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RIGHTS OF COTENANTS IN OIL LEASEHOLDS

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The Supreme Court of Wyoming has had occasion to pass upon questions involving joint tenancies and tenancies in common, frequently referred to by the term 'cotenancies',[1] in several cases.[2] However, it has never directly considered or passed upon the rights of oil and gas lessees who have leases from less than all cotenant owners, though it appears from the statement of facts in *Denver Joint Stock Land Bank of Denver v. Dixon*[3] that the issue was incidentally involved. But its determination was unnecessary since the case turned on another point.

Nevertheless, this particular phase of the law of oil and gas is of particular significance to lawyers practicing in a petroleum industrialized state such as Wyoming. For that reason it is appropriate that the applicable cases and principles of law be dissertated upon. Too, the impact of the income tax law upon the majority view will also be discussed brifely.

The common situation giving rise to the subject matter of this paper may be stated simply as follows: A and B are cotenants of the minerals in and under Blackacre. A gives C an oil and gas lease conveying A's share of the minerals, but B refuses to join in the lease or give a separate lease to C. What rights does C have in respect to the subject leasehold?

Of course, there is no problem confronting C if he has a lease from both A and B for it is clear that the entire lessee's interest would thereby pass to him, and he would be authorized to proceed with development work on the leasehold.[4] Obviously, too, he would be entitled to take a depletion allowance upon the entire production, excepting royalties, as he would thereby have an economic interest in all of the minerals.[5]

Unfortunately, however, in the above-stated fact situation, the Courts of the United States are not so in accord with each other. In fact, they

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1. "Cotenancy" is a term broad enough in scope to comprise both tenancy in common and joint tenancy. Black's Law Dic., "Cotenancy", page 448 (3d ed. 1933).
2. Nussbacher v. Manderfeld, 64 Wyo. 55, 186 P.(2d) 548 (1947); Sharples Corporation v. Sinclair Wyoming Oil Company, 62 Wyo. 341, 167 P.(2d) 29 (1946); Binning v. Miller, 60 Wyo. 114, 146 P.(2d) 527 (1944); Black v. Beagle, 59 Wyo. 268, 139 P.(2d) 439 (1943); Binning v. Miller, 55 Wyo. 478, 102 P.(2d) 64 (1940); Gilland v. Union Pacific Railway Co., 6 Wyo. 185, 43 Pac. 508 (1895). No cases were found, in research on this problem, applying the principles of law discussed in this paper to tenancies by the entireties, and for that reason such tenancies are not referred to. However, it would seem likely that the same principles applicable to other cotenancies would be similarly applicable to entireties, unless affected and governed under the particular facts of the situation by 1945 Wyo. Comp. Stat. Sec. 66-209 and other Homestead laws.
3. 57 Wyo. 523, 529, 122 P.(2d) 842, 843 (1942).
4. 24 Am. Jur. "Gas and Oil" § 10.
5. Income Tax Regulations, Sec. 29.23 (m)-1. (As amended by T. D. 5413, Oct. 31, 1944, T. D. 5458, June 15, 1945, and T. D. 5461, July 9, 1945.)

are unevenly divided on their viewpoints as to the manner in which the problem should be resolved.

The majority and better view holds that A can lease to C and C can produce oil and gas from the leasehold and do all things necessary to effect the development of the lands, but in so doing neither A nor C can act to the exclusion of B or B's lessee. Further, C must account to B for the latter's share of the minerals produced, less B's proportionate share of all costs of development, production and marketing of the oil produced.[6]

The rule is founded upon equitable principles, and was undoubtedly engendered in the spirit of promoting the development of oil properties.[7] The obstinate cotenant should be entitled to his proportionate share of all the proceeds from the lands, but at the same time he should bear his share of the necessary costs of procuring it. He should not be heard to complain of the operator's activities upon the lands: by his obstinacy he has deprived C of exclusive development rights and moreover he has no written agreement with C providing for the payment of a royalty[8] free and clear of costs. He, therefore, cannot claim a royalty but must share as a working interest holder. Of course, the parties could subsequently enter into an agreement whereby B ratifies the lease between A and C and providing for the payment of a royalty as B's share of the production.

The minority view, on the other hand, forbids either A or C to develop and produce the oil and gas without the express or implied consent of B.[9] This viewpoint appears to be rather archaic in that the reasoning behind it is mainly founded upon the common-law principle forbidding one cotenant to commit waste on the common estate.[10] And as can be expected of a rule founded on principles of law wholly unrelated to oil and gas law, it is shot through with exceptions. Thus, some minority jurisdictions will excuse a cotenant's "waste" if development operations were carried out to prevent undue drainage by wells situate upon abutting lands and an accounting is made to the non-consenting cotenant; or, under such existing circumstances, a Court of equity may appoint a receiver to develop the leasehold for the benefit of the cotenants.[11] The necessity of the circumstances has caused these exceptions to be provided for, of course; but the inconvenience, delay, expense and general unnecessariness given rise to by the application of the minority rule is readily apparent.

6. 1 Summers, Oil and Gas §§ 37 and 38; 2 Summers, Oil and Gas. § 222 (Perm. Ed. 1938); Glassmire, Oil and Gas Leases and Royalties, § 78, p. 291 (2d ed. 1938); Annotations, 40 A.L.R. 1400 (1926), 91 A.L.R. 205 (1934).
7. "The development of all mineral resources, particularly oil and gas, is the settled policy of the states and the nation and should not be hampered except on practical and substantial grounds." See Boone v. Kingsbury, 206 Cal. 148, 273 Pac. 797, 812 (1928).
8. See the term "royalty" discussed in Note, 1 Wyo. L. J. 92 (1947).
9. See Note 6, supra.
10. 14 Am. Jur. "Cotenancy" §§ 25 and 29; Am. Jur. "Gas and Oil" § 10.
11. 24 Am. Jur. "Gas and Oil" § 10.

In *Earp v. Mid-Continent Petroleum Corporation*,[12] the Supreme Court of Oklahohma succinctly summarized and applied the cogent reasoning of the Tenth Circuit Court of Appeals in the leading authority, *Prairie Oil & Gas Co. v. Allen*.[13] Justice Busby of the Oklahoma Court, in writing the opinion for the majority in the *Earp* case, stated:[14]

". . . the owners of undivided portions of oil and gas rights in and under real estate are tenants in common. Each of such cotenants may enter upon the premises for the purpose of exploring for oil and gas and may drill and develop the premises. However, one cotenant cannot exercise that right to the exclusion of the other and each may exercise the same right and privilege with reference to the common property. Upon the discovery of oil and gas upon the premises, the producing cotenant must account to the non-consenting or non-producing cotenant for his pro rata share of the net profits apportioned according to the fractional interest of such cotenant; the net profits being determined by deducting from the market value of the oil and gas produced, the necessary expense of developing, extracting, and marketing the same. Each of the cotenants may lease his undivided interest in the common property without the consent of the other cotenants, such a lease being effective as to his interest in the property but ineffective as to the interest belonging to his cotenants. During the period of such a lease the lessee enjoys the same rights and privilges to enter upon the common premises for the purpose of exploration and development which his lessors had prior to the execution of the lease.

"It is also decided in the *Prairie Oil & Gas Company* case, . . . that the lessee upon entry becomes a tenant with the cotenants of his lessors and upon production is liable to account to the non-consenting or non-participating cotenant on the same basis that his lessor would have been compelled to account had the production been accomplished by him. . . ."

The various majority rule decisions do not seem to make any distinction between the different kinds of interests held by cotenants in a given leasehold. Thus, the rule is applied equally to cotenants who are only possessed of the mineral estate, as well as to cotenants possessed of both the surface and minerals.[15] Obviously, they could hardly be consistent with themselves if they held otherwise.

Moreover, the divergent theories and property concepts of minerals in place[16] seem to have little or no influence on Courts in rendering their decisions on the instant cotenancy problem. States following both the ownership and non-ownership theories have followed the majority rule.

12. 167 Okl. 86. 27 P. (2d) 855 (1933). [Favorably cited for another principle in Sharples Corporation v. Sinclair Wyoming Oil Company, 62 Wyo. 341, 360, 167 P. (2d) 29, 35 (1945)].
13. 2 F. (2d) 566 (10th Cir., 1924).
14. Earp v. Mid-Continent Petroleum Corporation, 167 Okl. 86, 27 P. (2d) 855, at page 858 (1933).
15. See 1 Summers, Oil & Gas § 38, p. 108 (Perm. Ed. 1938).
16. See discussion of Mineral Severance, Note 2 Wyo. L. J. 62 (1948).

Thus, Texas which follows the absolute ownership theory respecting the status of oil and gas in situ,[17] has followed the majority rule in a number of cases.[18] California, which treats oil and gas as a *profit à prendre* or an interest in the nature of an incorporeal hereditament,[19] (the Wyoming viewpoint[20]) is also a majority rule jurisdiction.[21] Oklahoma, the leading advocate of the non-ownership theory which declares oil to be the property of no one in situ and only the personal property of its producer when brought to the surface,[22] has given us the leading authorities on the majority rule.[23] Of particular interest are Kansas[24] on the one hand, and West Virginia and Illinois[25] on the other, which differ on the rule applicable to the cotenancy question but concur in general on the qualified ownership theory about oil and gas in situ.[26] West Virginia and Illinois are the principal states which adhere to the minority rule.[27]

Probably the chief criticism of the minority rule is that it is so impractical. This conclusion is ineluctable if one views the operations of the oil industry realistically. Oil leasing operations and developmental processes are very much different from other types of business operations. If an operator is unduly delayed or hampered in getting rights to commence operations upon a given tract, he will more often than not abandon his efforts to this end and procure some other leasehold for development. The willing lessors may never have another opportunity to make an agreement resulting in early development of the property if unforseen disappointments resulting from drilling activities in the area cause the drillers to leave.

More significantly, the minority rule is hardly consonant with the fact that mineral interests are frequently divided and owned by altogether too many persons.[28] In such situations, it is almost a physical impossibility to secure leases from all owners, and under the minority rule an operator willing to develop and produce the leasehold would be helpless to do so unless, perhaps, the lands were being drained. This condition is incompatible with public policy favoring the development of mineral lands.

17. Glassmire, Oil and Gas Leases and Royalties, § 30 (2d ed. 1938).
18. 2 Summers, Oil and Gas § 222, p. 21 (Perm. Ed. 1938).
19. Dabney-Johnston Oil Corporation v. Walden, 4 Cal.(2d) 637, 649, 52 P.(2d) 237, 243 (1935); Glassmire, Oil and Gas Leases and Royalties, § 33 (2d ed. 1938). But cf. Note, 63 Harv. L. Rev. 905 (1950).
20. Denver Joint Stock Land Bank of Denver v. Dixon, 57 Wyo. 523, 122 P.(2d) 842 (1942).
21. See Little v. Mountain View Dairies, Inc., 200 P.(2d) 576, 578 (Cal. 1948), and authorities cited.
22. Glassmire, Oil and Gas Leases and Royalties, §§ 35 and 36 (2d ed. 1938) (the minority theory). Compare Atwater v. Gaylord, 63 Wyo. 492, 184 P.(2d) 437 (1947), and see discussion of this case in Note, 2 Wyo. L. J. 132 (1948).
23. See note 12, supra. The Prairie Oil and Gas Case. supra, note 13, arose from the U. S. District Court for the Eastern District of Oklahoma.
24. Johnson v. Kansas Natural Gas Co., 90 Kan. 565, 135 Pac. 589. (1933); Compton v. People's Gas Co., 75 Kan. 572, 89 Pac. 1039 (1907).
25. See 1 Summers, Oil and Gas §§ 37 and 38 (Perm. Ed. 1938).
26. Glassmire, Oil and Gas Leases and Royalties, § 33 (2d ed. 1938).
27. See note 25, *supra*.
28. See Glassmire, Oil and Gas Leases and Royalties, § 83 (2d ed. 1938).

In some instances, a possible solution under the minority rule would be that the willing cotenant secure a partition of the common estate. This certainly can be done,[29] but again the question of practicality raises its frustrating head. Generally speaking, an oil operator would not wait the necessary time for the partition proceedings to be consummated; and most important of all, he would not desire to operate upon the acreage after partition if, as is commonly done, the lands were partitioned in a checkerboard pattern of 40 acre plots. His time is precious due to the high costs of maintaining idle crews and equipment, and he is anxious to avoid a multiplicity of offsets to his acreage.

Returning again to the majority rule, the effect of income tax laws on operations under the rule does not appear to give rise to any disagreeable complications. Nevertheless, the matter does deserve attention so as to point out what may be expected tax-wise.

An operator may be willing to "wild-cat" drill a given acreage, oftentimes not concerned whether it be proven a productive or non-productive leasehold. If it proves productive he acquires new production for his benefit, and if it proves non-productive he has a sizeable income tax deduction.[30]

However, in a situation involving an obstinate cotenant, he has but a part of the total production to gain, and probably the whole of the development costs to lose if the hole is non-productive. There is little doubt but what he could claim the entire loss as an income tax deduction, but in view of the limited gain he stands to make the business advisability of the venture may in some instances be the determining factor.

Similarly, the depletion allowances afforded to operators by federal laws and regulations[31] could be claimed by the operator on income derived from production but only to the extent of his share of the production. The non-consenting cotenant is entitled to his proportionate share of the production (less his share of the costs of development, operation and management), and being an owner of an 'economic interest' in the oil and gas deposits, he would be entitled to take depletion on all production attributable to his interest in the minerals.[32] Thus, in the hypothetical example set forth previously, the lessee (C) would have an economic interest' in the minerals owned by A alone but not in those owned by B. C, therefore, would be entitled to take depletion on all production he was entitled to by virtue of being A's lessee but could naturally take none on the production attributable to B's interest.

29. Note, 3 Wyo. L. J. 144 (1949).
30. Federal Income Tax Regulations, Sec. 29.23 (m)-16(b) (2) (iv).
31. Int. Rev. Code § 114(b) (3); Federal Income Tax Regulations, Sec. 29.23 (m)-4.
32. See note 5, *supra*.

Therefore, it would appear that the solution to the cotenancy problem presented by the majority jurisdictions is the most happy one. However, in determining whether or not to function under the principles of the majority rule, the operator should very carefully consider the business complications entailed.