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Lien Assertions: A Re-awakened Interest in the Mineral Industry

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Lien Assertions: A Re-awakened Interest in the Mineral Industry

BY W. ROBINSON BEARD* AND SHARON K. MORRIS**

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INTRODUCTION

In recent years, operators, suppliers and lessors in the mineral industry have experienced severe financial difficulties resulting from the low prices received for produced oil, natural gas and coal.¹ Reduced revenues have caused working interest owners to experience increasing difficulties in meeting obligations for supplies, wages, taxes, royalties or other rentals, and payment of other expenses incident to the mineral business. These increased financial difficulties have re-awakened creditors' interest in remedies available for nonpayment—specifically statutory liens provided under state law to secure payment of debts.²

The applicability of each of the various statutory liens, however, frequently depends on the characterization of the item upon which the lien is placed. In the mineral industry, this characterization becomes very complex, given the chameleon-like nature of minerals. In many states the characterization changes from realty to personalty upon extraction. A lien which would easily apply to the minerals in place classified as realty may no longer be available once those minerals are extracted from the ground and become personalty. The availability of any given lien is further complicated by the sale of the mineral after extraction since many liens do not extend to include proceeds received from the sale of the attached property.

The purpose of this article is to survey the many liens ap-

¹ Since their peak in the mid-1970's, prices for oil, natural gas and coal have been in steady decline, reaching the February, 1986 low levels of approximately \$10-\$15/barrel for crude oil, (*See More Oil Companies Paying Less For Crude*, Lexington Herald-Leader, Feb. 25, 1986, at C6, col.1); \$35/ton for coal (*See Marx, Oil Price Effects Likely To Trickle Into State*, Lexington Herald-Leader, Feb. 2, 1986, at A14, col. 1), and \$5.738/MCF (or \$5.591/MCF if over 200 MCF's are purchased) for natural gas (Telephone interview with Robert Calin, Marketing Division, Columbia Gas of Kentucky (Feb. 7, 1986)).

² *See, e.g.*, KY. REV. STAT. § 376.140-.150 (1972) [hereinafter KRS] (granting lien to person performing labor or furnishing materials to mineral leaseholds); KRS § 381.460 (1972) (allowing lien for persons making improvements on land); KRS § 383.070(1) (1972) (lien for rent granted to landlords).

plicable to the mineral industry and examine in detail those liens which are applicable to produced minerals and the proceeds of such minerals once sold. Part 1 delineates the various liens which apply to mineral operations in Kentucky. Part 2 examines whether mechanics and materialmen liens under Kentucky statutory law³ apply to oil runs or gas runs, or the proceeds therefrom. Finally, Part 3 canvasses how other state statutes treat these liens, recognizing that the potentially unique provisions of each statute must be considered when addressing similar problems across state lines.

I. LIENS APPLICABLE TO THE MINERAL INDUSTRY

In the mineral industry as in other areas of commerce, liens can be used by creditors to tie up or encumber the real and personal property of owners and operators. As a result, they can be very valuable tools for suppliers and very troublesome encumbrances to operators against whose property the liens are placed. Liens applicable to the mineral industry include the following, albeit not exhaustive, categories.

A. Contractual Liens

Liens may be created by the parties through specific contractual provisions under various bodies of law. Providers of services to either landowners or lessees equipping wells and mines can secure their advances with contractual agreements known and recognized as mortgages against real property⁴ and as security agreements against personal property.⁵ The specific property covered by such mortgages or security agreements is subject only to the draftsman's craft. Furthermore, the liens are perfected and become binding on the parties upon proper filing *without notice*.⁶ Nevertheless, problems frequently arise in de-

³ KRS § 376.010 (Supp. 1984). A mechanic's or materialman's lien generally allows redress to persons who have performed labor or have furnished materials for the construction or alteration of a structure on real property or for other improvements thereon if such labor or materials were provided at the request of the owner or his agent.

⁴ These mortgages are regulated as to form and recordation in KRS Ch. 382 (1972 and Supp. 1984).

⁵ Security agreements are regulated as to form and priority by the U.C.C., Article 9 (1978).

⁶ See, e.g., KRS § 382.270 (1972); KRS § 355.9-312(5) (Supp. 1984).

termining whether property "affixed" to the ground is subject to the lien of a mortgage because it is "real property" or whether it is subject to Article 9 security agreement requirements as a "trade fixture."⁷

B. Common Law Liens

The simplest form of lien arises out of the right to retain possession of the property of another until a debt is paid. In this sense, a pledge of indebtedness is a form of lien and can be enforced under common law lien theories. One example of a possessory lien in proceeds is when an operator withholds a share of the proceeds from a working interest owner until that owner pays a share of the costs.

Whether or not a common law lien can be asserted, however, depends entirely on actual physical possession of the property. In *Central Contractor's Service, Inc. v. Ohio County Stone Company*,⁸ the Kentucky Court of Appeals denied common law lien relief, stating that the lien required possession of the property, and that without such possession the appellant could not enforce his claim.⁹ Any right to property based upon common law lien concepts ends with the claimant's surrender of possession.¹⁰

C. Equitable Lien

Equitable liens generally arise either from a written contract in which the parties show an intent to charge a particular prop-

⁷ See *Ratliff v. Utilities Elkhorn Coal Co.*, 186 S.W.2d 415 (Ky. 1945) (shops, buildings, tenant houses, store buildings, and store houses erected in connection with a coal mine were found to be personal property capable of removal by lessee); *Baine v. Graber*, 112 S.W.2d 66 (Ky. 1938) (underground pipes and well casings held to be personal property); *Hammonds v. Central Kentucky Natural Gas Co.*, 75 S.W.2d 204, 205 (Ky. 1934) (natural gas, being "wild and migratory in nature", is not subject to being owned until it is captured, at which time it becomes the personal property of the one extracting it); *Patton v. Woodrow*, 248 S.W. 226 (Ky. 1923); *American Pulverizer Co. v. Cantrell*, 694 S.W.2d 714 (Ky. App. 1985) (case remanded to trial court to determine as a matter of fact the degree to which the machinery had become attached to the real property in order to decide whether the machinery was personal property or a fixture).

⁸ 255 S.W.2d 17 (Ky. 1952).

⁹ *Id.* at 21; see also note 137 and accompanying text.

¹⁰ See also *McFerran v. Louisville Title Co.'s Receiver*, 71 S.W.2d 655, 657 (Ky. 1934) (held that since the claimant had surrendered possession of the cash deposits in dispute, he was no longer entitled to a common law lien on the deposits).

erty with a debt, or are implied or enforced by a court of equity if the court feels such application is warranted. These liens have been enforced by Kentucky courts when, under the circumstances, fair dealing and good conscience warrant the declaration of a lien in order to protect one of the parties.¹¹

Although an equitable lien was discussed in the *Central Contractor's Service* strip mining case,¹² the court found it was not applicable since such a lien was enforceable "only in special cases where the party asserting it shows some superior right."¹³ Since the claimant had not properly filed a lien statement when it had supplied tractors to the mining company, the court concluded that the claimant failed to show a "superior" right to the property and was therefore not entitled to an equitable lien on it.¹⁴

D. General Mechanic's Liens

Many state statutes provide priority to claims asserted by mechanics and materialmen who have furnished work or materials for construction or improvements on property. The lien, which secures payment of the price or value of the work performed or materials furnished in erecting or repairing a structure, attaches to the land as well as to the buildings and improvements.¹⁵ If the lien claimant has done work or supplied

¹¹ See *Back v. Back's Adm'r*, 135 S.W.2d 911 (Ky. 1940). The court explained the concept by stating:

We have frequently written that in addition to the establishment of a lien by a written contract which shows an intention to charge some particular property with a debt or an obligation, there is a thoroughly well-established principle which, if the facts warranting it exist, creates a charge known as an equitable lien. This is where a court of equity out of a general consideration of right and justice as applied to the relations of the parties, and the circumstances of their dealings in the particular case, creates a situation which in good conscience warrants the declaration of a lien.

Id. at 914; see also *Owensboro Banking Co. v. Lewis*, 106 S.W.2d 1000, 1004 (Ky. 1937).

¹² See *Central Contractor's Service, Inc. v. Ohio County Stone Co.*, 255 S.W.2d 17 (Ky. 1952).

¹³ *Id.* at 21.

¹⁴ *Id.* For further discussion of equitable lien application, see *McFerran*, 71 S.W.2d at 657.

¹⁵ See *In re Louisville Daily News & Enquirer*, 20 F.Supp. 465, 466 (W.D. Ky. 1937). The lien dates from the commencement of work upon the improvements and attaches to the contracting owner's interest in the land. See KRS § 376.010-.130 (1972 and Supp. 1984).

materials by contract with a *lessee* of mineral property for a term of years, the claimant may remove such additions or improvements if he can do so without material injury to previous improvements.¹⁶ In Kentucky, subcontractors and laborers are protected by liens, but only for amounts that do not exceed the aggregate total of the original contract price agreed upon *between the owner and the original contractor*.¹⁷

Although general mechanic's liens are applicable to mineral operations, the particular state statute must be examined to determine whether the individuals claiming the lien have performed a *type of work* protected by the statute. In addition, the work must be performed "by contract with, or by the written consent of the owner, contractor, subcontractor, architect or authorized agent of the owner."¹⁸

It should be noted that shorter deadlines and different filing requirements apply to liens asserted against projects owned by state or local governments such as mining operations conducted on state university properties.¹⁹ Public project lien statutes must also be carefully scrutinized since these liens attach not to the property, but to funds due.²⁰ Filing deadlines, however, are not always rigidly enforced. If the mechanic's or materialman's lien claimant has failed to file a statement or lien within the statutory deadlines, the filing period may be extended if the claimant has in good faith supplied additional materials such as replacement parts or repairs necessary to complete the original contract.²¹

E. Specific Mechanic's Lien for Mineral Development

In addition to the general mechanic's lien, which requires an agreement between the *owner* (or his agent) and the original contractor, Kentucky provides a lien for a person furnishing work, supplies, machinery or other things of value to the *lessee*

¹⁶ See KRS § 376.040 (1972).

¹⁷ See generally KRS Ch. 376 (1972). The procedures for enforcement of the general liens are beyond the scope of this article, but a good discussion can be found in Coleman & Peltier, *Mechanics' Liens*, 68 Ky. L.J. 681 (1980).

¹⁸ KRS § 376.010(1) (Supp. 1984) (emphasis added).

¹⁹ See KRS §§ 376.210-.260 (1972 and Supp. 1984).

²⁰ KRS § 376.210 (1972).

²¹ See, e.g., *Sandusky Foundary & Machine Co. v. Wickliffe*, 483 F.2d 695 (6th Cir. 1973); *City of Ashland v. Ben Williamson & Co.*, 171 S.W.2d 96 (Ky. 1943); *Akers & Co. v. Weil*, 65 S.W.2d 712 (Ky. 1933).

of an oil, gas or other mineral property.²² The lien is applicable to secure payment from a lessee's entire interest.²³ This lien, which extends under the wording of "other minerals" to the coal industry as well as the oil and gas industry,²⁴ must be perfected and enforced in the same manner as the general mechanic's and materialman's liens.²⁵

F. *Lien for Licensed Engineers and Land Surveyors*

Licensed engineers and land surveyors are given a lien²⁶ similar to a mechanic's lien but the lien is available only if the claimant has contracted directly with the owner or with the agent of the owner of the property.²⁷ The lien applies to "the building, structure, land or project on which such services were performed."²⁸ Priority of the lien in Kentucky, as in most states, is governed by statute,²⁹ and claimants must generally file a statement, with the county clerk of the county where the property is located, within six (6) months³⁰ of commencement of the work and file suit to enforce the lien within twelve (12) months from the date of filing.³¹ Engineers or surveyors who perform services for public improvement projects in Kentucky must perfect liens allowable by this section of the statute by complying with Kentucky Revised Statutes (KRS) sections 376.210 to 376.260. These sections provide for shorter deadlines and different filing requirements than a mechanic's lien.³²

²² KRS § 376.140 (1972).

²³ *Id.*; see also *Continental Supply Co. v. Sandy River Oil Co.'s Receiver*, 291 S.W. 49, 52 (Ky. 1927), where the court discussed the predecessor to the current act, stating:

This act extends to those who perform labor or furnish material and supplies in the development of oil leases a lien on the leasehold to secure the payment for such labor, material, and supplies. This lien is exactly like the ordinary mechanic liens provided for by sections 2463 *et seq.* of the Statutes. Indeed, the 1924 act is a literal copy with the changes necessary to make it applicable to oil leaseholds of the mechanic's lien statute.

²⁴ See *Central Contractors*, 255 S.W.2d at 19 (the court allowed such a lien to apply to a coal mining operation).

²⁵ KRS § 376.140(3) (1972); see also *supra* notes 15-21 and accompanying text.

²⁶ KRS § 376.075 (Supp. 1984).

²⁷ *Id.* at (3).

²⁸ *Id.* at (1).

²⁹ See KRS § 376.010(1)-(2) (Supp. 1984).

³⁰ See KRS § 376.075(4) (Supp. 1984).

³¹ *Id.* at (5).

³² See *supra* note 18 and accompanying text.

G. *Employee's Lien*

This special lien is available to employees of "any mine . . . or of any . . . other manufacturing establishment, or of any other business, whether incorporated or not."³³ Although the lien might at first appear to have general application, it actually applies only in very narrow circumstances: upon the failure, insolvency or bankruptcy of the employer.³⁴ When such circumstances exist, the lien attaches to the property³⁵ of the employer, but does not attach to the mine itself if the employer is an independent contractor and is not the agent of the owner.³⁶

The function of the employee's lien statute in present times appears to be to benefit employees upon the employer's bankruptcy or reorganization under the Bankruptcy Code³⁷ and to provide to employees of the debtor in bankruptcy proceedings priority rights over secured creditors.³⁸ While this priority has been recognized by courts of bankruptcy,³⁹ the continuing validity of statutory priority for employees of the debtor in bankruptcy over perfected mortgage holders and security interest holders may be subject to question. The Bankruptcy Code provides that employees of a debtor employer have only a priority

³³ KRS § 376.150 (1972); *see also* KRS §§ 376.160-.190 (1972).

³⁴ According to the wording of KRS § 376.150(1) (1972), the lien only applies "when the property or effects of [the employer] . . . are assigned for the benefit of, or are to be distributed among creditors, whether by operation of law or by its own act. . . ." The lien was previously used rather frequently in bankruptcy situations, but it is of questionable value today since the lien's application may have been pre-empted by the 1978 Bankruptcy Code, codified at 11 U.S.C. §§ 507-510 (1984). *See also infra* text accompanying note 41.

³⁵ KRS § 376.150(1) (1972), specifically allows the lien to apply to both real and personal property, stating "the *property and effects* which have been involved in the business and upon the *accessories* connected therewith, *including any interest in real property* used in carrying on the business." (Emphasis added).

³⁶ *See* Superior Elkhorn Coal Co. v. Allen, 37 S.W.2d 52 (Ky. 1931). The court explained that "the employees of an independent contractor operating a coal mine are not at the same time employees of the owner of the mine within the meaning and purpose [of the statute]," and that the employees of the operator were therefore not entitled to a lien on the property of the owner. *Id.* at 55.

³⁷ 11 U.S.C. §§ 507-510 (1984).

³⁸ KRS §§ 376.150, .160, .180 (1972), provide that the lien when applicable prevails over the rights of prior perfected mortgage holders in the property of the employer used in the business. *See* Leslie's Adm'x v. Branham, 158 S.W.2d 949 (Ky. 1942).

³⁹ *See* Freeman Furniture Factories v. Bowlds, 136 F.2d 136 (6th Cir. 1943); *In re* Bennett, 153 F. 673 (6th Cir. 1907).

claim against assets not subject to the claims of secured creditors.⁴⁰

H. State and Local Tax Liens

Kentucky's statute creating a lien for unpaid taxes is very broad, providing that the state, as well as each county, city or taxing district, have a lien on the property assessed for taxes due them respectively for five (5) years following the date when the taxes become delinquent. A lien is also enforceable on any real property owned by a delinquent taxpayer on the date when the sheriff offers the tax lien claims for sale as provided in subsequent sections.⁴¹ Furthermore, the lien allows for interest, penalties, fees, commissions, charges, and other expenses.

To ensure that the Commonwealth of Kentucky and its local governmental units could collect taxes due on property assessed, the legislature granted priority to the tax liens, stating that the lien "shall have priority over any other obligation or liability for which the property is liable."⁴² KRS section 134.420(2) also provides that the state (but not counties and cities and other taxing districts) shall have a "lien of equal rank" with the lien provided in subsection 1 of "*all property of a taxpayer*" (emphasis added) who owes any of several enumerated taxes or other tax when such taxes are not included in or covered by the lien provided in subsection 1. However, the lien on *all property* arises only from the time that the assessment becomes delinquent.⁴³ The lien on all other property is subject to the rights and duties of a holder in due course and to the rights of "any person taking the property or lien thereon for value without actual or constructive notice."⁴⁴ Such language allows parties who became purchasers or lien holders of property prior to the time that notice of state tax lien was filed in an appropriate clerk's office to have priority on all other property not covered specifically by KRS section 134.420.

Tax liens of cities of the third through the sixth classes⁴⁵ are

⁴⁰ See 11 U.S.C. § 507(a)(3)-(4) (1984). The lien would be enforceable under 11 U.S.C. § 544(b) (1984).

⁴¹ KRS § 134.420(1) (1982).

⁴² *Id.*

⁴³ KRS § 134.420(2) (1982).

⁴⁴ *Id.*

⁴⁵ Cities in Kentucky are classified into six categories by the state legislature according to their population. The classes are listed in KRS § 81.010 (Supp. 1984).

protected in the same manner. If found applicable under the particular circumstances, the lien on the specific property assessed is superior to prior recorded mortgages and security interests.⁴⁶ A lien established on all other property not specifically covered by the statute, however, remains subject to the rights of mortgagees under prior recorded mortgages or security interests.⁴⁷

Finally, according to the court in *Commonwealth v. J.V. Jellico Coal Co.*,⁴⁸ if the state seeks to apply the lien to a coal lessee's rights under a lease, the lien can apply to the *lessee's interest only*, and does not apply to the real property if the lease has been terminated in accordance with its terms.⁴⁹ In that case, the property in question belonged to the lessee and had been assessed by the taxing authority. When the bankrupt lessee failed to make payment, the Commonwealth sought to enforce a lien against the lessor of the real property. The court held that the lessor's cancellation of the coal lease, pursuant to the terms of a lease which terminated the lessee's interest upon bankruptcy, acted to terminate the taxing authority's lien on the land itself—particularly since the legislature had singled out coal, oil, and gas leases for special statutory treatment.⁵⁰

I. Unemployment Compensation Liens

Liens created by statute in favor of the Commonwealth of Kentucky Cabinet of Human Resources to secure amounts of contribution, interest and penalty payable by employers for unemployment compensation are of particular interest to mining companies.⁵¹ The liens have the same priority as state, county, and municipal *ad valorem* tax liens, and are superior to the lien of any mortgage or encumbrance created "upon all property of any subject employer. . . ."⁵² The lien commences from the time

⁴⁶ See *Midland-Guardian Co. v. McElroy*, 563 S.W.2d 752 (Ky. App. 1978) (holding that taxes assessed against particular property had priority over a recorded mortgage); see also Ky. OAG 83-477 (December 9, 1983).

⁴⁷ See Ky. OAG 83-477.

⁴⁸ 12 S.W.2d 698 (Ky. 1928).

⁴⁹ *Id.* at 699.

⁵⁰ *Id.*

⁵¹ See KRS §§ 341.310-.315 (1983).

⁵² KRS § 341.310(1) (1983).

the contributions, interest, and penalties become due, with notice of the lien to be filed with the county clerk in any county where the subject employer has property registered in books designated by the statute as "Miscellaneous State Tax Liens."⁵³ However, the treatment of such liens in cases of insolvency or reorganization under the Bankruptcy Code is subject to question since they are entitled only to priority status rather than secured creditor status.⁵⁴ If the liens are enforceable as claims against property ahead of secured creditors in Bankruptcy Court, the liens would also be enforceable pursuant to 11 U.S.C. section 544(b).⁵⁵

J. Workers' Compensation Lien

All awards against an employer for workers' compensation benefits (to the extent not paid from applicable insurance funds) can constitute a lien "against the assets of the employer to the same extent as is allowed by law for any unpaid wages for labor."⁵⁶ Kentucky courts have held that the lien to secure unemployment compensation contributions under KRS section 341.310 has priority not only over the lien to secure workers' compensation awards under KRS section 341.175, but also over the lien securing laborers' wages under KRS sections 376.150 and 376.160.⁵⁷

The application of this lien to the mineral industry was discussed at length in *Adkins v. Carol Mining Company*.⁵⁸ The court held that

as a general rule, a statutory lien does not take precedence over a prior contractual lien, it is . . . within the power of the Legislature to give a statutory lien priority over other liens, and, having such power, where the statute clearly shows and

⁵³ KRS § 341.310(2) (1983).

⁵⁴ See 11 U.S.C. § 507(a)(7)(D) (1984).

⁵⁵ See 11 U.S.C. § 544(b) (1984).

⁵⁶ KRS § 342.175 (1983).

⁵⁷ In *Commonwealth ex rel. Unemployment Comp. Comm'n v. Durham*, 161 S.W.2d 610 (Ky. 1942), the court stated: "[T]he sovereign State of Kentucky did not choose to place the laborers' claim for wages ahead of its claim for taxes and the Legislature in enacting the Act provided that the Commission's claim for unemployment compensation contributions against the employer would be superior to all other liens."

⁵⁸ 136 S.W.2d 32 (Ky. 1940).

declares an intention to cause the statutory lien to override or take precedence over a prior contractual lien, it must be construed as effecting such priority of lien over it.⁵⁹

The court thereby granted superiority to the workers' compensation liens and laborer's wage liens over contractual liens for rents and royalties.⁶⁰

K. Landlords' Liens

Kentucky provides a statutory lien for the benefit of landlords⁶¹ which, as applied to the mineral industry, is the product of two separate statutes. KRS section 383.070(1) provides that "[a] landlord renting premises for farming or coal mining purposes shall have a lien on the *produce* of the premises rented and the fixtures, household furniture, and other personal property owned by the tenant or undertenant . . ."⁶² dating from the time possession is taken under a lease. Furthermore, the statute secures one year's rent "due and to become due."⁶³

KRS section 383.070(2), on the other hand, provides that "every other landlord" (thus including oil and gas lessors) shall have a lien only "on the fixtures, household furniture, and other personal property of the tenant or undertenant" dating from the time possession was taken. The lien secures the payment of four (4) months' rent, as long as the rent is not past due for more than four (4) months or 120 days.⁶⁴ By its express terms, the lien provides coal lessors with substantially greater rights than oil and gas lessors, including a specific lien on "the produce of the premises rented."⁶⁵ No similar words are found in the section applicable to oil and gas leases, appearing to indicate that the produce of the gas or oil well would not be covered by the lien. However, there are no reported Kentucky decisions on this point.

L. Federal Tax Lien

Liens in favor of the United States are governed by the

⁵⁹ *Id.* at 38.

⁶⁰ *Id.* at 39.

⁶¹ KRS § 383.070 (1972).

⁶² KRS § 383.070(1) (1972).

⁶³ *Id.*

⁶⁴ KRS § 383.070(2) (1972).

⁶⁵ *Id.* at (1).

Federal Tax Lien Act of 1966.⁶⁶ The lien is enforceable against third parties from the date a Notice of Lien is filed in the local county clerk's office to validate the lien. From that date, the lien applies to all property and rights to property, whether real or personal, belonging to the person who has neglected or refused to pay a federal tax for which he or she is liable.⁶⁷ Although the Federal Tax Lien Act should be subject to uniform interpretation nationwide, its application is dependent upon state law to determine whether rights of the taxpayer constitute "property or rights in property" within the language of the federal statutes.⁶⁸

A recent Oklahoma decision involving the application of a federal tax lien to oil and gas runs will undoubtedly have impact in Kentucky unless significant differences in Kentucky law are found. In *Bigheart Pipeline Corp. v. United States*,⁶⁹ federal employment taxes were assessed against an operator. The operator assigned a seventy-eight percent interest in the working rights of an undeveloped oil and gas lease prior to the time that the federal government filed notice of the tax lien, but the assignment was not recorded until after the tax lien notices were filed in the appropriate office.⁷⁰ A customer purchased oil from the assignee. Upon receipt of the notice of levy, the customer withheld payment to the assignee and instituted an interpleader action in district court.⁷¹ In determining the rights of the government to the proceeds of the oil runs, the federal district court stated that an oil lessee has a property interest, in the nature of a *profit a prendre* under Oklahoma law,⁷² which does not vest any right in the oil in place but merely creates a right to prospect for and take out oil if and when found.⁷³ Since, at the time the

⁶⁶ 26 U.S.C. § 6321-6326 (1982).

⁶⁷ 26 U.S.C. § 6321 (1982).

⁶⁸ See *United States v. Bank of Celina*, 721 F.2d 163 (6th Cir. 1983).

⁶⁹ 600 F. Supp. 50 (N.D. Okla. 1984).

⁷⁰ *Id.* at 51-52.

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.* (citing *Kolachny v. Galbreath*, 110 P. 902 (Okla. 1910) and *Frank Oil Co. v. Belleview Gas & Oil*, 119 P. 260 (Okla. 1911)).

⁷⁴ *Bigheart*, 600 F. Supp. at 53. The court stated:

The Court believes under § 6321 and applicable case law, a federal tax lien clearly may attach to a contingent interest. The statute itself provides a lien in favor of the United States can attach upon all property or "rights in property." In *Randall v. H. Nakashima & Co.*, 542 F.2d 270 (5th Cir.

taxpayer's interest was assigned, the lessee taxpayer's interest was contingent, the court held that the federal tax lien attached to the contingent interest just as it might have attached to a contract right.⁷⁴ The court also held the federal tax lien attached to the oil as it was extracted by the assignee and to the proceeds upon the sale of the oil by the operator.⁷⁵

M. Execution Liens

Under Kentucky law, the rendition of a judgment *in personam* for a sum of money does not, by itself, create a lien upon any property for the satisfaction of the judgment. Instead, an execution against personal property must be obtained upon application to the court.⁷⁶ The ordinary writ of execution, comparable to the common law writ of *fieri facias*,⁷⁷ becomes a lien only from the time it is placed in the hands of a proper officer for execution.⁷⁸ Enforceability of the execution lien, however, can frequently become a very complex matter open to interpretation by the courts.

In *Adams v. Napier*,⁷⁹ the court held that where the officer had failed to adequately appraise the value of the property, there could be no levy of execution and sale of land.⁸⁰ More recently, the court in *W. E. Stephens Manufacturing Co. v. Miller*,⁸¹ set aside an execution lien because of the sheriff's failure to properly execute the lien, explaining that the property on which a levy is made must be adequately described with such particularity and distinctness so as to reasonably identify the property.⁸²

1976), the court held a taxpayer's contract right was a property interest to which a federal lien could attach.

⁷⁵ *Id.* at 53-54.

⁷⁶ KRS § 426.010 (1972).

⁷⁷ *Fieri facias* is translated as "cause it to be done." In practice, it refers to a writ ordering the sheriff to levy and make the amount of a judgment from the goods and chattels of the debtor. BLACK'S LAW DICTIONARY, 754 (5th ed. 1979).

⁷⁸ KRS § 426.120(1) (1972).

⁷⁹ 334 S.W.2d 915 (Ky. 1960).

⁸⁰ *Id.* at 917.

⁸¹ 429 S.W.2d 384 (Ky. 1968).

⁸² *Id.* at 387. The court held that an endorsement stating "Executed the within execution upon all of H.C. Miller, d/b/a Miller's of Bardstown fixtures and equipment and his motor vehicle" was invalid, as was a subsequent endorsement which stated "Executed the within Execution by levying upon all of H.C. Miller's of Bardstown fixtures and equipment and his motor vehicle." The court, however, held valid an

A complex question of statutory application arises when the execution lien claimant attempts to levy upon a lessee's working interest in a mine—particularly when the underlying claim arises out of a totally unrelated matter. For instance, if the claimant is the supplier of goods or services to an operation on a particular parcel of land, can it successfully place a levy against the lessee's operating interest in another mine in an attempt to satisfy its mechanic's lien judgment?

Unfortunately, Kentucky case law which details the proper attachment procedures in such situations is inadequate. The courts also have failed to provide any guidelines as to whether the lessee's working interest should be treated as personalty or realty for attachment purposes.

When faced with the dilemma of needing to attach a mineral lessee's working interest in a mine or well, the claimant should therefore attempt to comply with the personal property attachment requirements by: (i) placing the lien in the hands of the proper officer;⁸³ (ii) giving the officer detailed attachment instructions (including advising him to actually survey the property and properly appraise it);⁸⁴ (iii) requesting him to endorse the writ by describing the property with particularity;⁸⁵ and (iv) specifying that the defendant debtor be properly notified of the levy.⁸⁶ Even after taking such pains to assure enforceability, however, the claimant may still find that his execution lien will fail if the lessee's working interest is classified as an interest in real property rather than in personalty. Therefore, the cautious claimant must also comply with the real property attachment requirement by filing a *lis pendens* notice on the leasehold interest.⁸⁷

The order of disposition of property under an execution lien also is controlled by statute. Personal property must be levied

endorsement which stated "Executed the within execution by levying same on all of the stock of merchandise, fixtures and appliances located in the store building now operated by H.C. Miller under the name of Miller's of Bardstown and located at 106 North Third Street, Bardstown, Kentucky, on this the 6th day of July, 1965." *Id.* at 386.

⁸³ See KRS § 426.120(1) (1972).

⁸⁴ See *C.T.C. Investment Co. v. Daniel Boone Coal Corp.*, 58 F.2d 305 (6th Cir. 1931); *Adams*, 334 S.W.2d at 917.

⁸⁵ See *Stephens Manufacturing*, 429 S.W.2d at 387.

⁸⁶ See *C.T.C. Investment*, 58 F.2d at 316-17.

⁸⁷ See KRS § 382.450 (1970).

upon and sold under execution prior to the sale of any land.⁸⁸ If there is insufficient personalty to satisfy the entire judgment, the local sheriff may levy upon the judgment debtor's realty without the issuance of any further execution.⁸⁹ Choses in action, however, have been held not subject to levy under execution.⁹⁰

The validity of the execution lien as against subsequent purchasers or lessees of the property dates only from the time a *lis pendens* notice is filed in the county clerk's office for the county in which the property is located.⁹¹ Although the personal estate of the judgment debtor may be sold at or near the place of the levy,⁹² prior newspaper advertisement is required for sale of any kind of properties with an appraised value of \$100 or more.⁹³

N. Mine Reclamation Liens

Amounts spent "to restore, reclaim, abate, control, or prevent adverse effects of past coal mining practices on privately owned land" can be recovered by the federal government⁹⁴ or by the state⁹⁵ under a Mine Reclamation Lien. Although the liens attach upon the land as of the date of expenditures of the monies, the Secretary of Interior or corresponding state official is required to file a statement in the appropriate clerk's office. The amount of the lien cannot be in excess of the amount determined by appraisal to be the increase in the market value of the land as a result of the restoration of the premises.⁹⁶

O. Improvements

Any person believing himself to be the owner of the property by reason of a claim in law or equity, but who is later dispossessed of the property by judgment of a court of competent jurisdiction, is granted a statutory right to the "value of the

⁸⁸ See KRS § 426.130 (1972).

⁸⁹ See KRS § 426.140 (1972); see also Ky. OAG 84-173.

⁹⁰ See *Doyle v. Sleeper*, 31 Ky. (1 Dana) 531 (1833).

⁹¹ See KRS §§ 382.440-.470 (1972 and Supp. 1984).

⁹² See KRS § 426.160 (1972).

⁹³ See KRS § 426.560 (1972).

⁹⁴ See Surface Mining Control and Reclamation Act of 1977 (SMCRA), Pub. L. No. 95-87, 91 Stat. 465 (1977) (codified at 30 U.S.C. § 1238).

⁹⁵ KRS § 350.575 (1983).

⁹⁶ *Id.* at (1); see also SMCRA § 408(a), 30 U.S.C. § 1238(a) (1982).

improvements'' created by him while an occupant of the land.⁹⁷ Under statutory proceedings, the dispossessed occupant is given a judgment for monetary damages in the amount of the improvements and is then entitled to a lien upon the land recovered from him to satisfy the judgment.⁹⁸ The displaced occupant is also entitled to the benefit of any crops growing on the land at the time of the judgment of eviction.⁹⁹

This lien is only available, however, if the occupant believes *in good faith* that he is the owner of the land. In *Raydure v. Lindley*,¹⁰⁰ the court refused to grant an improvement lien to a party who had forcibly taken possession of the land for the purpose of drilling for oil.¹⁰¹ The court determined that such persons were not entitled to protection because they could not meet the "good faith" standard.¹⁰²

P. Trust Fund for Benefit of Materialmen

Although KRS section 376.070(1) technically does not create a lien, it may create a broad right in favor of suppliers. The statute provides a specific right in the *proceeds* of the project to which supplies were furnished.¹⁰³ Although this statute has apparently never been applied in the mineral field, it is conceivable that such an application might occur if the word "owner" were construed to include both the fee owner and the owner of a working interest in a well or mine—i.e., a mineral lessee. Under such a construction, subcontractors and suppliers would have a lien upon the proceeds of the mineral output in the form of payments received by either the fee owner, the operator/miner, or a general contractor. One court has interpreted the statute to create a property interest

⁹⁷ See KRS § 381.460-.570 (1972 and Supp. 1984).

⁹⁸ See KRS § 381.550 (1972).

⁹⁹ See KRS § 381.570 (1972).

¹⁰⁰ 268 F. 338 (6th Cir. 1920).

¹⁰¹ *Id.* at 342.

¹⁰² *Id.* at 343.

¹⁰³ KRS § 376.070(1) (1972), provides:

Any contractor, architect or other person who builds, repairs or improves the property of another under such circumstances that a mechanics' or materialman's lien may be imposed on the property shall, from the proceeds of any payment received from the owner, pay in full all persons who have furnished material or performed labor on the property.

in favor of suppliers in funds held under trust for them by a general contractor.¹⁰⁴

Q. Illegal Mining Operations

Under KRS section 351.177(3), the Department of Mines and Minerals is "empowered with the authority to seize and take possession of any equipment being used for the purpose of illegal mining of coal without a valid mine license as required by K.R.S. Section 351.175." Furthermore, seizure of equipment used in such illegal operations can occur without issuance of a warrant.¹⁰⁵ Although not technically a statutory lien, this section has the same impact of tying up ownership of equipment seized from "wildcat" operators.

Upon conviction of persons for violation of KRS section 351.175, the statute further provides for the sale of all equipment so seized through a sealed bidding process, with proceeds from the sale being deposited in an "illegal mining fund"¹⁰⁶ to be used to enforce Chapters 351 and 352.¹⁰⁷ The forfeiture and sale of seized property, however, is subject to a valid lienholder's claim.¹⁰⁸ In order to prevail, the lienholder must establish at a special hearing "that the property was being used in connection with mining without a license without the knowledge, consent or approval of the owner or lienor."¹⁰⁹

II. APPLICATION OF STATUTORY LIENS TO OIL AND COAL REDUCED TO POSSESSION AND TO THE PROCEEDS OF OIL RUNS AND COAL MINED

With the exception of common law possessory liens, equitable liens, and contractual liens, all the liens described in Part I are statutory. The application of these liens to minerals extracted after lien attachment to the real property is of critical

¹⁰⁴ See *In re D. & B. Electric, Inc.*, 4 Bankr. 263 (Bankr. W.D. Ky. 1980) (the court reached this conclusion by relying on *Henry A. Petter Supply Co. v. Hal Perry Constr. Co.*, 563 S.W.2d 749 (Ky. Ct. App. 1978)).

¹⁰⁵ See Ky. OAG 82-417.

¹⁰⁶ KRS § 351.177(4) (1984).

¹⁰⁷ *Id.* at (11).

¹⁰⁸ *Id.* at (5).

¹⁰⁹ *Id.*

importance to all parties affected. Lien claimants may seek to have their liens apply to the extracted oil or gas or coal, or they may attempt to apply the liens to the *proceeds* of such extraction.¹¹⁰

A case law survey of the various statutory liens applicable to mineral interests in Kentucky leads to the conclusion that Kentucky courts have not yet addressed the question of which lien interests, if any, attach to oil and gas runs, coal produced from working mines, or the proceeds of either type of mineral sold. The wording of the landlord's lien statute against a coal mine,¹¹¹ and the wording of KRS section 376.070(1), which provides the basis for the trust fund theory,¹¹² appear to provide the only clear instances of Kentucky authority attaching a lien to the *produce* of a mineral working interest.¹¹³ The remaining state statutes are silent with respect to "produce" or "proceeds" of the property subject to the lien. Such silence could be construed to mean that the liens do not attach to oil runs, produced coal or gas, or to the proceeds of such operations.¹¹⁴

Other courts, however, have refused to apply strict statutory construction where the property owner has sold the property in an attempt to remove it from the reach of the creditor.¹¹⁵ Instead, they have allowed the creditor to "follow the proceeds of the property in the hands of the [owner] and subject the proceeds to his debt."¹¹⁶ Such treatment is generally available, however, only when the secured goods have been wrongfully converted or sold to a bona fide purchaser. If these preliminary conditions

¹¹⁰ U.C.C. § 9-306(1) (1960) defines proceeds as "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds."

¹¹¹ KRS § 383.070(1) (1972) provides that the landlord has a lien "on the produce of the premises rented and the fixtures, household furniture, and other personal property owned by the tenant, or undertenant. . . ." Within the second section of the same statute, the rights of other mineral landlords are much narrower—being solely applicable to "fixtures, household furniture, and other personal property." *Id.* at 2. By not using the same term "produce of the premises," the statute appears to exclude the right of the landlord to produced oil and gas or any proceeds derived therefrom.

¹¹² For the text of KRS § 376.070(1) (1972), see *supra* note 103.

¹¹³ See *supra* notes 103-111 and accompanying text.

¹¹⁴ See *infra* notes 176-179 and accompanying text.

¹¹⁵ See, e.g., *Moore v. Boxman*, 245 N.E.2d 866 (Ind. 1969); *Crawford v. Baker*, 32 S.W.2d 340 (Ky. 1930); *McGregor Co. v. Heritage*, 631 P.2d 1355, 1360 (Ore. 1981).

¹¹⁶ *Crawford*, 32 S.W.2d at 343.

are not met, the lien's application will not extend to proceeds unless there are specific statutory provisions to that effect.

This distinction is illustrated in *McGregor v. Heritage*,¹¹⁷ an Oregon case. The lien was an agricultural services lien provided by Oregon statute.¹¹⁸ In refusing to extend the lien to cover the proceeds of a potato crop, the Oregon Supreme Court explained:

It has been held that some common law or equitable liens extend to the proceeds of the sale of the security. Mortgages, trust deeds and security agreements may also result in rights sometimes referred to as "liens," and it has been held that the "liens" under such agreements may also extend to the proceeds of the sale of the security.

We also find cases in which courts have held that common law and equitable liens, as well as "liens" under mortgages and other types of security agreements, may extend to the proceeds of the sale of the security when the security has been wrongfully converted or sold to a bona fide purchaser so as to destroy the lien upon the security or make it impossible to enforce the lien against the security. . . .

We find no authority, however (and none has been cited to us), to support a rule to the effect that when, . . . the goods subject to a lien created by statute which provides for a lien against the goods are not wrongfully converted or sold to a bona fide purchaser, but are sold or delivered to a third party who has notice of the lien, the lien holder can nevertheless enforce such a statutory lien against the proceeds of the goods, rather than foreclose it against the goods themselves, in the absence of statutory provisions to that effect.¹¹⁹

The court concluded that since the defendant had failed "to plead and prove that wrongful conversion or sale took place without [its] knowledge and before [it] was able to enforce [its] lien against the security,"¹²⁰ and since there were no statutory provisions specifying the extension of coverage to these proceeds, the defendant was not entitled to recover from the proceeds of the crop.¹²¹

¹¹⁷ 631 P.2d 1355 (Ore. 1981).

¹¹⁸ OR. REV. STAT. § 87.266 (1985).

¹¹⁹ *McGregor*, 631 P.2d at 1360.

¹²⁰ *Id.* at 1361.

¹²¹ *Id.*

It is crucial to all parties that the applicability of the various liens to proceeds and produced minerals be clearly established. Mineral operators require regular cash flow from the extraction of the minerals in order to continue operation. Purchasers of the oil and gas or coal expect to pay for the ownership of the mineral, free and clear of lien rights in third parties. Obviously, paying the agreed amount twice in order to obtain clear ownership of the extracted minerals is undesirable.

Kentucky has had no decisions from its highest court delineating the relative rights of lienholders, working interest holders, and/or purchasers in situations where liens are asserted against leasehold interests. Although the following cases show one or more applications of lien actions in the mineral industry, they fail to address whether one or more of the liens attached to produced oil or gas, or to mined coal, or to the proceeds of either.

A. *Central Contractor's Service v. Ohio County Stone Co.*

In *Central Contractor's Service v. Ohio County Stone Co.*,¹²² several statutory lien claims were consolidated in a single action against Central Contractors Service.¹²³ The liens were created against a predecessor, Indianhead Mining Corporation, which had acquired a strip of land in Ohio County for surface mining purposes. Indianhead erected a steel tippie, a tower house, a machine shop, and other buildings on the property, and had purchased equipment and materials for use in the mining operation.¹²⁴ When the mining company subsequently ceased operations and filed for bankruptcy, its property was sold to Central Contractors Service "subject to any and all liens and claims whatsoever."¹²⁵

Central Contractors did not deny that the bankrupt company was indebted to the lien claimants nor did it deny that the equipment and materials had been used on the property. It did, however, attack the validity of the liens on several grounds. It first questioned the technical sufficiency of the liens under the

¹²² 255 S.W.2d 17 (Ky. 1952).

¹²³ *Id.* at 19.

¹²⁴ *Id.*

¹²⁵ *Id.*

general mechanics' lien statute¹²⁶ because the property identified in the lien statement filed with the clerk's office was not described adequately. The court dismissed this challenge, finding that the property was described with enough specificity to allow adequate identification.¹²⁷

Central Contractors also resisted the liens on the basis that the petition to foreclose the lien did not describe the property charged, other than being a claim against "all the property and assets" or all of the "real estate described herein and the personal property and assets, tipple, building. . . ."¹²⁸ The court found that this was an adequate description for the purpose of the foreclosure action,¹²⁹ and that the lien,¹³⁰ created specifically to apply against the lessee's lease interest and equipment in situations like the one before the court, applied to *all* machinery and equipment. Thus, personalty was subject to the mechanic's lien under that section. The court further held that oral agreements for the supply of goods were sufficient contracts for purposes of the lien.¹³¹

Central Contractors then challenged the nature of the judgment as being a judgment *in personam* against it. The court explained that the judgment was not in its nature "personal," but was one solely for the purpose of "subjecting Central's property to a lien for the specific amounts set forth."¹³² Thus, the court determined that the claims of most of the lien claimants were valid as against the personal property improvements acquired by Central Contractors from the bankrupt mining company. Although two of the lien claimants had not correctly followed the steps prescribed by statute¹³³ the court found that

¹²⁶ KRS § 376.010 (1952) provided that the statement of lien must comply with the predecessor to KRS § 376.080 (1978), containing "a description of the property intended to be covered by the lien sufficiently accurate to identify [it]."

¹²⁷ *Central Contractors*, 255 S.W.2d at 19.

¹²⁸ The court stated: "It is clear that each of these petitions identifies the property to be charged as all that used or occupied by the Mining Co. at the site of its mining operation." *Id.*

¹²⁹ *Id.*

¹³⁰ See KRS § 376.140 (1972).

¹³¹ See *Central Contractors*, 255 S.W.2d at 20.

¹³² *Id.*

¹³³ KRS § 376.120 (1972), requires that "[a]ny person holding a lien against the property, whether arising under the provisions of KRS § 376.010 or otherwise, is required to present his claim with the evidence in its support to the commissioner."

one of them had complied sufficiently with the requirements of KRS section 376.120 by providing the required information to the Special Commissioner.¹³⁴

The other lien claimant, Williams Tractor Company, had supplied repairs and spare parts but had failed to file the required statement of lien; as a result, its claim was denied.¹³⁵ Although Williams Tractor argued that the failure to file the required statement should be excused because of the bankruptcy proceedings against the debtor, this excuse was disallowed by the court.¹³⁶ Williams Tractor then asserted a common law lien which was dismissed by the court because the claimant did not have any of the debtor's property in its possession.¹³⁷ The court also denied the claimant's equitable lien argument, stating that since Williams Tractor could not show some superior right to any property, it could not obtain the benefit of an equitable lien after failing to comply with statutory requirements.¹³⁸

While the decision in *Central Contractors* may be helpful to those wishing to assert liens against tangible personal property of mineral operators, it provides no guidance as to the entitlement of lien claimants to oil runs, to produced coal, or to the proceeds of either.

B. *Adkins v. Carol Mining Co.*

*Adkins v. Carol Mining Co.*¹³⁹ involved a dispute between mineral lessors to a bankrupt mining company and the employees of the defunct company over compensation and wage claims against the assets of the mining company.¹⁴⁰ The lessor royalty holders instituted a petition alleging the mining company's insolvency and breach of the terms of the mineral leases, and

¹³⁴ *Central Contractors*, 255 S.W.2d at 21. (Lien claimant W. H. Greer was found to have followed the proper procedures authorized by KRS § 376.120 and was therefore granted his lien claim.)

¹³⁵ *Id.* (Williams Tractor Company had failed to comply with the procedures set forth in KRS § 376.010(2), requiring the claimant to "file in the office of the county clerk of the county wherein he has furnished or expects to furnish labor or materials, and the amount in full thereof.")

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Id.*

¹³⁹ 136 S.W.2d 32 (Ky. 1940).

¹⁴⁰ *Id.* at 34.

sought an injunction restraining the mining company and its agent "from mining and removing coal from the premises or trespassing thereon."¹⁴¹ The labor claimants, having been joined in the action, set up their statutory liens for compensation and unpaid wages, and asserted that their liens were entitled to statutory priority over the claims of the royalty holders.¹⁴²

Finding that KRS section 376.150 gave priority to the unpaid wages, the court granted priority status to the employees for both unpaid wages and unpaid compensation benefits up to the amounts of those benefits and wages.¹⁴³ Since the mining operations had been terminated by the injunction, the question of application of the liens to mined coal or the proceeds following the sale was never addressed by the court.

C. *Weir v. Jarecki Manufacturing Co.*

Although *Weir v. Jarecki Manufacturing Co.*¹⁴⁴ has often been criticized on a point not immediately relevant here,¹⁴⁵ the case might provide some guidance on whether mechanic's lien claimants can attach to "oil runs." In *Weir*, the holders of an entire working interest in an oil and gas lease assigned an undivided one-half interest in the lease to an individual named Curtis who, in consideration for the assignment, agreed to drill,

¹⁴¹ *Id.* at 33.

¹⁴² *Id.* at 33-34 (the claims of priority were based on KRS §§ 376.150 and 342.175).

¹⁴³ *Id.* at 38-39.

¹⁴⁴ 72 S.W.2d 450 (Ky. 1934).

¹⁴⁵ The court in *Weir* attempted to draw a distinction based on the fact that the contract underlying the dispute had been recorded. *Id.* at 452. This distinction was later criticized in *Campbell & Summerhays, Inc. v. Greene*, 381 S.W.2d 531, 533, (Ky. 1964), where the court explained:

In *Weir v. Jarecki Mfg. Co.*, 254 Ky. 738, 72 S.W.2d 450, where a contract for the sale of an undivided interest in an oil and gas lease required the vendee to drill certain wells, it was held that the persons who furnished labor and materials for the drilling of the wells could not enforce a lien against the interest of the vendor. Some importance was attached to the fact that the *recorded* contract of sale contained a provision that the wells should be drilled without cost or expense to the vendors. The opinion in the *Weir* case undertook to distinguish *Penney v. Kentucky Utilities Co.*, 238 Ky. 167, 37 S.W.2d 5, where a contract for the sale of a hotel property required the vendee to make substantial improvements, and it was held that liens could be enforced against the vendor's interest.

We can see no real distinction between the *Weir* and *Penney* cases and it is our opinion now that the *Weir* decision is unsound, particularly as concerns the significance of recording.

equip and fully complete six wells on the leased property and to run oil from the wells into storage tanks free of any expense to the holders.¹⁴⁶ The agreement also provided that Curtis' rights would be forfeited if he failed to complete all six wells.¹⁴⁷

Curtis began the development of drilling operations and completed the first well before assigning the lease agreement to a corporation of which he was an organizer. The successor corporation then borrowed a sum of money from a local bank and granted its interest in the lease as collateral security for the loan, also authorizing the bank to collect the oil runs and apply the same to repay the note.¹⁴⁸ The development company failed before completion of the final well, whereupon the royalty holders sued for forfeiture of the assignment.¹⁴⁹

The trial court entered a judgment declaring that the forfeiture was effective for failure to comply with the terms of the assignment.¹⁵⁰ Following these actions, mechanic's lien claims were filed, and the commissioner of the lower court held that the claimants had a lien on the entire leasehold in the sum of their respective claims.¹⁵¹ On review, Kentucky's highest court found that the mechanic's lien claimants were entitled to a lien against the leasehold¹⁵² under the predecessor to KRS section 376.140.¹⁵³ The court, addressing the question of what property was subject to the mechanic's lien claims, stated: "It is a settled rule that a mechanic's lien attaches only to the interest in the property of the person who creates the lien, and that his interest only can be sold to satisfy same, unless the owner consents in writing that such liens can be created."¹⁵⁴

The court focused upon the interests of Curtis, the original assignee, and the development corporation and found that the leasehold held by the development corporation was in the nature of the interest held by a purchaser of land which was subject to

¹⁴⁶ *Weir*, 72 S.W.2d at 450.

¹⁴⁷ *Id.* at 451.

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² *Weir*, 72 S.W.2d at 452-53 (the court held that the leasehold was the one-half interest assigned by appellants to Curtis and his assignee corporation).

¹⁵³ Ky. St. Supp. 1924, § 2479a-1 to 2479a-7.

¹⁵⁴ *Id.* at 452.

being divested.¹⁵⁵ Therefore, the court ruled that the mechanic's lien claims did not attach to the real property interest held by the original assignors of the working interest but only to the property held by the development company and the improvements brought to the property during the term of its possession.¹⁵⁶

The court then determined that the mechanic's lien claimants were entitled to enforce their liens against the one-half interest in the lease assigned to the development corporation, and that the bank, which had loaned money to the development corporation in exchange for a pledge of the same leasehold interest, was entitled to a contractual lien on one-half of the oil runs (the other half belonging to the original royalty holders).¹⁵⁷

Weir would thus appear to stand for the proposition that the lien claims of materialmen and suppliers against the property of oil and gas lessees under KRS section 376.140 do not attach to oil runs or proceeds of oil runs. Thus, such rights to the oil itself and the proceeds therefrom appear to be free of the lien claimants' rights. The difficulty in reaching this conclusion, however, is the possibility—whether logical or not—that the security interest granted to the bank was perfected prior to the time that the first labor and materials were supplied by the lien claimants and thus the mechanic's lien claims attached to the leasehold subject to the prior-created contractual lien. This result would not be consistent with the statement in the case that Curtis had developed a well before the assignment to the grantor of the contractual lien to the bank, but no further clarification can be obtained from the face of the ruling itself.

D. Continental Supply Co. v. Sandy River Oil Co.'s Receiver

*Continental Supply Co. v. Sandy River Oil Co.'s Receiver*¹⁵⁸ is significant primarily for its history of the specific statutory lien provided for mineral development, the predecessor to KRS section 376.140.¹⁵⁹ The court found that mechanic's lien claims were

¹⁵⁵ *Id.* at 453.

¹⁵⁶ *Id.* at 454.

¹⁵⁷ *Id.*

¹⁵⁸ 291 S.W. 49 (Ky. 1927).

¹⁵⁹ Ky. St. Supp. 1924, § 2479a-1 to 2479a-7. This was the same provision under review in *Weir*. See *supra* notes 144-57 and accompanying text.

effective against a leasehold for supplies furnished in the development of the leasehold and subjected the lessee's assets to the lien claims.¹⁶⁰ In response to a challenge made to the priority of the mechanic's lien claimants over subsequent attaching creditors, the court held that the attachment lien creditor's claims were inferior to the claims of the mechanic's lien holders.¹⁶¹ Once again, however, the court did not address entitlement to oil runs, or to proceeds of oil runs, or to proceeds of other minerals extracted from the property.

III. PRINCIPLES DERIVED FROM DECISIONS IN OTHER STATES

Absent a definitive decision of its own, a Kentucky court might look to opinions from other states for guidance. However, commentators, who discuss the entitlement of mechanic's lien claimants to proceeds of oil and gas runs,¹⁶² caution that general rules cannot and should not be drawn in most lien situations because the liens are statutory in nature and courts have generally interpreted the applicability of statutory liens quite strictly.¹⁶³ This is primarily due to the fact that lien statutes, and specifically mechanic's lien statutes, are in derogation of common law.¹⁶⁴

Therefore, although each mineral lien statute must be analyzed in detail to determine its scope, mechanic's lien statutes which provide a lien against property of the working interest owner of the leasehold estate generally do not apply to oil and gas produced or the proceeds thereof unless the statute expressly enumerates oil, gas, minerals or proceeds as being subject to the lien.¹⁶⁵

This result does not appear to be dependent upon ownership or non-ownership theories,¹⁶⁶ since mechanic's liens have been

¹⁶⁰ *Continental Supply*, 291 S.W. at 51-53.

¹⁶¹ *Id.* at 53.

¹⁶² See, e.g., Annot., 59 A.L.R.3d 278 (1974); Kite & Cook, *Enforcing and Defending Against Liens on Mineral Interests: Reliance v. Reality*, 29 ROCKY MOUNT. MIN. L. INST. 111 (1984).

¹⁶³ See Kite & Cook, *supra* note 162, at 116. However, the authors continue by stating: "[O]nce it is determined that the particular party is entitled to claim a lien, the remedies provided by the lien statutes are liberally construed to provide substantial justice." *Id.*

¹⁶⁴ See *Southport Petroleum Co. v. Fithian*, 13 So.2d 382, 383 (La. 1943).

¹⁶⁵ See Annot., *supra* note 162, at 282.

¹⁶⁶ Under the ownership theory, minerals are considered part of the realty, while

held not to attach to oil runs and proceeds in Louisiana,¹⁶⁷ Oklahoma,¹⁶⁸ or Kansas¹⁶⁹—all states that apply the non-ownership theory to oil and gas prior to production—or in Arkansas¹⁷⁰ or Colorado¹⁷¹—two states which consider unproduced oil and gas to be part of the real property subject to a leasehold interest. A review of the cases indicates that a mechanic's lien claim has been clearly and unequivocally granted against such an interest only when a state's mechanic's lien statute expressly grants a lien against produced oil or gas and the proceeds therefrom.¹⁷²

One major complication arises when applying these decisions to Kentucky mineral lien disputes. The basic assumption behind the decisions from other states that statutes in derogation of the

under the non-ownership theory, the lessee has only a right to search for and reduce the mineral to possession, and there is no title in the minerals as long as they remain in the earth. See Annot., *supra* note 162, at 287.

¹⁶⁷ See *Southport* 13 So.2d 382. Plaintiff who had purchased crude oil from lessee asked the court to determine to whom it owed the purchase price of oil because of several lien claims to the proceeds. The court held that the lien was only valid against oil produced and stored on the leasehold, and was not valid on oil produced from wells and funds derived from the sale of such oil. In so ruling, the court pointed out that, since in Louisiana there is no title to oil as long as it remains in the earth, even the oil flowing through the pipelines of a well cannot be considered part of the well and cannot therefore be subject to a lien. *Id.* at 383-84.

¹⁶⁸ See *Stanolind Crude Oil Purchasing Co. v. Busey*, 90 P.2d 876 (Okla. 1939) (where the court concluded that a lien attached only to property specifically mentioned in the statute and did not therefore apply to all oil as and when produced since the statute did not mention proceeds).

¹⁶⁹ See *Black v. Giarth*, 128 P. 183 (Kan. 1912) (where the court held that a lien perfected according to the statute did not attach against the proceeds of oil, but rather attached against the leasehold itself).

¹⁷⁰ See *Tarheel Drilling & Equipment Co. v. Valley Steel Products Co.*, 330 S.W.2d 717 (Ark. 1960) (where the court in dictum indicated a readiness to apply a lien to proceeds from minerals underlying the surface where a lien could be shown to cover the land).

¹⁷¹ See *Chambers v. Nation*, 497 P.2d 5 (Colo. 1972) (where proceeds resulting from the sale of oil produced from a well after attachment of the lien were held not to be subject to attachment where the applicable statute did not specifically mention proceeds).

¹⁷² See *Pheister v. Ogden Smelting & Refining Mills, Inc.*, 364 P.2d 1078 (Wyo. 1961) (where mechanic's lien claimant successfully asserted a claim against the oil produced and the proceeds from the sale of the oil under a statute which expressly mentioned proceeds); see also *La Bellman v. Gleason & Sanders, Inc.*, 418 P.2d 949 (Okla. 1966) (where the court refused to apply a lien against proceeds from an oil run because the statute in effect at that time of the attachment did not specifically mention proceeds even though the amended statute in effect at the time of the trial did contain such specific language).

common law are to be strictly construed does not apply in Kentucky.¹⁷³ This is not to say, however, that these cases would not be persuasive in Kentucky since Kentucky's courts could reach the same result based on a different analysis.

In *Powers v. Brewer*,¹⁷⁴ the court noted that mechanic's lien statutes do not create personal liability against the owner of the property for the supplies furnished but create only a right *in rem* against the property.¹⁷⁵ Thus, unless the statute identifies a particular type of property as being subject to a mechanic's lien, a claimant will have no right against it. More recently, the Kentucky Supreme Court and the Kentucky Court of Appeals have said that statutes should be narrowly construed when a clear meaning is apparent and that the courts should not psychoanalyze legislative intent to reach a result that the legislature might have, but did not, provide for in the statute.¹⁷⁶

The second principle used to decide whether proceeds of operations are subject to lien claims is equally applicable in Kentucky. Since at least two lien statutes¹⁷⁷ specifically use the term "produce" or "proceeds" when describing what property is subject to a lien, the absence of those words from the mechanic's lien statutes¹⁷⁸ cannot be ignored or considered inadvertent, particularly in view of the positions taken by other states' courts.¹⁷⁹ It would therefore appear unlikely that a lien claimant would be successful in asserting a claim against the proceeds of oil or gas runs under current Kentucky statutes.

CONCLUSION

A survey of the case law addressing various statutory liens applicable to mineral interests in Kentucky leads to the conclu-

¹⁷³ See KRS § 446.080(1) (1985).

¹⁷⁴ 38 S.W.2d 466 (Ky. 1931).

¹⁷⁵ *Id.* at 469.

¹⁷⁶ See *Apache Coal Co. v. Fuller*, 541 S.W.2d 933, 935 (Ky. App. 1976) (where the court stated: "Our function in interpreting statutes is limited to analyzing and applying what the legislature has said, and does not extend to psychoanalyzing the legislature and applying what it may have meant to say."); accord *Smith v. Magruder*, 566 S.W.2d 430, 431 (1978).

¹⁷⁷ See KRS §§ 383.070(1) & 376.070(1) (1972).

¹⁷⁸ See KRS § 376.010 (Supp. 1984) and § 376.140 (1972).

¹⁷⁹ See Annot., 59 A.L.R. 3d 278, 283-299 (1974).

sion that the courts have not considered which lien interests attach to oil and gas runs, coal produced from working mines, or the proceeds of either type of mineral sold. In the absence of clear authority, the interests of all affected parties are in peril. Absent a single, complex test case involving representative holders of all types of liens, judicial decisions are not likely to provide effective guidance for many years to come—particularly when one considers the variety of statutory liens applicable to the mineral industry.

Clarity and certainty appear to be unobtainable—except through a series of legislative amendments to the many lien statutes applicable to the mineral industry. Since this industry is so integral to the economic growth of Kentucky and since the use of lien attachments is spreading rapidly in the industry, the Legislature should seriously consider taking action to clarify the types of property subject to such liens.