production expenses are “actual” and, if so, are they “reasonable;” and above all “whether the gas is in fact marketable at the wellhead.”¹⁸

New Mexico has not directly stated that the implied covenant to market imposes the market condition rule. If the rule is adopted, the question remains what post-production expenses are or are not deductible. It is clear that any expense deduction used in a royalty calculation must be an “actual” expense and if it is actual, it must be “reasonable.”

Endnotes

¹ 2000-NMCA-081, 129 N.M. 529, 10 P.3d 853.

² *Heritage Resources, Inc. v. NationsBank*, 939 S.W.2d 118 (Tex. 1996) and *Merritt v. Southwestern Elec. Power Co.*, 499 So.2d 210 (La. Ct. App. 1986).

³ *Babin v. First Energy Corp.*, 693 So.2d 813, 815-816 (La. Ct. App. 1997).

⁴ *Rogers v. Westerman Farm Company*, 29 P.3d 887, 2001 Colo. LEXIS 559, July 2, 2001; *Mittelestaedt v. Santa Fe Minerals, Inc.*, 1998 OK 7,

954 P.2d 1203; *Sternberger v. Marathon Oil Co.*, 257 Kan. 315, 894 P.2d 788 (1995); *Hanna Oil and Gas Co. v. Taylor*, 297 Ark. 80, 759 S.W.2d 563 (1988).

⁵ 407 F.3d 1091, 1110-111 (10th Cir. N.M. 2005).

⁶ 407 F.3d 1110-111, citing *Creson*, 10 P.3d at 856, 859 and noting that plaintiffs did not dispute the type of cost deducted or whether the costs were not the actual costs or were inflated; plaintiffs conceded the carbon dioxide gas was marketable at the wellhead.

⁷ *Enhanced Oil Recovery*, National Petroleum Council, 1984, 11-21.

⁸ 51 N.M. 95, 179 P.2d 263 (1947).

⁹ 66 N.M. 260, 346 P.2d 1041 (1959).

¹⁰ *Id.* at 263.

¹¹ *Id.*

¹² 83 F.2d 425, 432 (10th Cir 1936).

¹³ 82 N.M. 245, 248, 479 P.2d 294 (1970).

¹⁴ *Id.* (Citations omitted; emphasis added.)

¹⁵ 54 N.M. 27, 34, 213 P.2d 212 (1949). (Emphasis added.)

¹⁶ 2003-NMCA-092, 134 N.M. 162, 79 P.3d 96.

¹⁷ *Id.*

¹⁸ *Elliott* at 1110-111.

Countervailing Equities: The New Mexico Legislature's Search For Harmony At The Nexus Of Water And Mineral Law

Mark S. Barron

The production of oil, gas, and other mineral resources often involves the diversion and treatment of large quantities of water. In arid New Mexico, however, when water is injected, produced, or otherwise diverted, such usage "is affected with a public interest."¹ In regulating such use, the Legislature must account for principles of conservation and environmental integrity, as well as consider the discouraging impact regulation may have on mineral production and economic development.² Consequently, determining the methods through which water may be permissibly used, and establishing ownership rights to the water before and after any diversion or treatment, requires balancing a complicated array of countervailing equities at the nexus of water and mineral law.

Absent express action by the Legislature, establishing rights to water diverted or treated during the mineral extraction process implicates traditional water law doctrines of prior appropriation and beneficial use. This is true even when it is mineral development itself that has led to the production or migration of the water. Drilling for oil and gas, for example, often results in the production of "artificial" waters, or "water whose appearance or accumulation is due to escape, seepage, loss, waste, drainage or percolation from constructed works, either directly or indirectly, and which depend for their continuance upon the acts of man."³ Moreover, many times these artificial waters are the result of water being injected into the ground to force the minerals to the surface. Nevertheless, it is well-settled law in New Mexico that "[w]hen waters, either artificial surface waters or natural surface waters, reach an established underground water basin by percolation, seepage or otherwise, they become public waters."⁴

In light of these common law rules, the New Mexico Legislature has recognized that "existing principles of prior appropriation, beneficial use and impairment of water rights, when applied to the diversion of water to permit mineral production, may cause severe economic hardship and impact to persons engaged in mineral production, to the owners of water rights and to the citizens of New Mexico."⁵ As a result, the Legislature passed the Mine Dewatering Act in an attempt "to promote maximum economic development of mineral resources while ensuring that such

development does not impair existing water rights."⁶ Although the Mine Dewatering Act does not create water rights for mineral operators,⁷ it does allow for some development that would be otherwise impermissible under water law alone. Pursuant to the Act, the state engineer may approve applications to utilize water for mining purposes, even in cases in which the



mineral operator does not have an independent water right.⁸ Moreover, when development activities impair existing water rights held by third parties, the state engineer may *still* approve mining activities if the mineral operator can implement an adequate plan to replace the water.⁹

The Mine Dewatering Act is not unique in permitting special uses of water in the interests of mineral production; several other statutes reflect a similar policy choice on the part of the Legislature. Section 72-12-1.3 of the New Mexico Statutes Annotated, for example, allows for some temporary uses of underground public water in "drilling operations designed to discover or develop the natural mineral resources of the state."¹⁰ Similarly, as long as producers comply with regulations promulgated by the Oil Conservation Division of the state's Energy, Minerals and Natural Resources Department, no permit is needed from the state engineer for the disposition of water produced in mineral extraction efforts.¹¹

In summation, under New Mexico common law, water injected or produced in mineral development operations would seem to be public water subject to appropriation in accordance with the state's statutory water scheme. Under this scheme, mineral producers are compelled to shoulder the burden and endure the often prohibitive costs of compliance with statutory and regulatory water law. In recognition of the economic importance of mineral development to the economy of New Mexico, however, the Legislature has created an independent body of mineral law that creates some limited exceptions to the most costly aspects of that compliance. The result is a legislative policy that attempts to account for concerns regarding environmental health and safety, while at the same time promoting economic development of the state's mineral resources.

Endnotes

¹ N.M. Stat. Ann. § 72-12A-2(A)(1)-(2)

² See S.B. 493, 47th Leg., 2d Sess. (N.M. 2006)

³ *Reynolds v. City of Roswell*, 99 N.M. 84, 87, 654 P.2d 537, 540 (1982)

⁴ *State ex rel. Reynolds v. King*, 63 N.M. 425, 428, 321 P.2d 200, 201 (1958).

See also *Kelley v. Carlsbad Irrigation Dist.*, 76 N.M. 466, 472, 415 P.2d 849, 853

(1966) (holding that once water "loses its identity as surface water, such waters become public.")

⁵ N.M. Stat. Ann. § 72-12A-2(A)(3).

⁶ N.M. Stat. Ann. § 72-12A-2(B).

⁷ N.M. Stat. Ann. § 72-12A-5(A).

⁸ N.M. Stat. Ann. § 72-12A-7(A)-(C).

⁹ N.M. Stat. Ann. § 72-12A-7(D)-(H). The Act also does not preclude the filing for or issuance of a permit to appropriate water.

¹⁰ N.M. Stat. Ann. § 72-12-1.3.

¹¹ N.M. Stat. Ann. § 72-2-12.1.

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What's the Connection?

continued from page 4

² New Mexico Environment Department, *Fish Consumption Advisories Due to Mercury Contamination* (revised 2001).

³ Tox. Profile, *supra* note 1, at 389.

⁴ *Id.* at 392.

⁵ *Air Quality and Clean Energy: San Juan Power Plant*, <http://www.grandcanyontrust.org/programs/air/san-juan.php>.

⁶ Jesse Harlan Alderman, *Energy Company Official Seeks to Win Over Critics*, *The Durango Herald*, January 24, 2006.

⁷ National Institute of Health Division of Safety, *Mercury Health Hazards*, <http://www.nih.gov/od/ors/ds/nomercury/health.htm>.

⁸ Centers for Disease Control, *Blood and Hair Mercury Levels in Young Children and Women of Childbearing Age- United State 1999*, *MMWR Weekly* 50(08),140 (2001), <http://www.cdc.gov/mmwr/preview/mmwrhtml/mm5008a2.htm>.

⁹ 70 Fed. Reg. 95, 28608 (May 18, 2005).

¹⁰ CAIR instituted a cap and trade program for NOx and SO2.

¹¹ Fed. Reg., *supra* note 10, at 28623.

¹² *Id.* at 28627.

¹³ *Id.* at 28611.

¹⁴ Government Accountability Office, *Observations on EPA's Cost-Benefit Analysis of its Mercury Control Options*, GAO-05-052 (February 2005).

¹⁵ The States filing suit were New Jersey, California, Connecticut, Maine, Massachusetts, New Hampshire, New Mexico, New York, Pennsylvania, Vermont and Wisconsin. New York State Attorney General Eliot Spitzer, *Press Release: Eleven States Sue EPA to Block Second Mercury Rule* (May 18, 2005).

¹⁶ The states petitioning EPA were New Jersey, California, Connecticut, Delaware, Illinois, Maine, Massachusetts, New Hampshire, New Mexico, New York, Pennsylvania, Rhode Island, Vermont, and Wisconsin.

¹⁷ The environmental organizations petitioning the EPA were the Natural Resources Defense Council, Clean Air Task Force, Ohio Environmental Council, U.S. Public Interest Research Group, and the Natural Resources Council of Maine.

¹⁸ Environmental Protection Agency, *Fact Sheet-Reconsideration of the Clean Air Mercury Rule* (October 21, 2005).

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