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Oil and Gas - Survey of Rights under Oil and Gas Leases

cannot do directly.[43] Thus there has been the counterplay of the two interests, namely, that of safeguarding the taxpayer from the costs of improper municipal contracts, as opposed to the inequities of a municipality being enriched at another's expense.[44]

The majority of decisions place the municipality under the same obligation to do justice as a private corporation where there is not an abrogation of a public safeguard and hold that wherever possible restitution in value should be made.[45] Under this principle municipal corporations, in part to protect the credit of the municipality, like a private corporation or individual, should be compelled to do justice and equity,[46] but only within the bounds established to protect the municipality.

OIL AND GAS — SURVEY OF RIGHTS UNDER OIL AND GAS LEASES

THE EXCEPTIONAL physical properties of oil and gas are reflected in the manner in which courts have created the law which governs them. Recent developments in the search of oil and gas in North Dakota and the resultant leasing of oil, gas and mineral rights in much of the state's real property have led many property owners to attempt to classify the legal rights of the parties arising under this special type of lease.

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[43] Barnard v. Chicago, 316 Ill. 519, 147 N.E. 384 (1925) (protection of taxpayers demanded strict construction); McCurdy v. Shiawassee County, 154 Mich. 550, 118 N.W. 625 (1908). See Village of Harvey v. Wilson, 78 Ill. App. 544 (1898) for an example of a statutory safeguard made meaningless.

[44] The trend is toward allowance of quasi contract recovery in a greater number of situations. See Note, 36 Mich. L. Rev. 855, 858 (1938).

[45] First Nat. Bank of Goodhue v. Village of Goodhue, 120 Minn. 362, 139 N.W. 599 (1913) (criticized in 16 Va. L. Rv. 628, 635 (1930) for allowing recovery when loan was made without prior voter authorization required and also where the president of the council was an official in the loaning bank). "As against individuals the law implies a promise to pay in such cases and the implication extends equally to corporations." San Francisco Gas Co. v. San Francisco, 9 Cal. 453 (1858).

[46] "Equity properly recognizes that a municipal corporation should not be permitted to take the property of another, and receive the benefits thereof, and thus be enriched through the loss of another without compensation." Bartelson v. International School Dist., 43 N.D. 253, 256, 174 N.W. 78, 79 (1919). *Accord*: Pimentel v. City of San Francisco, 21 Cal. 351 (1863) ("The city is not excepted from the common obligation to do justice which binds individuals"); Iverson v. Williams School Dist., 42 N.D. 622, 172 N.W. 818 (1919).

UNDERLYING LAW OF OIL AND GAS

Broadly speaking, the law of oil and gas is *sui generis*.[1] In the early cases the courts experienced much difficulty in giving oil and gas a definite status as property and in attempting to distinguish the rights of the landowner from his lessee's or grantee's. Analogies were drawn from the rules relating to animals *ferae naturae*,[2] underground water, solid minerals, and even air. Because oil and gas when *in situ* have few migratory tendencies but still may escape without the volition of the surface owner, it was natural that confusion would result in classifying oil and gas as property. In the famous Pennsylvania case of *Westmoreland v. DeWitt* [3] the early theory that the property owner had absolute dominion over the oil and gas underlying his land,[4] developed from the idea that oil and gas were part of the total aggregate of the land, gave way to the better view that the owner of the surface lost his right to the oil and gas if they escaped into the land of another, and the landowner only acquired absolute control when the oil and gas were actually brought within his grasp and into his possession on the surface.[5]

LEGAL INTERESTS CREATED BY LEASES IN GENERAL

In the ordinary lease for production the owner does not entirely divest himself of his rights to gas and oil under his land. The legal effect of each individual lease is, of course, governed by the intent of the parties as drawn from the terminology used. If the landowner completely divests himself of his rights, the lessee receives all legal interest that the original landowner had in the land.[6] But where something is retained, courts have run the gauntlet in arriving at their conclusions as to what legal interests have been created by oil and gas leases, finding the rights to be in the nature of a *profit a prendre*,[7] an incor-

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[1] Colby, *The Law of Oil and Gas*, 31 Calif. L. Rev. 357 (1943).

[2] Westmoreland Gas Co. v. DeWitt, 130 Pa. 235, 18 Atl. 724 (1889); Colby, *supra* note 1, at 261.

[3] 130 Pa. 235, 18 Atl. 724 (1889).

[4] This theory is exemplified by the early case of Hague v. Wheeler, 157 Pa. 324, 27 Atl. 714 (1893).

[5] Ohio Oil Co. v. Indiana, 177 U.S. 190 (1900).

[6] See Sommers, Oil and Gas §§38, 39 (1927).

[7] Funk v. Halderman, 53 Pa. 229 (1866). A *profit a prendre* is a right exercised by one man in the soil of another, accompanied with participation in the profits of the soil. A right to take part of the soil or produce of the land, it is considered an interest or estate in the land itself. Gadow v. Hunholtz, 160 Wis. 293, 151 N.W. 810 (1915).

poreal hereditament,[8] an estate in land,[9] not an estate in land,[10] a freehold,[11] a tenancy at will,[12] a servitude,[13] a chattel real,[14] real estate,[15] an interest in land,[16] not an interest in land,[17] and personal property.[18] The basic principle on which the lease for production lies today is that the lessee has merely a license to explore, conveying no interest in the land, and the lease is looked upon as an incorporeal hereditament and as personal property.[19]

Thus, in some jurisdictions, the lease passes no present title of any kind whatsoever,[20] but other courts have stated that as the prime object of an oil and gas lease is the extraction of the subsurface oil and gas for the parties' mutual benefit, the lessee is vested with a qualified or determinable fee.[21] Generally, if the lease is for a fixed period of years, it may be regarded as a chattel real, but if it is capable of infinite duration it assumes the nature of a freehold or defeasible fee, and vests in the lessee a present interest in the land in the nature of a *profit a prendre* in gross, although it does not pass title to oil and gas in place in the ground.[22] When the oil and gas lease amounts to little more than a license to explore, and although contemplating the vesting of a conditional estate in the lessee in the event of discovery of oil and gas within the time specified, passes no present title of any kind, the lessee gains the right of ingress and egress from the land, the right to produce oil and gas when once found, but gets no vested rights until oil and gas is discovered.[23] This is the normal lease for production.

Leases for Production and Grants of Mineral Rights

The distinction between the ordinary lease for production and the grant or reservation of a mineral right in the land

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[8] Heller v. Dailey, 28 Ind. App. 555, 63 N.E. 490 (1902).
[9] Southern Oil Co. v. Colquitt, 28 Tex. Civ. App. 292, 69 S.W. 169 (1902).
[10] Duff v. Keaton, 33 Okla. 92, 124 Pac. 291 (1912).
[11] Daughtee v. Ohio Oil Co., 240 Ill. 361, 88 N.E. 818 (1909).
[12] Knight v. Ind. Coal and Iron Co., 47 Ind. 103 (1874).
[13] Frost Johnson Lumber Co. v. Sallings Heirs, 150 La. 756, 91 So. 207 (1922).
[14] Duff v. Keaton, 33 Okla. 92, 124 Pac. 291 (1912).
[15] Columbian Oil Co. v. Blake, 13 Ind. App. 680, 42 N.E. 234 (1895).
[16] Montana & W. Oil Co. v. Gibson, 19 Wyo. 1, 113 Pac. 784 (1911).
[17] Nat. Gas and Oil Co. v. Matolock, 177 Iowa 225, 97 N.W. 787 (1912).
[18] Wagner v. Mallory, 169 N.Y. 501, 62 N.E. 584 (1902).
[19] Burden v. Gypsy Oil Co., 141 Kan. 147, 40 P.2d 463 (1935).
[20] Huggins v. Daly, 99 Fed. 606 (4th Cir. 1900).
[21] Leonard v. Prater, 36 S.W.2d 216 (Tex. Civ. App. 1931).
[22] Transcontinental Oil Co. v. Emerson, 298 Ill. 394, 131 N.E. 645 (1921).
[23] Huggins v. Daly, 99 Fed. 606 (4th Cir. 1900).

should be noted. In general, a conveyance of minerals, or a reservation of the mineral rights in land transferred, includes the oil and gas.[24] If the reservation retained by the transferor or the mineral right given to the grantee assumes the form of a "royalty," a real obligation is imposed on the land, and is a species of real right running with the land.[25] In Oklahoma, a conveyance of oil and gas *and* other mineral rights in and under the land is a conveyance of an interest in the land itself and creates a separate estate therein.[26] Such a right would be considered a vested right.[27] Following the general rule that oil and gas are looked upon as minerals, a reservation of *minerals only* in a deed includes oil and gas, at least where at the time of the execution of the deed oil and gas are being developed in the vicinity.[28] A deed must contain language that expressly excludes oil and gas if a general deed of minerals is granted; otherwise the general rule will apply.[29]

ROYALTY RIGHTS

Royalty rights have been given different interpretations by the courts. While a royalty is the consideration for the rights and privileges granted to the lessee and consists of the right to share in any minerals discovered,[30] the right to a royalty becomes vested only when the oil or gas, or other mineral becomes captive and reduced to personal property. Therefore it would appear that when oil and gas remain in the ground in place as realty, they would not be included in the term royalty, although a royalty is an interest in real estate entitling the owner to a share of the production.[31] Royalty refers not to the oil in place, but is the compensation paid for the privilege of drilling and producing and does not include a perpetual interest in the oil and gas in the ground.[32] On the other hand, the

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[24] Continental Oil Co. v. Landry, 215 La. 518, 41 So.2d 73 (1949).

[25] Little v. Mountain View Dairies, 208 P.2d 361 (Cal. 1949).

[26] Cornelius v. Jackson, 209 P.2d 166 (Okla. 1948), *cert. denied*, 335 U.S. 906 (1949); Martin v. Atkinson Warren & Henley Co., 195 Okla. 19, 154 P.2d 945 (1945).

[27] Burke v. Southern Pacific Ry., 234 U.S. 669 (1914); Ohio Oil Co. v. Indiana, 177 U.S. 190 (1900); Walks v. Midland Carbon Co., 254 U.S. 300 (1920).

[28] Barker v. Campbell-Radcliff Land Co., 64 Okla. 249, 167 Pac. 468 (1917).

[29] Bodcaw Lumber Co. v. Goode, 160 Ark. 48, 254 S.W. 345 (1923); Hudson v. McGuire, 188 Ky. 712, 223 S.W. 1101 (1920); Murray v. Allred, 100 Tenn. 100, 43 S.W. 355 (1897).

[30] See Note, 90 A.L.R. 770 (1934).

[31] Hulse v. Hulse, 155 Ill. App. 343 (1910); Palmer v. Crews, 35 So.2d 240 (Miss. 1948).

[32] Bellport v. Harrison, 123 Kan. 310, 255 Pac. 52 (1927).

mineral interest is an interest in the oil and gas in place and constitutes an actual interest in real estate,[33] and may or may not produce royalties under the lease. In case the property owner grants the right to enter and explore and as his consideration takes a certain fractional interest in the form of royalties if minerals are discovered, it must be remembered that the concept of royalty always presupposes development or production of the mineral to which it relates.[34] The term royalty is generally applied in the oil industry to the fractional interests in production of oil and gas which are created by the owner of the land either by reservation when an oil and gas lease is entered into or by a direct grant to a third person.[35] It would seem that the essential difference between the sale of a royalty interest and the sale of a mineral in land leased for minerals, is that the purchaser of the royalty interest receives nothing under the lease unless profitable production is obtained, whereas the purchaser of a mineral interest unless there is a stipulation to the contrary is entitled to receive his proportionate part of the renewal rentals under the lease and a like proportion of the price of subsequnt lease renewals paid thereunder.[36] As oil and gas lose their character of real property when produced and marketed, they become the property of the owner of the well.[37] It follows that where land subject to an oil and gas lease is subdivided and sold, the royalties from a producing well belong to the owner of the tract on which the well is drilled.

CONCLUSION

The property owner should remember that it is within his power to divide his land horizontally as well as vertically in such a manner that title to the surface may rest in one person, but title to the oil and gas or other minerals and the right to extract them, in another.[38] Once they are extracted, they become personal property subject to the law of personal property. The general rule is that the lessee under an oil and gas

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[33] Holland v. Shaffer, 162 Kan. 474, 178 P.2d 235 (1947).
[34] McIntosh v. Vail, 126 W.Va. 355, 28 S.E.2d 95 (1943).
[35] La Leguna Ranch Co. v. Dodge, 18 Cal.2d 132, 114 P.2d 351 (1941); Confer Belgam Oil Co. v. Wirt Franklin Petroleum Co., 209 S.W.2d 376 (Tex. Civ App. 1948). See Note, 135 A.L.R. 546 (1941).
[36] Bennett v. Robinson, 25 So.2d 641 (La.App. 1946).
[37] Kelly v. Ohio Oil Co., 57 Ohio 317, 49 N.E. 399 (1897).
[38] Texas Co. v. Daugherty, 107 Tex. 226, 176 S.W. 717 (1915).

lease owes to his lessor an obligation to exercise reasonable diligence in drilling an exploratory well, in the operation of the well, and in protecting the deposit against drainage.[39] The North Dakota court, in the recent case of *Herman Hanson Oil Syndicate v. Benz*,[40] appears to have taken the point of view that the obligation to drill the exploratory well with reasonable diligence is to be construed equitably and the lease will not be considered abandoned through failure to drill a started well to completion where extrinsic reasons halt operations.

[39] See Merrill, Covenants Implied in Oil and Gas Leases, c. 2 (2d ed. 1940); 23 Tex.L. Rev. 137 (1945).

[40] 40 N.W.2d 304 (N.D. 1949).