

June 2, 2004: State's authority to take natural gas royalties in kind

The Honorable Manny M. Aragon

State Senator

P.O. Drawer Z

Albuquerque, NM 87103

Re: Opinion Request – New Mexico State Land Office / Sale of Royalty Natural Gas

Dear Senator Aragon:

You requested our advice regarding the state's authority to take natural gas and natural gas liquid royalties in kind. Your questions arise because the Commissioner of Public Lands is contemplating whether to take royalties in kind to increase trust and general budget income. In particular, you ask:

1. Do the restrictions in Section 10 of the New Mexico Enabling Act on “any sale or contract for the sale of ... natural products of ... [state trust] lands,” including appraisal, public bidding/auction and advertising requirements, apply to the sale of natural gas royalties taken in kind (in lieu of cash payments) from lessees?
2. Is the Commissioner of Public Lands required to follow competitive bidding procedures when selling royalty gas?
3. Does NMSA 1978, Section [19-10-67](#), which governs sales of royalty oil, apply to sales of royalty gas and natural gas liquids? Does NMSA 1978, Section [19-10-61](#), which governs sales of royalty gas, apply to sales of royalty oil?
4. What does the phrase “at the time of exercising the option” mean for purposes of Section [19-10-61](#)'s limitations on the consideration for which royalty gas may be sold?
5. Does Section [19-10-61](#) allow the Commissioner to contract for the sale of royalty gas taken in kind so long as he does not receive a net consideration, plus or minus the relevant spot market, that is less than the consideration being received when he exercised the option to take the gas in kind, even though the total/gross price in the spot market will continue to rise and fall?
6. May the Commissioner of Public Lands, consistent with Section [19-10-61](#), calculate the “net consideration ... being received at the time of exercising the option” by using a historic Permian/San Juan basin yearly price differential? If so, what is the appropriate number of calendar yearly averages that the Commissioner may use for the calculation?

As discussed below, (1) the requirements of Section 10 of the Enabling Act do not apply to the receipt and sale of royalty gas; (2) the Commissioner of Public Lands is not required to use competitive bidding when selling royalty gas; (3) different statutory requirements apply to the sale of royalty gas and royalty oil; (4) “net consideration at the time of exercising the option” is the market value of natural gas at or reasonably close to the time the Commissioner elects to take royalty gas in kind; (5) the Commissioner of Public Lands retains discretion under NMSA 1978, Section 19-10-61 to determine the method of calculating net consideration for purposes of selling royalty gas, including the appropriate weight given to fluctuations in spot market prices; and (6) the Commissioner may, if appropriate, consider historic average prices or yearly price differentials when calculating net consideration for purposes of Section 19-10-61.

1. Application of Section 10 of the Enabling Act to Sales of Royalty Gas

The Enabling Act was enacted by Congress in 1910 and established the terms for the admission of New Mexico as a state. See Ch. 310, 36 Stat. 557 (1910). Among other things, the Enabling Act grants public land to New Mexico subject to certain terms and conditions and requires that the state constitution consent to those terms and conditions. §§ 2, 10. The required consent is reflected in Article XXI, [Section 9](#) of the New Mexico Constitution which, in effect, incorporates the relevant portions of the Enabling Act and makes them part of the fundamental law of New Mexico. See State ex rel. Interstate Stream Comm’n v. Reynolds, 71 N.M. 389, 396-97, 378 P.2d 622 (1963).

Section 10 of the Enabling Act provides, in pertinent part, that public lands granted to the state:

shall be ... held in trust, to be disposed of in whole or in part only in manner as herein provided ... and that the natural products and money proceeds of any of said lands shall be subject to the same trusts as the lands producing the same.

Section 10 also provides the procedures for conveying public lands, including sale or lease to the highest and best bidder at public auction for consideration at no less than the appraised value or minimum value established by the Act. The required procedures apply not only to the sale or lease of public lands, but also to the “natural products” of those lands. Natural products include minerals, such as oil and gas, produced on public lands. See Neel v. Barker, 27 N.M. 605, 607, 204 P. 205 (1922).¹

The terms and conditions on land grants imposed under Section 10 of the Enabling Act may be modified only by amendment of the New Mexico Constitution with the consent of Congress. N.M. Const. arts. XIX, § 4, XXI, § 10; Enabling Act, § 2; Bryant v. Board of Loan Comm’rs, 28 N.M. 319, 329, 211 P. 597 (1922). In 1928, after receiving the requisite consent of Congress, see Joint Resolution No. 7, ch. 28, 45 Stat. 58 (1928),² the state constitution was amended to allow the legislature to set the procedures for “[l]eases and other contracts, reserving a royalty to the state, for the development and production of any and all minerals ... on lands granted or confirmed to the state” under

the Enabling Act. See N.M. Const. [art. XXIV](#). Specifically, contracts covered by the provision:

may be made under such provisions relating to the necessity or requirement for or the mode and manner of appraisal, advertisement and competitive bidding, and containing such terms and provisions, as may be provided by act of the legislature....

Use of the proceeds from the leases and other contracts is limited to the purposes of the original grants. Id.

[Article XXIV](#) allows the legislature to enact laws waiving the Enabling Act's appraisal, advertisement and bidding requirements on mineral leases. Pursuant to this authorization, the legislature has given the Commissioner of Public Lands authority to issue leases for the exploration, development and production of oil and natural gas from public lands "upon such terms and conditions as the commissioner may deem to be for the best interests of the state." NMSA 1978, § [19-10-1](#) (1929, as amended through 1941). The legislature also has enacted oil and gas lease terms giving the Commissioner of Public Lands the option of reserving natural gas royalties to the state in kind, §§ [19-10-4](#) to [-4.3](#) (1985), and authorization to sell or exchange royalty gas. § [19-10-61](#) (1972). Accordingly, unless otherwise imposed by the Commissioner of Public Lands, the limitations on the conveyance of natural gas from public lands under Section 10 of the Enabling Act do not apply to the sale of royalty gas.

2. Requirement for Competitive Bidding When Selling Royalty Gas

Under NMSA 1978, Section [19-10-61](#) (1972), the Commissioner of Public Lands is authorized

to negotiate and enter into agreements for the sale or exchange of royalty gas taken in kind under oil and gas leases issued by the state. Provided, however, he shall not dispose of said gas for a net consideration of less than that being received at the time of exercising the option.

This provision leaves to the Commissioner of Public Lands the discretion to negotiate the terms of royalty gas sales, subject to the limitation on consideration. There is no requirement that the Commissioner follow competitive bidding procedures when selling royalty gas.

3. Proper Application of NMSA 1978, Sections [19-10-61](#) and [19-10-67](#)

As discussed above, NMSA 1978, Section [19-10-61](#) authorizes the Commissioner of Public Lands to sell royalty gas taken in kind under oil and gas leases issued by the state. In a separate provision, the legislature has authorized the Commissioner to sell royalty oil. § [19-10-67](#). Under that provision, royalty oil may be sold only "by competitive bidding," and "upon notice and advertisement on sealed bids." For purposes of Section

[19-10-67](#), the term “royalty oil” is defined as “crude oil, liquid petroleum products, condensates from wells or lease plants or a mixture thereof.” § [19-10-65](#).

Because the legislature has addressed sales of royalty gas and royalty oil in separate provisions, we conclude that it intended to regulate them differently. This conclusion is supported by the statutory definition of “royalty oil” for purposes of Section [19-10-67](#), which does not encompass royalty gas. Accordingly, while royalty oil, as defined in the law, may be sold only under the competitive bidding process described in Section [19-10-67](#), the Commissioner of Public Lands is granted relatively unrestricted authority under Section [19-10-61](#) to negotiate agreements for the sale of royalty gas.

4. The Time the Option to Take Royalty Gas is Exercised under Section [19-10-61](#)

As discussed above, Section [19-10-61](#) requires that net consideration received for royalty gas be no less than the consideration being received “at the time of exercising the option.” According to your request, the Commissioner of Public Lands would like to calculate the price at the time of exercising the option based on the prices over a period of years before the option is exercised to average out extremes in pricing.

Generally, absent any indication of contrary legislative intent, the words used in a statute are interpreted according to their ordinary and usual sense. See Bettini v. City of Las Cruces, 82 N.M. 633, 634, 485 P.2d 967 (1971). Under the applicable rules of statutory construction, language may not be read into a statute that makes sense as written. See Burroughs v. Board of County Comm’rs, 88 N.M. 303, 306, 540 P.2d 233 (1975).

As usually understood, the phrase “at the time of” may be used interchangeably with the word “when,” a definition of which is: “at or during the time that.” Webster’s Third New International Dictionary 2602 (1986). Thus, Section [19-10-61](#)’s reference to consideration “being received at the time of exercising the option” likely was intended to refer to the market price at or reasonably close to the time the Commissioner of Public Lands elected to take the royalty gas.

Nevertheless, as discussed below, the method of calculating net consideration for purposes of Section [19-10-61](#) is left to the Commissioner’s discretion. Thus, provided he acts reasonably, the Commissioner is not precluded from considering applicable prices over a period of years to measure net consideration at the time of exercising the option to take royalty gas.

5. Calculation of “Net Consideration” under Section [19-10-61](#)

Section [19-10-61](#) prohibits the Commissioner of Public Lands from disposing of royalty gas for a net consideration of less than that being received at the time of exercising the option to take royalty gas in kind. According to your request, the market price for gas is not fixed, but fluctuates at a price plus or minus a known and published spot market price for each spot market transaction center, also known as a hub. In New Mexico, the

hubs upon which spot market prices are based are the Permian Basin's Waha Hub and the San Juan Basin's Blanco Hub.

Under Section [19-10-61](#), the minimum consideration the Commissioner of Public Lands may receive for royalty gas is the market price or market value at which the gas was selling at the time the Commissioner elected to take it in kind. The statute does not define "net consideration" or dictate a particular method for determining the market value for royalty gas taken in kind. This gives the Commissioner leeway to consider changes in the market and pricing mechanisms for gas since Section [19-10-61](#) was enacted. Accordingly, he may apply whatever factors he reasonably believes necessary, including allowances for fluctuating spot market prices, to determine net compensation for purposes of Section [19-10-61](#).

6. Use of a Yearly Price Differential to Determine Net Consideration

According to your request, the impetus for the Commissioner of Public Lands' proposal to take natural gas royalties in kind includes the need to address price disparities between San Juan basin gas and Permian basin gas. Historically, the yearly average price for San Juan Basin gas has been materially less than the price for gas from the Permian basin, and the differential has increased over the last several years. The Commissioner believes that the differential may be alleviated if, for purposes of Section [19-10-61](#), he is able to calculate the consideration for natural gas at the time he exercises the option to take royalty gas based on the average yearly calendar differentials between the San Juan basin and the Permian basin.

Under Section [19-10-61](#), the "net consideration" for which royalty gas may be sold must be at least the same as that being received at the time the Commissioner exercises the option to purchase royalty gas in kind. As discussed above, the Commissioner retains discretion to determine the most appropriate method for calculating net consideration at the time the option is exercised. This includes authority to base the calculation on average yearly price differentials between the San Juan and Permian basins.

If we may be of further assistance, please let us know. Your request to us was for a formal Attorney General's Opinion on the matters discussed above. Such an opinion would be a public document available to the general public. Although we are providing you our legal advice in the form of a letter instead of an Attorney General's Opinion, we believe this letter is also a public document, not subject to the attorney-client privilege. Therefore, we may provide copies of this letter to the public.

Sincerely,

Elizabeth A. Glenn

Assistant Attorney General

1 For purposes of this letter, we assume that, but for N.M. Const. [art. XXIV](#), discussed in the text, [infra](#), the disposition of natural gas produced on public lands would be subject to the requirements of Section 10 of the Enabling Act. There is some New Mexico authority to the contrary. [See Neel v. Barker](#), 27 N.M. at 608-11 (concluding that public lands discovered to be mineral in character after they were acquired by New Mexico were excluded from the Enabling Act's restrictions on conveyance). However, the United States Supreme Court subsequently held that mineral lands granted to Arizona were subject to the same conditions as other granted lands and, in the process, concluded that the reasoning used in [Neel](#) to reach the opposite result was wrong. [See ASARCO Inc. v. Kadish](#), 490 U.S. 605, 628 (1989). In addition, Congress passed the Jones Act, 44 Stat. 1026, in 1927 that expressly extended to mineral lands granted to Western states the same requirements for conveyance that applied to non-mineral public lands. [See ASARCO Inc.](#), 490 U.S. at 627.

2 [See also ASARCO Inc.](#), 490 U.S. at 631, n. 5 (explaining that Congress passed Joint Resolution No. 7 after "the New Mexico government," in response to the enactment of the federal Jones Act, "immediately petitioned Congress to authorize a state plebiscite to codify [the holding in [Neel v. Barker](#)] as law").