

Chapter 15

Mechanics' Liens in the Oil Patch: An Illusory Remedy

Marilyn Kite
Holland & Hart
Cheyenne, Wyoming
John Gallinger
Holland & Hart
Washington, DC
Brent Waite
Holland & Hart
Denver, Colorado

Synopsis

§ 15.01. Introduction.

§ 15.02. Characteristics of Statutory Mineral Liens.

[1]--Statutory Creation.

[2]--In Rem.

§ 15.03. Persons and Activities Eligible to Establish a Lien.

[1]--Persons Entitled to Statutory Liens.

[a]--Individuals, Partnerships, and Corporations.

[b]--Laborers.

[c]--Materialmen.

[d]--Subcontractors.

[2]--Activities Giving Rise to Mechanics' or Mineral Liens.

[a]--Improvements.

[b]--Contract.

[c]--Labor.

[d]--Supplying Materials.

[e]--Surveyors, Engineers, Architects – Professional and Other
Supervisory Services.

[f]--Drilling Contractor.

[g]--Equipment Rental.

[h]--Attorneys' Fees.

§ 15.04. Property Interests Subject to Lien.

[1]--Oil and Gas Leases.

[a]--Lessees.

[b]--Working Interests.

[c]--Farmor/farmee Interests.

[d]--Drill Site.

[2]--Royalties.

[3]--Fee and Severed Mineral Interests.

[4]--Personal Property, Production, Proceeds, and Runs.

[a]--Production in Tanks and Pipelines.

[b]--Proceeds.

[c]--"Attached" and "Detached" Personal Property.

§ 15.05. Filing the Lien Statement and Perfecting the Lien.

[1]--Preliminary Notice Requirements.

[2]--Filing Requirements.

[3]--Service.

§ 15.06. Enforcing the Mineral Lien.

[1]--Foreclosure Action.

[2]--Time Limitations.

[3]--Notice and Process.

[4]--Priority of Mineral Liens in Relation to Other Claims.

[5]--The Effect of Bankruptcy.

§ 15.07. Avoiding Mineral Liens.

[1]--Defenses.

[2]--Bonds.

[3]--Other Procedures.

§ 15.08. Conclusion.

§ 15.01. Introduction.

Mechanics' liens usually provide a satisfactory means for ensuring that contractors and others are paid so

long as the liens arise in the context for which they were created: construction. Because these liens are designed to protect persons improving property by contributions of labor and goods, their characteristics favor contractors and parties working for or supplying them. The liens typically have priority over other claims relating back to the commencement of the work; subcontractors and laborers are protected in that the attached property secures their debt; and the lien arises on performance of the work.

A mechanic's lien, when perfected, prevents conveyance of the attached property until the underlying debt is satisfied. If the debt continues unsatisfied, the lien can be foreclosed, the property sold, and the proceeds will be disbursed to the lienholders. Hence, this security device is properly called a "lien," having its origin in Old French, meaning to tie together or to bind.⁽¹⁾

Oil and gas development, however, introduces complexities to the creation of mechanics' liens not found in the normal construction setting. These complexities cause the knot a lien ties on oil and gas properties to look less like a simple square knot and more like a Gordian knot. The denouement may not meet expectations of any of the parties.

Extracting oil and gas or other minerals typically involves a large cast. Geologists, engineers, suppliers, laborers, managers, and investors are all necessary to drill and operate a producing well. Compounding the number of players are the legal relationships that prime the necessary exploratory, drilling, and production activities: partnerships, joint ventures, farmout agreements, unit and operating agreements, and drilling and supply contracts. The diversity of property or mineral interests involved makes the relationships even more complicated.

These varying interests and parties are amalgamated by the frenetic pace of mineral development, which discourages the use of typical security arrangements. Oil and gas leases may be close to expiration; quick investment decisions must be made. Parties often rely on proceeds from the development of oil and gas properties to pay the costs of development. When proceeds do not reach anticipated levels, creditors must look elsewhere to satisfy their debts. Consequently, mechanics' type liens may become the central, and even sole, security device for contractors and suppliers.

Since general mechanics' and materialmen's liens do not fit neatly into oil and gas development, state legislatures have responded differently to provide a lien more suitable to oil and gas development. The result is that a particular state's lien statutes will ordinarily follow one of three patterns: (1) the state has only a general mechanics' lien;⁽²⁾ (2) the state has separate mineral lien statutes;⁽³⁾ or (3) the state incorporates oil and gas specific statutes into its general mechanic's lien act.⁽⁴⁾ Some states also have separate lien provisions granting operators a lien against interest holders in a unitized area.⁽⁵⁾

The result of this effort to accommodate contractor, subcontractor, and supplier interests in oil and gas development, at first, may appear to be an impressive arsenal of remedies in case of nonpayment. There are four types of liens that are applicable to oil and gas development, which can often be invoked conjunctively. These are (1) the simple common law lien, which creates the right to retain possession of property of another until a debt is paid; (2) the equitable lien, which arises out of a contract stating an intention to create a lien or out of the general relation of the parties; (3) the usual, general statutory mechanics' and materialmen's liens; and (4) statutory mineral liens, which specifically apply to oil and gas development.

The advantage of the typical mechanic's lien is its simple effectiveness. In the oil and gas context, however, a party may find this lien's requirements bothersome or even troubling. Too often a simple missed step or deadline will prove fatal. Additionally, judging the interaction between the statutes of a general mechanic's lien and those of oil and gas liens is uncertain. If the state has only a general mechanic's lien, adapting these statutes to the oil and gas context can pose significant uncertainties. Finally, there lurks the all-important

question of whether the lien may attach to any of the valuable oil and gas interests.

Consequently, the result of applying a mechanic's lien in the oil patch may be that its simple effectiveness in other areas disappears. Worse, because of the complexities, a contractor or subcontractor who must rely on the lien may discover that the lien is elusive at best. At its worst, it is illusory.

The mechanic's lien may also be, at the least, annoying to holders of oil and gas interests. Property rights normally take priority from the time of their recordation. However, the priority of a mechanic's lien will relate back to the time that work was first performed or materials were first supplied. Further, certain oil and gas interests may be subject to a lien even though the holders of these interests did not expressly agree to the work performed by the contractor. Consequently, mechanics' liens are troublesome for holders of oil and gas interests. They may be difficult to prevent. They inhibit property transfers and reduce property values. The cloud a lien creates on an interest may be especially annoying because it may arise unexpectedly.

The four types of liens are not equally useful. For example, the common law lien requires possession of the lien property by the creditor, so its use is limited in oil and gas development. It may apply where an operator retains possession of proceeds pending a working interest owner's payment of its share of development costs. Equitable liens are more important in oil and gas developments because they are based on the general relationships of the parties, and these relationships, although prevalent in the oil and gas context, are not always reduced to writing in a timely manner. An equitable lien may also prove valuable because the statutory procedures necessary for establishing and foreclosing mechanics' liens need not always be followed.⁽⁶⁾ Foreclosure simply involves initiating legal action for a collection of the debt and asserting a lien against specific property.⁽⁷⁾

The statutory mineral or mechanics' liens are the more important liens because they arise automatically on the performance of a broad scope of lienable activities. Consequently, they are more frequently encountered. Because of their importance, this Chapter will concentrate on these liens and discusses the particularities of their use in the oil patch. By better understanding the operation of these liens in oil and gas development, one can prevent the potentially unsavory experience of holding illusory expectations of these liens.

§ 15.02. Characteristics of Statutory Mineral Liens.

[1]--Statutory Creation.

Mechanics' liens are purely a statutory creation.⁽⁸⁾ Oil and gas liens have been upheld as a constitutionally reasonable classification that does not violate substantive due process or equal protection standards.⁽⁹⁾ Although a court can liberally construe provisions of the lien statute, it cannot disregard the steps essential to a lien's creation or extend the statute beyond its reasonable confines.⁽¹⁰⁾ The precise language of a particular mechanic's or mineral lien statute, therefore, must be carefully examined. While this Chapter summarizes the more significant provisions of several Eastern states' lien statutes, this summary is not a comprehensive review of all aspects of these lien laws. Care must be taken to examine carefully the relevant statutory provisions, the most current court decisions, and any subsequent legislative revisions.

In a state that has adopted both general mechanics' and mineral liens, it may be unclear whether the mineral lien provisions were intended to exclude the general mechanic lien. Some states expressly provide that mineral liens are conjunctive with other liens and remedies.⁽¹¹⁾ In the absence of such provisions, some courts have still held that the two liens are cumulative.⁽¹²⁾ One court, however, has held that where the procedures of the two liens conflict, the mineral lien excludes the general mechanic's lien even though a party may have complied with the requirements of the general mechanic's lien.⁽¹³⁾ Prudence dictates that a party comply with the procedures of both statutes, but if compliance with only one is possible, the specific