Opinion No. 37-1642

May 13, 1937

BY: FRANK H. PATTON, Attorney General

TO: Mr. Carl B. Livingston State Land Office Santa Fe, New Mexico

*{*94}* On May 5th you submitted a request for the opinion of this office on matters pertaining to oil and gas leases now in effect wherein the State of New Mexico, through the State Land Office, is the lessor.

Your inquiries relate to leaseforms 44 and 44-A in current use as authorized by Section 2, Chapter 18, Laws of 1931, which leases provide for a definite term of years, for instance, five, ten and the like plus an indefinite period described as follows:

"and as long thereafter as oil and gas in paying quantities, or either of them, is produced from said land by the lessee."

Paragraph 7 of said lease-form provides as follows:

"The lessee with the consent of the lessor, shall have the right to assign this lease in whole or in part. Provided, however, that no assignment of an **undivided interest** in the lease **or in any part thereof** nor any assignment of less than a legal subdivision shall be recognized or approved by the lessor. **Upon approval in writing by the lessor of an assignment, the assignor shall stand relieved from all obligations to the lessor with respect to the lands embraced in the assignment and the lessor shall likewise be relieved from all obligation to the assignor as to such tracts, and the assignee shall succeed to all the rights and privileges of the assignor with respect to such tracts and shall be held to have assumed all the duties and obligations of the assignor to the lessor as to such tracts."**

From various existing oil leases there are now assignments that have been made by the original lessee to various assignees with the consent of the lessor upon Form 33-A2 of an assignment prescribed by the lessor. Said assignment form, after reciting that the "assignor" has received a valuable consideration therefor from the "assignee," provides as follows:

"* * * party of the second part, ha___ sold, transferred, set over and **assigned,** and by these presents do___ sell, transfer, set over and **assign** to the Assignee ___heirs, successors and assigns, **all of the assignor** ___ right, title, interest and claim in and to that certain Oil and Gas Lease No.___, made by the State of New Mexico to___ under date of___, 193], ___ one of the Assignors herein, in and to the following described **subdivisions of land in said lease described, and insofar as said lease affects such subdivisions -- to wit:**

* * *

The Assignee assumes and agrees to perform all obligations to the State of New Mexico insofar as said described lands are affected, and to pay such rentals and royalties, and to do such other acts as are by said lease required as to the above described subdivisions, to the same extent and in the same manner as if the provisions of said lease were fully set out herein.

It is agreed that the Assignee shall succeed to all the rights, benefits and privileges granted the Lessee by the terms of said lease, as to the lands above described."

Section 132-404, New Mexico Statutes Annotated, 1929 Compilation, relating to assignments of such oil and gas leases provides in part as follows:

*{*95}* "All leases issued under the provisions of this act shall be **assignable** in whole or in **part;** Provided, however, that no assignment of an **undivided interest** in the lease or **any part thereof,** or any assignment of less than a legal subdivision shall be recognized or approved by the commissioner."

The questions propounded by you pertain to the **continuance** of the lease, after the definite term of years, because of production in paying quantities during the definite term of years and the continuance of such production after the expiration of the definite term of years, and resolve themselves into the following points:

"Where production of oil and gas in paying quantities is made during the definite term of years upon the acreage retained in the mother lease.

(a) Is an assignment, which is perfected **prior** to such production upon the mother lease, continued because of the production upon the mother lease?

(b) Is an assignment, perfected **after** discovery of production upon the mother lease, continued because of such production? **Where production of oil and gas in paying quantities is made upon the assignment during the definite term of years.**

(c) Is the mother lease continued because of the production upon the assignment?

(d) Does such production upon an assignment thereby continue other assignments made **before** such discovery?

(e) Does such production upon an assignment thereby continue other assignments from the mother lease made **after** such discovery?"

To start with, may we state that in the case of oil and gas leases, where the fixed and definite term is qualified and extended by some such provision as "as long thereafter as oil or gas in paying quantities, or either of them, is produced from said land by the lessee," the law is apparently well settled that such producing of oil or gas during the

fixed term extends the lease after the expiration of the fixed term as long as that condition shall continue. See Mills-Willinghem on Oil and Gas, Section 72, Page 118, and cases cited in footnote number 14.

On the strength of the foregoing statement of the law, we answer your inquiry (b) in the affirmative and hold that an assignment, perfected after discovery of production upon the mother lease is continued because of such production. The reason for this is obvious. Upon discovery of production upon the mother lease, the term thereof is extended after the expiration of the fixed period as long as production in paying quantities continues, and any assignment made after such discovery would carry with it the vesting right **theretofore** accrued to the land.

A more difficult question arises, however, as to the effect of the production of oil and gas, in cases where there have been assignments made prior to discovery, on a portion or legal subdivision of the original lease. The general questions presented are whether the production by an assignee on the part assigned inures to the benefit of the part retained by the lessee and to the entire lease, and further, whether production on the part retained by the lessee inures to the benefit of the part or parts assigned, when such discovery is made after the date of assignment.

We deem it proper at this time to attempt to construe the terms of the lease and assignments in order to determine the relationship existing between lessor, lessee and assignee and in order to determine whether or not the lease is, by its terms, divisible, and further, whether *{*96}* the assignments involved are **assignments** of the lease on a part of the land or whether the same constitute merely a sublease.

There is no doubt that an oil and gas lease, by its terms, may be divisible.

"The assignee in severality of a part of the lease is not a sublessee. This results from the divisibility of the commercial lease in its present form. It contemplates that when part has been assigned the several portions are thereafter (for certain purposes only) to be regarded as separate leases." Mills-Willinghem on Oil and Gas, Section 146, Page 214.

The question now presents itself whether paragraph 7 of the lease above quoted, makes the lease divisible.

In Smith vs. Sun Oil Company (La.), 116 South. 379, it was held that the following clause in an oil and gas lease gave the original lessee the right to divide the lease into two or more leases:

"'All covenants and agreements herein between the parties shall extend to and be binding upon their heirs, executors, administrators, successors and assigns; and this lease may be assigned, in whole or in part, either as to any interest therein or any portion of the premises; in which last event, lessee shall be liable only for the royalties accruing from the acreage retained by him, and, in the exercise of his option to extend this lease, shall have the privilege of paying such proportion of the rentals under this

lease as the acreage retained bears to the entire acreage covered by this lease, and the assignee of the lessee shall have corresponding rights and privileges with respect to said royalties and rentals as to the acreage so assigned.'"

Again in Roberson vs. Pioneer Gas Company, 173 La. 314, 137 South. 46, it was held that the following clause made the lease a divisible one:

'"If the estate of either party hereto is assigned -- and the privilege of assigning in whole or in part is hereby expressly allowed -- the covenants hereof shall extend to their heirs, executors, administrators, successors, or assigns; but no change in ownership of the land or assignment of rentals or royalties shall be binding until after the lessee has been furnished with a written transfer or assignment, or a true copy thereof; and it is hereby agreed in the event this lease shall be assigned as to part or as to parts of the above described lands, and the assignee or assignees of such part or parts shall fail or make default in the payment of the proportionate part of the rents due from him or them, such default shall not operate to defeat or affect this lease in so far as it covers a part or parts of said land upon which said lessee or assignee thereof shall make due payment of said rental.'"

On the strength of the foregoing citations, we are of the opinion that paragraph 7 of the lease involved herein makes the lease a divisible one.

The next question presented is whether the assignment of a portion of the land incorporated in the original lease, upon Form 33-A2 of the assignment heretofore set out, constitutes in fact and in law an **assignment** or whether the same constitutes in fact and in law a **sub-lease.**

The distinction between an assignment of a lease and a sub-lease has been properly stated in the following language in Roberson vs. Pioneer Gas Company (supra), involving an oil and gas lease, the Court distinguished between the assignment *{*97}* of a lease and a sub-lease as follows:

"The distinction between an assignment of a lease and a sublease is that, in an assignment, the assignor transfers his entire interest in the lease **in so far as it affects the property on which the lease is assigned;** whereas, in a sublease, the original lessee, or sublessor, retains an interest in the lease in so far as it affects the property subleased -- by imposing some obligation upon the sublessee in favor of the sublessor, such as an obligation to pay additional rent to the sublessor."

In Caudle vs. Brannon (Okla.), 56 P. (2d) 131, involving a coal lease, the following language is found:

"It is the general rule that the distinction between an assignment of a lease and a sublease is that, in an assignment, the assignor transfers his entire interest in the lease; whereas, in a sublease, the original lessee, or sublessor, retains some interest in the lease **in so far as it affects the property covered thereby,** by providing for additional

rentals or royalties, or providing for the use of certain property owned exclusively by the sublessor."

The Supreme Court of this state in the case of Hobbs vs. Cowley, 35 N.M. 413, 299 Pac. 1073, has expressly recognized a distinction between an assignment and a sublease, stating that whether an instrument has the legal effect of an assignment or a sublease depends upon the intention of the parties. See also Saling vs. Flesch, 85 Mont. 106, 277 Pac. 612.

In Smith vs. Sun Oil Company (supra), it was held that a contract whereby a lessee of an oil lease disposed of certain of his rights and obligations as to twenty (20) acres of land, but granted an interest less than his own was a sublease and not an assignment.

In Johnson vs. Moody, 168 La 799, 123 South. 330, it was held that a contract whereby the original lessee of land for oil and gas retained an **overriding royalty** and a **right of reversion** as against the other party was a sublease and not an assignment.

In Sunburst Oil & Rfg. Co. vs. Callender, 84 Mont. 178, 274 Pac. 834, it was held that a reservation of an **overriding royalty** in an assignment of a lease to a portion of a tract of land, which covered the entire tract, constituted the instrument a sublease and not an assignment.

In construing an instrument designated an assignment of the lessee's right in a portion of a tract of land under a lease of the entire tract, which, while being in terms an assignment, retained a reversionary interest in the lease, it was held in McNamer Realty Company vs. Sunburst Oil and Gas Company, 76 Mont. 332, 247 Pac. 166, that the instrument was a sublease and not an assignment, because of retention of an interest in the reversion; there was also an overriding royalty reversed by the assignor.

We believe the foregoing cases sufficiently distinguish an assignment from a sublease. The question now is whether in the matters herein involved we have an assignserved by the assignor.

To start with, we have a statute, Section 132-404 of the 1929 Compilation, cited above, expressly prohibiting the Commissioner of Public Lands from recognizing or approving any assignment of any portion of the lease of an undivided interest. This, in our opinion, prohibits a retention by the assignor of a reversionary interest in the portion assigned, such as an overriding royalty, etc.

Again in paragraph 7 of the lease, we find the same stipulation, namely, *{*98}* that no assignment of an undivided interest in the lease shall be recognized or approved by the lessor. In examining the form of assignment No. 33-A2, it appears from the terms thereof that the original lessee or assignor retains no interest whatsoever in the lease in so far as it affects the property assigned, and by the terms thereof the assignee assumes and agrees to perform all obligations to the lessor in so far as said described lands are affected and to pay all rentals and royalties thereon directly to the lessor, and

succeeding to all rights, benefits and privileges granted the assignor by the lessor on the lands assigned. And further, by the terms of paragraph 7 of the lease, upon approval in writing of the assignment by the lessor, the assignor stands relieved from all obligations to the lessor with respect to the lands embraced in the assignment.

In view of the terms of the lease, and the terms of the assignment, and in view of the authorities cited, it is our opinion that the instrument designed an assignment of oil and gas lease, being Form 33-A2, when properly executed on a portion of land originally leased by the lessor, constitutes in law and in fact an assignment and not a sublease.

The reason why we have gone somewhat into detail as to the distinction between an assignment and a sublease is that there is no doubt in our minds that if in law and in fact we had here a sublease, then clearly, under the authorities we have found, development or production in paying quantities by a sublessee on the portion that was subleased would inure to the benefit of the portion retained by the lessee and to the entire tract, and no doubt it would also be true that development or production in paying quantities upon the portion retained by the lessee would inure to the benefit of the portion subleased.

In the present case, however, we have an assignment and not a sublease and the question is whether or not a different rule should here prevail. We are of the opinion that a different rule should and does prevail.

We have here a situation, where the lease is by its terms divisible by assignment in part, and the assignee assumes no obligation whatsoever in regard to keeping the lease in force on the whole of the leased premises, and the assignor retains no interest whatsoever in the lease insofar as it affects the property on which the lease is assigned. The assignor, by the terms of paragraph 7 of the lease, upon approval in writing of the assignment by the lessor, is relieved from all obligations to the lessor with respect to the lands embraced in the assignment, and the lessor is likewise relieved from all obligations to the assignor as to such assigned tracts, and in view of all this the conclusion is inescapable that after such an assignment has been duly executed, the original lease has thereupon been divided into two or more separate and distinct leases, depending upon the number of assignments made.

This being so, and there being no privity of interest whatsoever between the assignor and the assignee, we fail to see why, upon reason and logic, after assignment is made that production by the assignor should inure to the benefit of the assignee, or that production by the assignee should inure to the benefit of the assignor, for the purpose of continuing the term of the lease under the qualifying term thereof "and as long thereafter as oil and gas in paying quantities, or either of them, is produced from said land by the lessee."

Exactly in point is the case of Roberson vs. Pioneer Gas Company (1931), 173 La. 314, 137 South. 46, and followed in Harrel vs. United Carbon Company, 52 Fed. (2d) 790, upon which cases, and the reasoning *{*99}* therein, we primarily base this opinion.

The following cases are ordinarily cited as holding a contrary view: Fisher vs. Crescent Oil Company (Tex. Civ. App.), 178 S. W. 905; Walker vs. Lane (Tex. Civ. App.), 233 S. W. 634; South Penn Oil Company vs. Snodgrass, 71 W. Va. 438, 76 S. E. 961; Harris vs. Michael, 70 W. Va. 356, 73 S. E. 934; Pierce Oil Corporation vs. Schacht, 75 Okla. 101, 181 Pac. 731; Battle vs. Adams (Tex. Civ. App.), 229 S. W. 930; Cowan vs. Phillips Petroleum Company (Kans.), 51 P. (2d) 988.

However, upon an examination of the foregoing decisions it will be found that they are not necessarily inconsistent with our present views.

For example, in Fisher vs. Crescent Oil Company, the contract of lease did not contain a divisibility clause.

In Walker vs. Lane, the so-called assignment was in fact a sublease because the assignor retained an overriding royalty of one-sixteenth of all oil that might be produced from that part of the land.

In South Penn Oil Company vs. Snodgrass, the Court held that a contract by which three owners of contiguous tracts of land join in one lease of the whole tract for the term of ten years and as long thereafter as oil or gas shall be produced from the premises, does not constitute three leases, or require the lessee to drill a well on each of the three contiguous tracts. Although this case is often times cited as contrary to our holding here, yet the proposition involved in said case is not at all applicable here.

In Harris vs. Michael there was no divisibility clause in the contract of lease.

In Pierce Oil Corporation vs. Schacht the Court merely held that the lessors selling a part of leased land to one person and another part to another person, and subsequent agreement of the purchasers with the lessee, changing the place of payment or deposit of royalty and rentals did not have the effect of dividing the lease into two leases, and that case is not at all inconsistent with our views here.

In Battle vs. Adams there was no issue in the case as to whether an assignment of the lease on a part of the land would have had the effect of dividing the lease into two leases, under the clause permitting an assignment, and the holding therein can not therefore be construed as being inconsistent with our views.

In Cowan vs. Phillips Petroleum Company although there was a divisibility clause and a subsequent assignment, yet in that case the matter of distinction between an assignment and a sublease, and its effect in connection with the divisibility clause in the lease, was not raised and that proposition was not therefore squarely presented to the court, and clearly, that decision can not be authority for a proposition not presented to the court.

In view, therefore, of the terms of the divisibility clause in the lease, and the terms of the assignment and in view of Hobbs vs. Cowley, 35 N.M. 413, distinguishing between an

assignment and a sublease, and in view of the holding in Roberson vs. Pioneer Gas Company (1931), 173 La. 314, 137 So. 46, followed in Harrel vs. United Carbon Company, 42 Fed. (2d) 790, we are of the opinion that in so far as your inquiries deal with Lease Forms 44 and 44-A, as authorized by Section 2 of Chapter 18, Laws of 1931, and Assignment Form 33-A2, they should be, in our opinion, answered as follows:

Inquiry (a) should be answered in the negative.

Inquiry (b) should be answered in the affirmative.

Inquiry (c) should be answered in the negative.

Inquiry (d) should be answered in the negative.

Inquiry (e) should be answered *{*100}* in the negative.

In so far as Lease Forms 35 and 36 are concerned, it appears that therein also is found a clause which can be construed as a divisibility clause and the answers to your inquiries with reference thereto would again depend entirely upon whether the instrument purported to be an assignment is in law and in fact an assignment or whether the same is a sublease.

In cases where the instrument is an assignment, then our opinion is that your inquiries should be answered exactly as we have heretofore answered them under Lease Forms 44 and 44-A. If the purported assignment is in law and in fact a sublease, then all of your inquiries should be answered in the affirmative.

Although your request for an opinion on these matters has presented questions on which counsel and even courts might disagree, and since our Supreme Court has not as yet passed directly on the matter, we have taken the view which, in our opinion, is most consistent with what we think is the better logic and reasoning.

By: FRED J. FEDERICI

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