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OIL AND GAS INTERESTS IN NEW YORK:
STATUTORY CONFLICTS

Parker Bailey†

I. SECTION 39 OF THE GENERAL CONSTRUCTION LAW; HISTORY AND
APPLICATION OF PARAGRAPH DEFINING OIL INTERESTS

Oil and gas were discovered in New York early in the nineteenth century.² In the latter part of the century, when territory was constantly being explored and developed for commercial production of oil, the following statute was enacted:

“All oil wells and all fixtures connected therewith, situate on lands leased for oil purposes and oil interests, and rights held under and by virtue of any lease or contract or other right or license to operate for or produce petroleum oil, shall be deemed personal property for all purposes except taxation, but nothing herein contained shall affect the laws now in force relating to taxation.”³

Chapter 27 of the Laws of 1909 amended this text by omitting the first word, “All”, and the concluding proviso, “but nothing herein contained shall affect the laws now in force relating to taxation”. The text has not been amended since 1909; it remains on the books as the second paragraph of section 39 of the General Construction Law.

It is to be inferred that the 1883 statute quoted above was contrived in part to assure lessees of their continuous interest (as against the owner of the fee) in fixtures and appurtenances placed on oil lands during the course of operations, but more particularly to bring within reach of creditors of lessees not only such fixtures, but also, in any cases theretofore doubtful, the producing rights and the output.⁴ Creditors, of course, could readily have

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²I THORNTON, OIL AND GAS (5th ed. Willis 1932-33) 4-5, 15.

³In Broman v. Young, 35 Hun 173, 181 (1885), the court makes the following observation as to the probable legislative intent in the enactment of Chapter 372 of the Laws of 1883:

“. . . that statute evidently was passed to protect the lessee in respect to the structures he should put on leased lands for the purpose of the business, as well as to enable his creditors to reach those structures, etc. Beyond that no purpose would seem to have been necessary.”

Statutes in many jurisdictions, providing for liens upon the structures used in production, and upon the output of the wells, are likewise a safeguard for creditors. New York had such a statute (L. 1880, c. 440), and the principal question in the Broman case, supra, involved construction of the 1880 lien statute. The 1883 statute defining oil interests as personality (L. 1883, c. 372; quoted at outset of this article) was commented upon incidentally. The court held that the lessee’s interest was the only interest chargeable with a lien by the act of 1880; that the interest of a mortgagee of the lessee’s interest was not so chargeable, there being no default on the part of the mortgagors, and
OIL AND GAS INTERESTS IN NEW YORK

reached certain interests of lessees prior to the enactment of the statute. A lease for years with the usual oil privileges could have been levied upon and sold as a chattel real. The statutory language, "rights held under and by virtue of any lease or contract or other right or license to operate for or produce petroleum oil", is broad enough to include all sorts of production agreements, loosely phrased though many of them were in the early days of the industry. The end attained by the statute is therefore not wholly a reclassification of the interests involved, although the language at first glance may seem to imply a pre-existing need for sweeping reclassification. Such language, declaratory in some aspects and mutatory in others, is bound to cause confusion. This peculiar trait of the 1883 statute will be illustrated even more strikingly in the ensuing discussion of the general exception therein, relating to taxation.

Only oil interests are covered by the 1883 definition, probably because when the statute was enacted gas was usually treated as a by-product, and not because of any predetermined legislative intention to classify oil interests separately from gas interests. Yet it is very important to note that other

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4 The courts are often reluctant to classify the interests involved in the type of agreement commonly referred to as an "oil and gas lease," and indeed the issues squarely presented for decision may not render any such classification necessary. For example, in Eaton v. Allegany Gas Co., 122 N. Y. 416, 25 N. E. 981 (1890) rev'd Eaton v. Wilcox, 42 Hun 61 (1886), the Court of Appeals adopted the term, "lease", used by the litigants for their agreement, but Chief Judge Follett, in his opinion, took pains to add the parenthetical qualification, "(so called for convenience)". And forty years later, in Belmont Quadrangle Drilling Corporation v. Galek, 137 Misc. 637, 640, 244
statutes of the period, covering only oil interests in express terms, may still be strictly construed as excluding gas interests.\(^7\)

It was early held that the definition of personalty in the 1883 statute did not apply to a certain reservation in a deed, so as to render invalid a sheriff's execution sale of the interest thereby reserved, as a chattel real. The reservation read as follows:

"Excepting and reserving all the oil, gas and other minerals in and beneath the surface of the said premises, with the exclusive right to dig, mine, bore and operate for the same on said premises, and with the right of way over said premises, ingress thereto and egress therefrom, as the same may be necessary or convenient for such operations for a period of twelve years from August 2, 1882, and with the right during said period to use so much of the said premises as may be convenient or necessary, to erect and place thereon tanks, engines, boilers, derricks, buildings and machinery and other structures for the purpose of such operations, and at any time to remove therefrom all such tanks, structures and machinery, and also reserving the right to take water off said premises or to use the same as may be required for such operations during said period."\(^8\)

Since the reservation antedated the statute by nearly a year, the general principle that the legislature could not change the nature of property rights previously vested might have been invoked, although a prospective definition of rights would be a proper exercise of legislative power.\(^9\) The court in the Dow case, however, based its holding squarely on the character of the interest reserved, emphasizing the fact that the privilege extended to "all the oil, gas and other minerals".\(^10\) The plaintiff bank had a judgment against Dow, and the interest in question, while still encumbered by the judgment lien, N. Y. Supp. 231 (Sup. Ct. 1930), the court enjoined the defendants from interfering with operations by the plaintiff corporation under the usual type of oil-gas agreement, holding that "Whatever the nature of the plaintiff's interest, it has a vested interest—a vested right—to go upon the land and explore. That right the plaintiff could enforce and protect." As stated in 1 Summers, The Law of Oil and Gas (Perm. Ed. 1938) 379: "... the classification of the oil and gas lessee's legal interest has been a piece-meal matter and has been done as a means to a particular end. There are, of course, several types of situations wherein the courts make no express classification of the lessee's interest as property. . . ."

\(^7\)In Davies v. Iroquois Gas Corporation, 161 Misc. 103, 292 N. Y. Supp. 111 (Sup. Ct. 1936), rev'd, 248 App. Div. 670, 288 N. Y. Supp. 927 (4th Dep't 1936), rev'd, 272 N. Y. 572, 4 N. E. (2d) 742 (1936), an injunction pendente lite was granted restraining the removal of a casing in a producing gas well, upon the ground that it would materially injure the freehold to remove the casing and plug the well, and upon the further ground that despite a clause in the lease permitting the removal of trade fixtures, the parties could not have contemplated, in a lease drawn in 1886, the plugging of a gas well, since the statute providing for plugging (L. 1882, c. 64) referred only to oil wells.

\(^8\)First National Bank of Richburg v. Dow, 41 Hun 13 (1886). The contract was dated August 2, 1882; the deed was not executed and delivered until January 3, 1884; both the contract and the deed, however, contained the reservation herein quoted.


\(^10\)Italics added.
was conveyed by Dow to a third party. The interest was then levied upon as a chattel real and was bid in by the plaintiff. Dow's grantee, French, was enjoined from operating or producing oil upon the premises. On appeal from the order denying his motion to vacate the injunction, French contended that the interest in question was improperly sold as a chattel real, but the court held as follows:

"It is contended, on the part of the appellant, that the only interest that Dow reserved in the land, was a license to enter and put down oil wells and operate for and take the oil therefrom during the term of twelve years, and that it was consequently within the provision of the statute quoted. A careful reading of the reservation will disclose the fact that this claim is not well founded, for he not only reserves the oil, gas and other minerals, but he reserves the exclusive right to dig, mine and bore for the same, with the right of way over the premises, ingress and egress to and from, with the right to use so much of the premises as may be convenient or necessary in his operation. Not only the oil, but every other mineral, iron, coal, lead or whatever other mineral that exists beneath the surface was reserved. He was the owner in fee; he conveyed the fee, reserving therefrom this interest for a term of years, which, under the statute, is denominated a chattel real. The statute to which we have referred pertains to lands leased for oil purposes and oil interests, held under and by virtue of a lease or contract, or right or license to operate for oil. It has no reference to an estate carved out of the fee. Such an estate frequently exists."

Prior to 1883, it appears that the New York courts recognized as interests in realty the various types of production agreements in connection with oil and gas lands, commonly referred to as "leases". In so recognizing these interests, however, the courts did not clearly commit themselves, as they had in some jurisdictions, to a theory of ownership of the oil and gas in place in the substrata. The attempted definitions of pre-production property

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21 First National Bank of Richburg v. Dow, 41 Hun 13, 15 (1886). The character of the interest reserved thus appears to have been the determining factor in the decision, although the court obscures the point by advertting to the fact that the interest was reserved, not granted. It might as readily have been said to be "carved out of the fee" if Dow had received it by grant instead of reserving it himself. See Restatement, Property (1936) § 27, comment j, as to the general effect of exceptions in a conveyance; and see Restatement, Property (Tent. Draft No. 8, 1937) § 25, comment a, for a full treatment of the historical distinction between reservations and exceptions.

22 The Allegheny Oil Co., Ltd. v. The Bradford Oil Co., 21 Hun 56 (1880), aff'd without opinion, 56 N. Y. 638; Alford v. Cobb, 35 Hun 651 (1885); Eaton v. Allegheny Gas Co., 122 N. Y. 416, 25 N. E. 981 (1890); see also Shepherd v. McCalmont Oil Co., 38 Hun 37 (1885). The various rights involved in the foregoing cases all were established prior to the enactment of L. 1883, c. 372.


For a discussion of the divergence in authority on the question of ownership of mineral substrata, see Greer, The Ownership of Petroleum Oil and Natural Gas in Place (1923) 1 Tex. L. Rev. 162, 170, where the opinion is expressed that New York
rights in oil and gas lands are often obscured by anticipatory consideration
of the nature of the rights in the oil or gas yield after production is under
way. The would-be producer, however, usually wishes assurance that his
operations will be unimpeded, and that his rights with respect to con-
templated production from a given area will be unencumbered with adverse
claims of previous lessees. He is also interested in finding out what the
taxgatherer may demand from him, both before and after production starts.
He is not especially interested in attempting to reconcile various judicial
utterances about unproduced oil or gas in the ground.14

It is unfortunate that the 1883 statute under discussion, although drafted
in all probability with post-production conditions mainly in mind, is broad
enough in its language to include the entire period after the signing of a
lease, no matter how long production may be deferred. Originally designed
for the protection of creditors of active producers, the statute now raises
curious questions—especially, as will shortly be seen, in the field of taxa-
tion—with respect to rights in lands which may be leased without any
thought of immediate operations. As to land which is due to produce paying
quantities of gas, without oil, the statute is probably of no effect because it
refers only to oil.15 As to land which is due to produce paying quantities of
oil, without gas, the “rights held under and by virtue of any lease or contract
or other right or license to operate” are deemed personal property, in general,
as are the wells and operating fixtures. As to land which may produce both
commodities, it can only be stated that the rights under an oil-gas lease and
the status of the operating appurtenances are governed in part by statute
and in part by common law, and that the attorney or judge who has to
analyze them is inevitably confronted with anomalies.16

follows the majority of jurisdictions in asserting the “doctrine of non-ownership”. But
see Hughes v. The United Pipe Lines, 119 N. Y. 423, 426, 23 N. E. 1042 (1890); Davies
v. Iroquois Gas Corporation, supra note 7; see also the discussion by Veasey, The Law
of Oil and Gas (1920) 18 Micl. L. Rev. 445, 448-9. The Shepherd and the Wagner
cases, supra, involved the rights of lessees as plaintiffs; the Hughes and the Davies
cases, supra, involved the rights of fee owners as plaintiffs. It is difficult, however, to
reconcile these cases, or to agree unqualifiedly with, for example, the statement in the
Hughes case to the effect that the “oil in the earth belonged to” the owner of the fee—
119 N. Y. 423, 426—despite the fact that the statement is approved in Rumsey v. Sulli-
van, 166 App. Div. 246, 249, 150 N. Y. Supp. 287 (4th Dep’t 1914). As pointed out in
under ground; . . .” See also 1 Summers, op. cit. supra note 6, at §§ 61, 62.
14See 1 Summers, op. cit. supra note 6, at § 11, esp. at pp. 19, 20; § 62.
15See Davies v. Iroquois Gas Corporation, supra note 7.
16The 1883 statute under discussion has been construed or commented upon in the
following cases: Bromn v. Young, 35 Hun 173 (1885), supra note 3; First National
Bank of Richburg v. Dow, 41 Hun 13 (1886), supra note 8, 11; Willetts v. Brown,
42 Hun 140 (1886); Wagner v. Maloney, 169 N. Y. 501, 62 N. E. 884 (1902), aff’g
41 App. Div. 126, 58 N. Y. Supp. 526 (4th Dep’t 1899); Buck v. Cleveland, 143
23, 185 N. Y. Supp. 809 (4th Dep’t 1920), cited infra notes 18, 27.
OIL AND GAS INTERESTS IN NEW YORK 23

II. TAXABILITY OF OIL AND GAS INTERESTS

At this point the property interests enumerated in the 1883 statute must be carefully considered in connection with the exception therein relating to taxation. As to the wells and operating fixtures the problem is fairly clear; prior to the enactment of the statute such properties, not readily severable from the freehold, would presumably have been regarded as realty for tax purposes, even though their removability might be expressly agreed upon as between lessor and lessee. The statute makes them personalty for all purposes except taxation, leaving them taxable as realty. But the producing rights, as such, under leases and kindred agreements, present an obscure problem, and the statute is misleading in any event because of its erroneous implication that all oil interests thereby "deemed personal property for all purposes except taxation" were actually taxable as real property before the statute was enacted. Wells and fixtures were probably so taxable, but leases for years were not.

The concluding proviso originally in the statute, "but nothing herein contained shall affect the laws now in force relating to taxation", may well have been added in order to preclude any contention that a change in the property classification of oil leases for years was intended. At common law a lease for years was not real property, and no general statute classifies such leases as real property. Estates for years are chattels real, at common law as well as by statute declaratory thereof; they have been regarded as


Matter of Hazelwood Oil Co., 195 App. Div. 23, 185 N. Y. Supp. 809 (4th Dep't 1920) (propriety of tax assessment of "oil well properties" as realty upheld). The nature of the interest created by the so-called lease held by the appellant company was not in issue. Nevertheless, at least two textwriters of repute have regarded the Hazelwood case as authority for the proposition that oil and gas leases are taxable in New York as real estate. See Summers, op. cit. supra note 6, at §§ 156, 791; see also Thornton, op. cit. supra note 1, at § 1252.


Despard v. Churchill, 53 N. Y. 192, 199 (1873); Matter of Ehrsam, 37 App. Div. 272, 275, 55 N. Y. Supp. 942 (4th Dep't 1899). In this connection, of course, the effect of the usual indeterminate period (gauged by "paying quantities" of the product) following the definite term of an oil-gas lease must be considered. For a full discussion of the difficulties involved in attempting to define the interest of the oil-gas lessee in accordance with common-law classifications of real property estates or interests, see 1 Summers, op. cit. supra note 6, Ch. 7, esp. § 153. The view expressed by Professor Summers with respect to the taxability of the lessee's interest as realty (see note 18, supra) may be based upon the theory that a lease with an indeterminate term following its definite term should be regarded as tantamount to a fee on special limitation, and therefore assessable as realty. The "paying quantities" clause is recognized as one of limitation in Eaton v. Allegany Gas Co., 122 N. Y. 416, 25 N. E. 981 (1890), supra notes 6, 12.


personalty for tax purposes even though buildings erected by the tenant (provided they were reserved to him by the lease) would be taxable to him as realty, just as oil well properties have been taxed against the lessee as realty.\textsuperscript{23}

The exception in the 1883 statute with respect to taxation thus makes moderate sense as applied to wells and fixtures. It does not make sense, except in the light of the original proviso just discussed, as applied to leases for years, because it wrongly implies that such leases were real property before the statute came into being. Since such leases were and are but chattels real, the statute is no more than declaratory of their common-law classification, and the declaration in its present form is anything but lucid. The confusing implication of a sweeping change in those interests persists in relation to taxation, as well as to the possibility of their being reached by creditors of lessees.\textsuperscript{24} Paraphrased with proper meaning, yet retaining as much of the original phraseology as possible, the statute might read:

"All oil wells and all fixtures connected therewith, situate on lands leased for oil purposes and oil interests, shall be deemed personal property for all purposes except taxation. Rights held under and by virtue of any lease or contract or other right or license to operate for or produce petroleum oil shall continue to be deemed personal property or chattels real, as the case may be, for all purposes. Nothing herein contained shall affect the laws now in force relating to taxation."

The principal tax problem in this field is that of determining the applicability, in advance of actual production, of the 1883 statute herein discussed. The practical importance of this is now greater than ever, in view of the fact that personal property in New York is no longer "liable to taxation locally for state or local purposes".\textsuperscript{25} As long as no operations leading to production of oil or gas are undertaken by a lessee, it would seem improper to tax his interests on any theory. His lease, as such, is not real property and is therefore not assessable. After drilling is done and production is under way, his wells and fixtures may properly be assessed as real property, at least when oil is the primary commercial product, with assessed valuation dependent upon the cost of drilling plus the cost of the tubing, casing, and other material constituting the well equipment. There would appear to be no difficulty in similarly assessing producing gas wells and fixtures as realty, since no statute obscures their common-law character. All such assessments,

\textsuperscript{24}See discussion supra p. 2.
\textsuperscript{25}TAX LAW § 3, as amended by L. 1933, c. 470.
it is believed, would be wholly independent of the assessment of an owner-lessee's interests. His land would be taxed in the usual course and with the usual criteria of valuation. His royalties under the typical lease would be taxable simply as income.

It is arguable, of course, that even basing the assessed valuation of the lessee's wells upon the cost of drilling and equipment is tantamount to taxing him by virtue of the lease or kindred agreement itself, since drilling and production must occur pursuant to rights conferred by such agreement. By confining the assessment, however, to the period of production, and by making only the wells and fixtures taxable to the lessee, the industry and the state alike would appear to gain best results: the industry, because no tax burden would be placed on its rights in advance of production; the state, because no difficulty would arise in classifying the assessed items as realty. Furthermore, valuation based on drilling and equipment cost is fairly sure to be set within limits which will minimize the probability of wasteful contest either by the industry or by the state.

III. Mechanics' Liens on Oil and Gas Properties

Another important statutory variance occurs in the Lien Law, which defines real property (section 2, paragraph 2):

"The term 'real property', when used in this chapter, includes real estate, lands, tenements and hereditaments, corporeal and incorporeal, fixtures, and all bridges and trestle work, and structures connected therewith, erected for the use of railroads, and all oil or gas wells and structures and fixtures connected therewith, and any lease of oil lands or other right to operate for the production of oil or gas upon such lands, and the right of franchise granted by a municipal corporation for the use of the streets or public places thereof, and all structures placed thereon for the use of such right or franchise."\(^{26}\)

The Appellate Division in the Fourth Judicial Department has stated that this section of the Lien Law supersedes the definition of "oil well properties" contained in section 39 of the General Construction Law.\(^{27}\) It is to be observed that oil and gas interests are treated alike in the Lien Law, and that the language is somewhat like that of the General Construction Law in so far as it deals with oil interests.

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\(^{26}\) Derived from L. 1897, c. 418, § 2; re-enacted without substantial change by L. 1916, c. 507.

\(^{27}\) Matter of Hazelwood Oil Co., 195 App. Div. 23, 25, 185 N. Y. Supp. 809 (4th Dep't 1920), supra note 18. For a discussion of lien statutes in other jurisdictions, see 4 Summers, op. cit. supra note 6, Ch. 23. Note also that oil and gas interests are now treated alike in the statute relating to plugging of wells (General Business Law §§ 308, 309). Cf. discussion of the earlier statute (L. 1882, c. 64) referring only to oil wells, supra note 7.
IV. ADVERSE CLAIMS

The determination of adverse claims to oil and gas properties is often troublesome, especially in view of the usual indeterminate term following the definite term of production agreements for oil or gas, dependent upon continuance of production "in paying quantities". Article 15 of the Real Property Law provides for determination of adverse claims to real property, but strict compliance with all the statutory conditions is necessary. Section 500 of the Real Property Law (the first section in Article 15) provides in part as follows:

"§ 500. Who may maintain an action. Where a person has been, or he and those whose estates he has, have been for one year in possession of real property, or of any undivided interest therein, claiming it in fee, or for life, or for a term of years not less than ten, he may maintain an action... to compel the determination of any claim adverse to that of the plaintiff which the defendant makes, or which it appears from the public records or from the allegations of the complaint, the defendant might make to any estate in that property in fee, or for life, or for a term of years not less than ten, ...")

A lessee under an oil-gas lease with a fixed term of ten or more years, even though the term were indeterminate thereafter, might avail himself of the remedy provided by Article 15, but a person holding under a term definitely limited to less than ten years could not. It is suggested, however, that the declaratory judgment, often resorted to in complex situations involving real property, is adequate for determining conflicting claims to oil and gas properties. The declaratory judgment has the advantage of adaptability to all sorts of situations; it has no limitations such as those set by Article 15 of the Real Property Law.


29It is believed that the usual definite term of oil or gas leases is ten years or more. See, however, Silberstein v. Murdoch, 216 App. Div. 665, 672, 215 N. Y. Supp. 667 (1st Dep't 1926), involving a lease for three years "and as long as oil or gas, or either of them, is produced". See also the comment in note 20, supra, concerning the lease with an indeterminate term following its definite term, as tantamount to a fee on special limitation.

1. Section 39 of the General Construction Law fixes the status of oil wells and fixtures as personalty for all purposes except taxation. They remain realty for taxation. Gas wells and fixtures, not being mentioned in the statute, likewise remain realty for taxation.

2. Section 39 of the General Construction Law makes no change in the taxable status of leases and other operating agreements. It calls them, as it calls the wells and fixtures, personalty “for all purposes except taxation”, thereby creating an erroneous impression that they were somehow taxable as realty prior to the enactment of the statute. A clarifying amendment would be desirable.

3. No oil or gas lease for a term of years is taxable as realty, either before or after production of the commodities is undertaken. After production is begun, the assessed valuation of the wells and fixtures, as realty, will depend upon the cost of drilling and equipment; but such assessment is based on the property status of the wells and fixtures, not on that of the lease.

4. Since section 39 of the General Construction Law is archaic in that it provides only for oil interests, there may be situations, e.g., attachment or execution, where the property status of gas wells would differ from that of oil wells. Such status, however, could not be clearly determined except in cases involving commercial production of only the one or the other substance. Statutory oil and common-law gas, both produced commercially from the same well, might readily give rise to unique difficulties in the application of a statute which happens to leave gas out of consideration. If amended as suggested above to show its true applicability in the field of taxation, the General Construction Law should be further amended to provide uniformly for both gas and oil interests.

5. The status of oil and gas properties in relation to mechanics’ liens is clearly fixed by the Lien Law, which for this particular purpose overrides the General Construction Law.

6. Adverse claims to oil and gas properties, questions of abandonment, boundaries, and the like, would seem to be best settled by declaratory judgment.