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IS A LEASE FOR OIL AND GAS MINING PURPOSES FOR A TERM OF YEARS REALTY OR PERSONALTY?

When the owner of a tract of land grants to another the exclusive right to explore and drill for oil and gas on his land, and, if the same be found in paying quantities to remove it, in consideration of the payment of a royalty, which is generally a certain proportion of the mineral itself, there exists what is commonly known as an oil and gas lease. The determination of the nature of this so-called lease, and of the rights of the parties thereto, has occasioned much diversity and confusion of language on the part of the courts in the states where oil lands are to be found.

The instrument (oil and gas lease) out of which the legal interest arises has been denominated a deed,¹ a lease,² a sale,³ a license,⁴ and an optional contract,⁵ and the legal interest created has been held to be a *profit a prendre*,⁶ a corporeal hereditament,⁷ an incorporeal hereditament,⁸ an estate in land,⁹ not an estate in land,¹⁰ an estate in oil and gas,¹¹ not an estate in oil and gas,¹² a servitude,¹³ a chattel real,¹⁴ real estate,¹⁵ interest in land,¹⁶ not an interest in land,¹⁷ personal property,¹⁸ a freeholder,¹⁹ and a tenancy at will.²⁰ In the light of this apparent confusion and the varied and sometimes careless terminology employed by the courts in giving expression to what is con-

¹ *Texas Co. v. Daugherty*, 107 Tex. 226, 176 S. W. 717.

² *Brown v. Beecher*, 120 Pa. 590, 15 Atl. 608.

³ *South Penn Oil Co. v. McIntire*, 44 W. Va. 305, 28 S. E. 926; Appeal of Stoughton, 88 Pa. 198.

⁴ *Mitchell v. Probat*, 52 Okl. 10, 152 Pac. 597.

⁵ *Brown v. Wilson*, 58 Okl. 392, 160 Pac. 94.

⁶ *Rich v. Doneghey*, 71 Okl. 204, 177 Pac. 36.

⁷ *Westmoreland Nat. Gas. Co. v. Dewitt*, 130 Pa. 235, 18 Atl. 724.

⁸ *Kelly v. Keys*, 213 Pa. 295, 62 Atl. 911.

⁹ *Southern Oil Co. v. Colquitt*, 69 S. W. (Texas) 169.

¹⁰ *Duff v. Keaton*, 33 Okl. 92, 124 P. 291.

¹¹ Note 1, supra.

¹² *Kolachny v. Galbreath*, 26 Okl. 772, 110 P. 902.

¹³ *Frost Johnson Lumber Co. v. Sallings Hrs.*, 150 La. 756, 91 So. 207.

¹⁴ Note 10, supra. *Stark v. Petty Bros.*, 195 Ky. 445.

¹⁵ *Columbia Oil Co. v. Blake*, 13 Ind. App. 680, 42 N. E. 234.

¹⁶ *Beckett-Iseman Oil Co. v. Backer*, 165 Ky. 118.

¹⁷ *Kokomo Nat. Gas. & Oil Co. v. Matlock*, 177 Ind. 225, 97 N. E. 787.

¹⁸ *Wagner v. Mallory*, 169 N. Y. 501, 62 N. E. 584.

¹⁹ *Wolford Oil & Gas Co. v. Shipman*, 233 Ill. 9, 84 N. E. 53.

²⁰ *Federal Oil Co. v. Western Oil Co.*, 112 Fed. 373.

sidered to be the nature of the lessee's legal interest in an oil and gas lease, we can only attempt to point out what rights a lessee actually gets, and to point out what the present tendency of the courts is to designate and classify these rights.

First of all it is important to notice what the right of the owner of the land is in the oil and gas beneath his land before he makes the lease. It has become the accepted opinion of the courts, excepting in the states of West Virginia, Kansas, and Texas, that the landowner has no property interest in the oil and gas which may be beneath the surface of his land, and can acquire no title to them until he reduces them to possession.²¹ The reason for the distinction between a landowner's right to oil and gas and his ownership in solid minerals like coal lies in the "vagrant and fugitive" nature of oil and gas which causes it to flow from one tract of land to another, and makes it possible for the owner of one tract to exhaust the supply from beneath the surrounding land. This view is termed the non-ownership theory

Under the ownership theory, which says that oil and gas are a part of the realty and that the owner has title to them, there is the anomalous situation of a landowner having title to a mineral, and then an adjacent landowner, by drilling and removing the mineral, acquiring title to the same mineral without any remedy to the first landowner for the taking. In other words, under the ownership concept, an adjacent landowner may deprive an owner of property of a part of his realty, title to which was absolute in him.

In the second place notice must be taken of the fact that there are two principal types of oil and gas leases, that type which in terms *grants the exclusive right* to explore for oil and gas for a fixed term and so long thereafter as oil and gas are found in paying quantities, and secondly, that which *grants the land* for the sole purpose of searching for oil, etc.

There have been very few decisions directly deciding that the lessee's interest was either realty or personalty, but in taxation cases some light is thrown on the problem where it has been necessary for the courts to decide whether such interest was tax-

²¹ *Lindsley v. Nat. Car. Gas Co.*, 220 U. S. 61, Tiffany, Sec. 256.

able as realty or personalty. In the states of Texas,²² Kansas,²³ and West Virginia,²⁴ which states adhere to the ownership theory, it has been held that, where the lease was of the type granting the land for oil and gas purposes, an estate in fee in oil and gas passed to the lessee which was subject to taxation as real property. Under the other type of lease, as was held in an Ohio²⁵ case the lessee's interest could not be taxed as realty, since the oil and gas were not conveyed in fee, and therefore the interest conveyed amounted to but a license or a lease at will. In this connection it is submitted that the courts, in determining the nature of the interest created by an oil and gas lease, should consider the substance rather than the form of the lease. Whatever the technical form, the underlying purpose of the lease is to give the lessee whatever rights the lessor has. That it is the present tendency of the courts to take this view of the matter, there is no question. Texas changed its position in a recent decision from that taken in the Daugherty case, *supra*, and the court said that it made no difference from a practical standpoint—that the lessee had no more privileges under one type of instrument than he had under the other—and held that the interest conveyed under the type of lease granting the exclusive rights to explore for oil and gas was real property, a determinable fee, which was a separate estate in land and subject to be taxed as such.²⁶

The Illinois court, without making any distinction in the type of lease, has consistently held that there is "a conveyance of an interest in the land itself, which, if of indefinite duration, is a freehold estate in the land", and the lessee's interest is taxable as land.²⁷ Illinois is a state adhering to the non-ownership theory. The Kentucky court in the case of *Wolfe Co. v. Beckett*,²⁸ in holding that the lessee's interest was taxable as realty, could discover no difference in the lessee's interest under a deed granting and demising the oil and gas, and under an ordinary lease. The court said "Why then say that a deed is

²² Note 1, *Supra*.

²³ *Kansas Natural Gas Co. v. Neosho Co.*, 89 Pac. 750.

²⁴ *State v. South Penn Oil Co.*, 24 S. E. 698.

²⁵ *Jones v. Wood*, 600 C. D. 538.

²⁶ *Stephens Co. v. Mid-Kansas Oil & Gas Co.*, 254 S. W. 290.

²⁷ *Transcontinental Oil Co. v. Emmerson*, 131 N. E. (Ill.) 645.

²⁸ 127 Ky. 252, 115 S. W. 447.

necessary to sever the oil from the realty, when the lease accomplished the same result? We therefore conclude that the form of contract is immaterial, and that it makes no difference whether the oil or gas privileges be conveyed by deed or lease, just so the effect of the instrument is to vest in the lessee all property rights to the oil or gas that may be found in paying quantities on the leased premises.”

The determination by the courts of the question whether the remedy of ejectment is available to a senior lessee to oust a junior lessee presents the problem of the lessee's interest as to whether it is realty or personalty. The majority rule²⁹ is that the lessee may maintain the action of ejectment prior to his entry upon the premises. Such being the rule, it must be conceded that the lessee has a possessory corporeal right in real property and that his interest is realty. The leading case on this problem is *Barnsdall v Bradford Gas Co.*, a Pennsylvania case,³⁰ and the court said in part: “By the agreement the exclusive right to take and appropriate all the minerals is conveyed and during the term of the lease the lessor has no right to enter and operate for oil and gas. The title to the oil, except the one-eighth interest thereof, is vested in the lessee, as is also the title to the gas and other minerals in the land. Under the rules of construction established, not only in other jurisdictions, but by our own cases, therefore, the agreement creates a corporeal interest in the lessee in the demised premises, and is not merely a license to enter and operate for oil and gas.” Kentucky is in accord with this case.³¹

Summers, in his book, “Oil and Gas” says at p. 205: “Although not determinative of the classification of real and personal property, all of the courts, where the question has been raised, hold that an oil and gas lease, without regards to its form, creates an interest in land within the meaning of the Statute of Frauds.”

As to whether or not mechanics liens attach to the lessee's interest, the cases are divided. In Pennsylvania, under a statute providing that such lien attached to leasehold estates, it was held³² that a lease of the usual type created a leasehold interest

²⁹ Tiffany Real Property, Vol. 1, p. 117.

³⁰ 225 Pa. 338, 26 L. R. A. (N. S.) 614.

³¹ Judge Cochran in *Beatty Oil and Gas Co. v. Blanton* 245 Fed. 979.

³² *McEwain v. Brown*, 11 Atl. 453.

in the lessee and that therefore his interest was attachable. The Kansas court held³³ in an early decision that no interest, leasehold or freehold, was created by an oil and gas lease. However, in a recent decision sustaining its former opinion, *Mason, V. Ch. J.*, in an able and exhaustive dissenting opinion, pointed out that a leasehold estate at common law was considered as real estate, but that, due to peculiar conditions existing under the system of feudal tenure, it was considered as personalty on the death of the lessee. He goes on to say "these reasons have long since ceased to exist, and, as a matter of fact, have never existed in the United States. Although oil and gas leases were unknown at common law, yet they are so analogous to leasehold estates and estates for years the same rule would be applicable."³⁴

On the general question of the lessee's interest in an oil and gas lease, the Oklahoma cases reflect the difficulty which the courts in the more recent oil-producing states have experienced in reaching a sound and exact conclusion upon many of the important propositions peculiar to the subject. In establishing a precedent as to whether the lessee's interest was realty or personalty the Oklahoma court was confronted by the confused and conflicting state of decision which is evidenced by our discussion under this head. Confronted by this situation it was inevitable that the early decisions of the Oklahoma court would be founded on certain isolated cases rather than upon a close observance of the true distinction in all the cases bearing upon the question. As early as 1908 it was decided that an oil and gas lease was an alienation of lands within the meaning of certain acts of Congress which placed restrictions upon the sale of Indian lands.³⁵ In the case of *Kolachny v. Galbreath*,³⁶ however, it was decided that the lessee's interest was an incorporeal hereditament only, and that an action in ejectment by a lessee who had never assumed possession of the leased premises would not lie. The rule in this case was not relaxed until 1918 when it was held that the interest vested by an oil and gas lease was such that if granted in the homestead the wife must join therein.³⁷ Having taken this position, the court, following the decision of

³³ *Eastern Oil Co. v. McEvoy*, 75 Kan. 515, 89 p. 1048.

³⁴ *First National Bank v. Dunlap*, 254 Pac. (Okl.) 729.

³⁵ *Eldred v. Okmulgee Loan & Tr Co.*, 22 Okla. 742, 98 p. 929.

³⁶ 26 Okla. 772, 110 Pac. 902.

³⁷ *Carter Oil v. Popp*, 174 Pac. (Okl.) 747.

Judge Cochran in the case of *Lindley v Radure*,³⁸ a Kentucky case, said. "The lease herein involved was not wholly executory and unperformed. So far as the lessors were concerned the lease was wholly executed, and by its terms there was granted to the lessee an estate in possession which vested immediately on its execution and delivery, under which lessees had the right, according to the terms of the lease, for a period of five years, to make exploration on the leased premises."³⁹ The court having gone thus far in receding from the position first taken was in a position to hold that an oil and gas lease vested the lessee with an interest in land. Therefore, in the case of *Rich v Doneghey*,⁴⁰ after reviewing all of the Oklahoma cases touching the question, the court fell into accord with the majority rule, and held that the lease granted to the lessee a present vested interest in the land.

Kentucky is one of the states adhering to the non-ownership theory,⁴¹ and, as indicated above in the taxation and ejectment cases, the court has held that the lessee's interest in an oil and gas lease was realty. In the *Union Gas and Oil Co. v Wiedemann Oil Co.* case⁴² the court said that oil and gas leases are to be considered real property, and that assignments of such are controlled by the laws regulating the sale of real estate. The most recent case involving this question was the case of *Gray-Mellon Oil Co. v Fairchild*⁴³ and the court, citing the above and many other cases, reaffirmed its former decisions and held that the lessee's interest was real property.

CONCLUSION

From the foregoing discussion we are led to the conclusion that the lessee's interest in an oil and gas lease is realty. The courts in their more recent decisions appear to be taking a more comprehensive view of the problem and seem to be tending to discard the old common law definitions and terminology having to do with property interests as inadequate because they developed during a period when oil and gas rights were not thought of.

³⁸ 238 Fed. 928.

³⁹ *Northwestern Oil Co. v. Brantne*, 175 Pac. (Okla.) 533.

⁴⁰ 177 Pac. (Okla.) 87.

⁴¹ *Louisville Gas Co. v. Kentucky Heating Co.*, 132 Ky. 435, "Ownership of Oil and Gas in Place," by Joe Hobson, 13 Ky. Law. Journal, 152.

⁴² 211 Ky. 361, 27 S. W. 323.

⁴³ 219 Ky. 142, 292 S. W. 743.

They are inclining to develop rules and terminology to fit a new and entirely different problem. As a practical proposition, the courts in the oil and gas producing states are led to the conclusion that a lessee gets whatever rights or interest the lessor has, and if the lessor's interest is realty, it is only reasonable to conclude that the lessee's interest is the same.

As shown by the above reference to the cases, the lessee's interest is taxable as realty, an action of ejectment will lie to oust a junior lessee, in equitable conversion cases a suit for specific performance may be brought at the instance of the heir;⁴⁴ the lessee's interest is land in so far as the Statute of Frauds is concerned, mechanics liens attach, the sale and assignment of such interest is controlled by the laws of real property, and finally, that the courts of the important oil producing states of Pennsylvania, Oklahoma, and Texas have in recent years come to accept the view of Illinois and Kentucky that the lessee's interest is realty

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⁴⁴ *Hill Oil & Gas Co. v. White*, 157 Pac. (Okla.) 710.