Opinion No. 19.

State Lands—Oil and Gas Leases—Rentals on Oil and Gas Leases.

HELD: The "delay drilling penalties" or "delay rentals" provided for by paragraph 9 of the Montana State Oil and Gas lease are rentals within the meaning of Section 81-1712, R. C. M., 1947, and should be credited to the public school Interest and Income fund.

May 4, 1953.

Miss Mary M. Condon
Superintendent of Public Instruction
State Capitol Building
Helena, Montana

Dear Miss Condon:

You have asked for my opinion upon the proper disposition of non-drilling penalties collected upon state oil and gas leases. You state that you have been informed that these penalties have been placed in the State General Fund and that it is your contention that these non-drilling penalties are a

part of the rental for these oil and gas leases and therefore should be placed to the credit of the Interest & Income funds for annual distribution to the public schools eligible for the same.

Provision for distribution of the proceeds from the leasing of state lands was first made in the Enabling Act which granted these lands to the State of Montana. Section 11 of that Act reads in parts as follows:

"With the exception of the lands granted for public buildings, the proceeds from the sale and other permanent disposition of any of the said lands and from every part thereof, shall constitute permanent funds for the support and maintenance of the public schools and the various state institutions for which the lands have been granted. Rentals on leased lands, interest on deferred payments on lands sold, interest on funds arising from these lands, and all other actual income, shall be available for the maintenance and support of such schools and institutions. Any state may, however, in its discretion, add a portion of the annual income to the permanent funds."

These grants of lands for public purposes were accepted by the State of Montana by paragraph 7, Ordinance No. 1 of the Constitution of the State of Montana:

"The state hereby accepts the several grants of land from the United States to the State of Montana, mentioned in an act of congress, entitled 'An Act to provide for the division of Dakota into two states, and to enable the people of North Dakota, South Dakota, Montana and Washington, to form Constitutions and state governments, and to be admitted into the Union on an equal footing with the original states, and to make donations of public lands to such states.' Approved February 22, 1889, upon the terms and conditions therein provided."

The Constitution presently provides for the distribution in Article XI, Section 5, as follows:

"Ninety-five per centum (95%) of all the interest received on the school funds of the state, and ninety-five per centum (95%) of all rents received from the leasing of school lands of all other income from the public school funds shall be apportioned annually to the several school districts of the state in proportion to the number of children and youths between the ages of six (6) and twenty-one (21) residing therein respectively, but no district shall be entitled to such distributive share that does not maintain a public free school for at least six months during the year for which such distribution is made. The remaining five per centum (5%) of all the interest received on the school funds of the state, and the remaining five per centum (5%) of all the rents received from the leasing of school lands and of all other income from the public school funds, shall annually be added to the public school funds of the state and become and forever remain an inseparable and inviolate part thereof."

Further provision for the distribution of these moneys was made in Section 81-1712, R. C. M., 1947, which was originally passed as Section 12 of Chapter 108, Laws of 1927. That section provides in part as follows:

"All fees, rentals, penalties, royalties and bonuses collected for or under such leases shall be paid to the register of state lands and by him credited as follows: All fees and penalties shall be credited to the state general fund; all rentals shall be credited to the income fund of the grant to which the lands under each lease belong; all moneys collected as royalties and bonuses shall be credited to the permanent fund arising from the grant to which the land under each particular lease belongs and become and forever remain an inseparable and inviolable part thereof; . . ."

Your question concerns the proper disposition of moneys collected under Section 9 of the Montana State Oil and Gas Lease which provides in part as follows:

". . . The State Board of Land Commissioners may, however, in its discretion, upon satisfactory showing by the lessee, extend the time for commencement or completion of such drilling obligation from year to year not exceeding ten years from and after the date this lease takes effect upon such terms and considerations as the Board may determine, **and upon the payment to the Commissioner of State Lands and Investments of such penalties per acre per year for each year beginning with the third year, payable each year in advance as the Board in its discretion may determine.**" (emphasis supplied.)

These charges are commonly referred to as "delay drilling penalties" or "delay rentals." They have always been treated both by the oil industry and by the courts as rentals. If unpaid they are recoverable in an action for rent (See Summers on Oil and Gas, Section 413, page 359, volume 2.) They are, in most cases, payable absolutely and the obligation to pay accrued rentals is not extinguished by forfeiture of the lease (Summers on Oil and Gas, Section 338, page 219, volume 2.) This type of payment is the commonest type of rental in oil and gas leases and is the only kind payable under the usual form of lease. It has long been accepted both by the oil industry and by the courts that "rental" in an oil and gas lease means payment for the privilege of delaying drilling operations. In the case of Texas Company vs. Fontenot, 200 La. 753, 8 So. (2d) 689, it is said:

"The words 'bonus,' 'rental' and 'royalty' used in connection with oil and gas leases are to be construed in the ordinary and popular sense, 'bonus' meaning the cash consideration paid or agreed to be paid for the execution of a lease, **'rental' being the consideration for the privilege of delaying drilling operations,** and 'royalty' being a share of the product or proceeds therefrom reserved to the owner for permitting another to use the property." (emphasis supplied.)

In the case of Carroll vs. Bowen, 180 Okl. 215, 68 Pac. (2d) 773, it was said:

"The term 'rental' as used in oil and gas leases refers to the consideration paid to the lessor for the privilege of delaying drilling operations."

See, also, Aldridge vs. Houston Oil Company, 116 Okl. 281, 244 Pac. 782; Dickson vs. Mapes, 181 Okl. 376, 73 Pac. (2d) 1131; Hill vs. Stanolind, 205 Pac. (2d) 643; and C. I. R., vs. Clarion Oil Company, 148 Fed. (2d) 671, 80 U. S. App. D. C. 41.

Montana, in accord with the overwhelming majority view, has always classified these payments as rental both before and since the enactment of Section 81-1712, supra. (See McDaniel vs. Hager-Stevenson, 75 Mont. 356, 243 Pac. 582, decided in 1925; Bowes vs. Republic Oil Company, et al., 78 Mont. 134, 252 Pac. 800 (1926); Abell vs. Bishop, 86 Mont. 478, 284 Pac. 525 (1930).

This point was definitely settled in the recent case of State ex rel. Dickgraber vs. Sheridan, 9 St. Rep. 40,..... Mont....., 254 Pac. (2d) 390, where it was said:

"Rent is the term applied to the privilege given to bore for gas and oil and for delay in beginning operations; while royalty is a certain percentage of the oil after it is found, or so much per gas well developed.

"The word 'rent' is derived from the Latin word 'reditus' meaning a return. It is return or pay for the use of the landlord's premises."

It was also pointed out in that case in the special concurring opinion of Mr. Justice Freebourn that any other construction might lead to serious constitutional objections. He pointed out that any payment which is not made in return for the permanent disposition of a part of the land falls into the classification of "all other actual income" within the meaning of the Enabling Act. He laid down the following rule:

"The Enabling Act, § 11, makes it clear that the parties to such pact intended: (1) If the lands given by the United States for public school purposes were held intact, 'rentals * * * and all other actual income' from such lands 'shall be available for the maintenance and support of such

schools and institutions' and (2) if such lands were sold or any part thereof permanently disposed of the money received therefor should become permanent funds for the support and maintenance of the public schools and named institutions."

It is therefore my opinion that "delay drilling penalties" or "delay rentals" provided for by paragraph 9 of the Montana State Oil and Gas lease are rentals within the meaning of Section 81-1712, R. C. M., 1947, and should be credited to the public school Interest and Income fund.