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MICHIGAN'S LEGISLATION GOVERNING OIL AND NATURAL GAS¹

By BOICE GROSS*

The discovery that Michigan had its own deposits of oil and natural gas brought with it the problems of regulation attendant on the production and distribution of these unique commodities,—unique because they are not quite minerals, as that term is ordinarily used, and not quite *ferrae naturae*, although the law of both of these has contributed to the molding of the now rather formidable body of law governing oil and gas. Much has been written in text books and in judicial opinions concerning the “migratory” nature of petroleum and natural gas.² Modern geology and research have established the proposition, now not questioned, that these products are physically capable of being reduced to absolute possession and that they are quite properly to be classed as property in the usual sense of the word.³

In the 1929 session the legislature of Michigan passed several statutes regulating the production and distribution of oil and natural gas which now stand on the books and, *prima facie* at least, have the force of law. Whether the provisions of these acts are enforceable

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¹The writer wishes to express appreciation for the very valuable assistance of Robert Dunn of the Michigan Public Utilities Commission, one of the drafters of the Pipe-line Acts.

Michigan Public Acts of 1929, No. 81, providing a procedure for record, forfeiture and surrender of oil, gas and other mineral leases does not raise problems connected with the scope of this article. Public Acts of 1929, page 483 and page 894 are acts dealing with the leasing of oil, gas and mineral rights in state owned land. Contracts affecting these rights are placed under the jurisdiction of the Conservation Department.

For a treatment of the problems involved in oil and gas leases, see Summer's “Law of Oil and Gas” and articles by Vesey in the MICHIGAN LAW REVIEW.

²Ohio Oil Co. v. Indiana, 177 U. S. 190; 44 L. ed. 729; Wagner v. Malory, 169 N. Y. 501, 62 N.E. 584.

³Kelley v. Ohio Oil Co., 57 Ohio St. 317, 49 N.E. 399; Ohio Oil Co. v. Indiana, *supra* note 2; Lindsley v. Natural Carbonic Gas. Co., 220 U. S. 61, 55 L. ed. 369, 31 Sup. Ct. 337.

in the sense of being constitutional is the question to be considered by this article.

It is to be noted that Michigan did not consider it necessary to enact many laws and that those it did adopt are not unduly detailed. The legislature did not desire to over-regulate and thus possibly discourage the development of the infant industry. The acts passed are those deemed the essential minimum to afford proper state supervision. If later events prove the need of further laws, then will be the time to adopt them. The laws passed appear to be, so far as they are valid, entirely adequate for Michigan's needs. The quality of flexibility which is apparent in their provisions is especially to be noted. The acts allow the exercise of wide discretion in the administrative bodies of the state government, permitting quick action where it is indicated, and providing the valuable privilege of different rules to fit varying conditions in the different oil and gas fields. This is accomplished by the provisions giving the Public Utilities Commission and the Conservation Department the power to prescribe rules to govern details.

The statutes are of three distinct types, the first being the taxing act; the second, statutes dealing with conservation and regulation of the mechanics of production; and the third, regulation of the distribution of the products. The Conservation Department of the state is given jurisdiction to regulate production and the Public Utilities Commission is charged with the administration of the statutes dealing with distribution. This division of function seems only logical and is quite unique among states having such legislation.

I. The Tax Statute

This act levies a tax on the producers of oil and natural gas, called a "severance" tax.⁴ It is a tax of 2% of the gross cash value of oil and gas taken from the earth. The duty of collecting the tax is laid on the purchasers of the oil or gas who are empowered to deduct the amount of the tax from the payment made to the producer. Producers and carriers are required to make monthly reports of production to the State Tax Commission and failure to make these reports is punishable by fine. The tax is made a lien on the oil and gas produced. An interesting feature of the act is

⁴Mich. P. A. 1929, No. 48, p. 85.

the provision that the attorney general may file a bill in the Ingham county circuit court to enjoin production by any person or company who is delinquent either in paying the tax or in making the report.⁶ Inasmuch as the proceeding provided does not appear to be ex parte or summary, it will probably be held valid if and when questioned. The statute provides that the severance tax shall be in lieu of all other taxes on the oil and gas and in lieu of taxes on leases and rights to develop resources. It is not, however, intended to excuse the payment of taxes on physical properties used in the business of producing oil or gas, nor is it in lieu of a franchise or corporation tax on corporations or associations.

The advantages of this sort of tax are apparent. It does away with the confusion and inequality which would inevitably arise if the oil and gas were to be valued by local assessors. It is impossible to determine how much oil or gas is located in a particular deposit underground, and if it were to be taxed when collected in pipe-lines or tanks, the bulk of it would escape taxation altogether. With the severance tax, only that which is reduced to possession is taxed and that at a uniform rate. It appears to be an excise tax in the nature of payment for the privilege of taking gas and oil from the earth—not a corporation or franchise tax which is levied for the privilege of acquiring and retaining corporate powers. This is shown by the fact that it is levied on persons as well as corporations. This type of tax is not a novelty in this country. The case of *Heisler v. Thomas Colliery Company*⁶ upheld the constitutionality of a statute which imposed a severance tax on anthracite coal. The validity of the statute was attacked on the ground that insofar as it was laid on coal destined for export from the state it was a burden on interstate commerce. The tax was, as the Michigan oil and gas severance tax is, laid on all anthracite mined in Pennsylvania and was thus nondiscriminatory and not a tax solely on interstate commerce. The decision in the case was unanimous and held the tax to be valid as a general property tax on a natural product. A tax laid on mining or producing ore in Minnesota was upheld in *Oliver Iron Co. v. Lord*,⁷ Mr. Justice Van Devanter saying that while the tax might

⁶Sec. 10, Mich. P. A. 1929, No. 48, p. 87.

⁶260 U. S. 245, 67 L. ed. 237, 43 Sup. Ct. 83.

⁷262 U. S. 172, 67 L. ed. 929, 43 Sup. Ct. 526.

indirectly affect commerce it was imposed only in respect of the mining, without discrimination against interstate commerce, and was not within the prohibition against burdening interstate commerce.⁸ This type of tax is distinguishable from a tax solely on transportation. Such a tax has been held void insofar as it is measured by the portion of production transported beyond the state.⁹

The cases of *Reading Ry. Co. v. State of Pa.*, and *Maryland v. Cumberland & Pa. R. R. Co.*,¹⁰ insofar as they invalidate a tax on coal mined within and shipped out of the state appear to be based on a misconception of the true nature of the tax. While the writer has been unable to find authority directly over-ruling these cases, the later decisions of the Maryland court indicate that the analysis of the dissenting justices in *Maryland v. Cumberland & Pa. R. R. Co.* has been accepted; that is, that such a tax is an excise laid on the privilege of doing the particular sort of business in the state, over and above the ordinary corporation or franchise tax, and that the measurement of the tax by the quantity of material in the hands of carriers is merely a convenient and reasonable method for determining the amount of the tax.¹¹

It therefore seems clear that the Michigan tax on oil and gas production is unobjectionable.

II. Conservation Statutes

There is little in these acts that is important from the legal point of view. The validity of most of the sections will scarcely be questioned. The provisions are reasonable and designed only to allow a proper exercise of supervision over the production of oil and natural gas in order to prevent waste and to protect the public interests.

⁸See also *La Coste v. Dept. of Conservation*, 263 U. S. 545, 68 L. ed. 437, 44 Sup. Ct. 186, upholding a tax on skins of wild fur-bearing animals, imposed after the skins were in the hands of dealers.

⁹*Eureka Pipe Line Co. v. Hallanan*, 257 U. S. 265, 66 L. ed. 227, 42 Sup. Ct. 101; *United Fuel Gas Co. v. Hallanan*, 257 U. S. 277, 66 L. ed. 234, 42 Sup. Ct. 105.

¹⁰15 Wall. 232; and 40 Md. 22.

¹¹See 32 A. L. R. 336 and cases there cited. The case of *Raydure v. Board of Supervisors*, 183 Ky. 84, 209 S.W. 19, which holds that a tax on the production of oil would be invalid if in lieu of all other taxes is based on a provision of the Kentucky constitution (Sec. 171) which does not appear in the Michigan constitution. See Art. 10, Sec. 3 constitution of state of Michigan for provision authorizing a tax on special industries, etc.

That a state has this power has been repeatedly held.¹² Briefly the acts provide for a supervisor of wells, for inspection where necessary to safety, and for issuance of permits to begin drilling and to abandon wells. An appeal board composed of the governor, secretary of state, and the attorney general, is provided to hear the complaint of anyone aggrieved by the rulings of the officers of the Conservation Department. The decision of the appeal board is made final and not subject to appeal.¹³ It is quite probable that the validity of the denial of an appeal from the rulings of this board will be attacked. The question of finality of the rulings of administrative tribunals is one characterized chiefly by uncertainty and obscurity. It has been held that there is nothing in the federal constitution which forbids a state to grant the final determination of a legal or fact question to a tribunal whether called a court or a board,¹⁴ where the question does not involve a denial of those general requirements of due process or of other rights derived from the federal constitution.¹⁵ The provision for notice and hearing of appeal for the party affected by the rulings of the supervisor of wells appears adequate to satisfy due process in this connection.¹⁶ Should the appeal board deny a fair hearing or decide contrary to the indisputable character of the evidence, its action would not be final, regardless of the statute purporting to give it finality.¹⁷ The rule is generally accepted that an administrative tribunal's rulings on questions properly within its jurisdiction will not be questioned by the courts. This appears to be true even where the statute setting up the tribunal does not expressly provide finality for the tribunal's decisions. The

¹²Wells v. Midland Carbon Co., 254 U. S. 300, 65 L. ed. 276; Quinton Relief Oil & Gas Co. v. Corp. Commission of Okla., 224 Pac. 156, 101 Okla. 164.

¹³Supervisor of Wells Act, Mich. P. A. 1929, No. 15, p. 31.

¹⁴Reetz v. Michigan, 188 U. S. 505, 23 Sup. Ct. 390, 47 L. ed. 563. (State board vested with power to determine finally questions of law and fact on which depended applicants right to practice medicine.)

¹⁵See Ben Avon Borough v. Ohio Valley Water Co., 253 U. S. 287, 64 L. ed. 908, 40 Sup. Ct. 527.

¹⁶Mich. P. A. 1929, No. 15, Sec. 15, p. 37.

¹⁷Interstate Commerce Commission v. Louisville & N. Ry. Co., 227 U. S. 88, 33 Sup. Ct. 185, 57 L. ed. 431; United States v. Chin Low, 208 U. S. 8, 52 L. ed. 369, 28 Sup. Ct. 201; Tang Tun v. Edsell, 223 U. S. 673, 32 Sup. Ct. 359, 56 L. ed. 606.

law recognizes a distinction, of course, between the power of an administrative tribunal to determine its own jurisdiction and its power to determine questions within its jurisdiction.¹⁸ It is said that while errors of fact made by such a body are not reviewable, errors of law are.¹⁹ This results from the circumstance that questions of jurisdiction of an administrative body are almost always questions of law.²⁰

It is certainly safe to say that a wide latitude is given administrative tribunals to determine conclusively the matters brought before them,²¹ and where the decision must be based largely upon an exercise of discretion (as must be the case in matters which will be brought before the Michigan appeal board) the latitude is extremely broad. In such cases it is almost impossible to make convincing proof of error, and even were a court to review the proceedings of the appeal board, the likelihood of reversal would be slight.²²

III. Acts Regulating Distribution

This class of statute is the most important and most interesting from the point of view of the lawyer. It consists of the oil-pipe line act²³ and the gas-pipe line act,²⁴ so-called because they purport to regulate the business of carrying and dealing in oil and natural gas by pipe-lines in Michigan. There is grave doubt of the validity of some of the sections in both of these acts, although it must be observed that the more questionable features are found in the gas-pipe line act and do not appear in the oil-pipe line act. In these

¹⁸For the distinction between the power of an administrative tribunal to determine its own jurisdiction and its power to determine questions within its jurisdiction, see *Interstate Commerce Commission v. Northern Pac. Ry. Co.*, 216 U. S. 538, 54 L. ed. 608, 30 Sup. Ct. 417; *Same v. United States Ex Rel. Humboldt S. S. Co.*, 224 U. S. 474, 32 Sup. Ct. 556, 56 L. ed. 849.

¹⁹*Ma-King Products Co. v. Blair*, 271 U. S. 479, 70 L. ed. 1046, 46 Sup. Ct. 544.

²⁰Yet in the famous case of *Ju Toy v. United States*, 198 U. S. 253, 49 L. ed. 1040, 25 Sup. Ct. 644, the jurisdiction clearly depended on a matter of fact (whether *Ju Toy* was born in the United States). The supreme court refused to review the findings of the commission.

²¹*John Dickinson, Administrative Justice and the Supremacy of Law*, p. 71.

²²See *Freund, Administrative Powers Over Persons and Property*, Sec. 155.

²³*Mich. P. A.* 1929, No. 16, p. 38.

²⁴*Mich. P. A.* 1929, No. 9, p. 21.

additional features the gas-pipe line act treads on extremely insecure ground.

Some of the features common to both the oil-pipe line act and the gas-pipe line act (hereinafter to be called, for brevity, the oil act and the gas act) are the sections making corporations, associations or persons who engage in the business of transporting either oil or gas by pipe lines, common carriers and common purchasers;²⁵ the provisions laying a duty on such carriers or purchasers to carry or buy all oil which they can and to take ratably of all oil or gas offered them; the provision that a carrier cannot discriminate in favor of one producer, (even if it is itself a producer) provided the oil or gas is of the same grade; the provision that acceptance of the terms of the acts is a condition precedent to the granting of the privilege to do business; and the provisions for penalties for violation of the acts. With these sections there should be little difficulty, because the acts do not attempt to force anyone who is carrying only his own production to become a common carrier. That, of course, would be an unconstitutional interference with private property. Similar regulations by Congress were held valid in the *Pipe-line Cases*.²⁶

The legal crux, so to speak, of the whole scheme of regulation of oil and gas, is found in these provisions of the gas act which do not appear in the oil act. These sections are obviously an attempt to keep Michigan's production of natural gas within the limits of the state. They are first, the provision that those corporations or persons whose lines are not wholly within the state shall have not the power of eminent domain nor the right to use the highways of the state;²⁷ and second, that the Public Utilities Commission shall have the power to make rules to preserve and protect the safety of the public.²⁸ The objection to the former is that it is a discrimination between interstate and intra-state lines, and therefore a burden on interstate commerce in violation of the federal Constitution. An act of Oklahoma²⁹

²⁵A person or corporation can, of course, be a common carrier and not a common purchaser.

²⁶*United States v. Ohio Oil Co.*, 234 U. S. 548, 34 Sup. Ct. 956, 58 L. ed. 1459. See also *Assoc. Pipe Line Co. v. R. R. Com. of Cal.*, 176 Cal. 518, 169 Pac. 62.

²⁷Mich. P. A. 1929, No. 9, Sec. 2, p. 22.

²⁸Mich. P. A. 1929, No. 9, Sec. 14, p. 25.

²⁹Acts Okla. 1907, c. 67, p. 586.

which prohibited construction of pipe-lines within the state (except for private use) for the transportation of natural gas, except by corporations organized in Oklahoma under charters, providing that the gas was not to be taken beyond the state line, nor sold or delivered to anyone else to be taken out of the state, was held void as an attempt to interfere with interstate commerce.³⁰ It is true that the case was not an open and shut proposition, Lurton, Holmes and Hughes dissenting on the ground that natural gas was peculiarly a state's own and could be dealt with as the state saw fit. The dissenting judges relied largely on *Hudson County Water Co. v. McCarter*,³¹ wherein the court held that a state has the power to restrict the use of its water to its own citizens. That case can quite easily be distinguished from the gas cases on the ground that water cannot be made the subject of absolute ownership in the sense that gas can be owned.³²

It is to be noted that the statute held invalid in *West v. Kansas Natural Gas Co.*³³ was almost a barefaced embargo on the exportation of natural gas. The Michigan act does not expressly prohibit the carrying of its gas beyond its borders, but the provisions are calculated to accomplish the same result. Sooner or later a pipe-line would have to cross under a state highway, and by the terms of the act an interstate pipe-line is not given the right to use the highways of the state. In view of the familiar legal maxim that what one cannot do directly, one cannot do indirectly, we would expect this sort of provision to be invalid, and we find it so held. The supreme court has held that a state cannot deny the right to use

³⁰*West v. Kansas Natural Gas Co.*, 221 U. S. 229, 31 Sup. Ct. 564, 55 L. ed. 716, 35 L. R. A. (N. S.) 1193. See *state ex rel. Corwin v. Indiana and Ohio Oil, Gas and Mining Co.*, 120 Ind. 575, 6 L. R. A. 579, 2 Int. Com. Rep. 758, 22 N.E. 778; *Pa. v. W. Va.*, & *Ohio v. W. Va.*, 262 U. S. 553, 43 Sup. Ct. 658, 67 L. ed. 1117, 32 A. L. R. 300, on rehearing affirmed, 263 U. S. 350, 44 Sup. Ct. 123, 67 L. ed. 1144. See also *Ohio Colliers v. Stuart*, 290 Fed. 1005 (Emergency Act operative for a short time, restricting export of coal mined in the state, held invalid).

³¹209 U. S. 349, 28 Sup. Ct. 529, 52 L. ed. 828, 14 Ann. Cas. 560.

³²See Note 32 A. L. R. 331, cases collected supporting the proposition that a state has no power to restrict or prohibit the exportation of natural products in which a private individual or corporation may gain an absolute property to the exclusion of any special property had by the state for the benefit of its people.

³³Supra note 30.

its highways and the power of eminent domain to interstate companies while granting those rights to intra-state companies.³⁴ It has been argued that a state may do this and it was so held in *Consumers Gas Trust Co. v. Harless*.³⁵ The opinion in this case proceeds upon the theory that although a state cannot impose a burden on interstate commerce, it is under no obligation to aid it by granting the extraordinary power of eminent domain. The argument is, to say the least, ingenious and entitled to some notice in a consideration of this point. Standing against it is the decision of the United States supreme court above noted and where a federal question is involved that decision must, of course, prevail. It must also be noted that the argument of the Indiana court that what a state may withhold entirely it may grant on any terms it may choose, has lost favor. The "geometric theory" is not now considered sound. When a state withholds the use of its highways and the power of eminent domain solely because of the interstate character of the business done, it must be clear on final analysis that it does impose burdens on interstate commerce, something which is beyond its power.³⁶

The second method by which Michigan would prevent exportation of its natural gas is the exercise of the power given to the Public Utilities Commission to make rules limiting the pressure which may be used in a gas pipe-line.³⁷ It is immediately apparent that a pressure limit might be set by the commission which would make it impossible practically for an interstate pipe-line to operate because of the larger distances it would ordinarily have to cover. Yet this limit might not interfere with operation by intra-state companies with shorter lines. Of course it is entirely possible that an inter-state line might be shorter than some of the intra-state lines and thus be unaffected by the pressure limit adopted. Furthermore, the act says nothing which would prevent an inter-state company from taking the gas from another carrier at a point close to the state line where it would be practicable for it to operate at the low pressure. That there cannot be one pressure limit for intra-state lines and another

³⁴*West v. Kansas Natural Gas Co.*, supra note 30; *Haskell v. Cowham*, 187 Fed. 403.

³⁵131 Ind. 446, 29 N.E. 1062, 15 L. R. A. 505.

³⁶See Note 35 L. R. A. (N. S.) 1193 at p. 1195.

³⁷That a state may do this, *Mfgs. Gas & Oil Co. v. Indiana Natural Gas and Oil Co.*, 155 Ind. 545, 58 N.E. 706.

for inter-state lines was decided in *Jamieson v. Indiana Natural Gas & Oil Co.*³⁸ The New Jersey court has held that a provision in a statute which regulated the pressure to be used in such a way that it virtually prohibited the exportation of natural gas was void as passing beyond the lawful domain of police regulation and imposing a burden on interstate commerce.³⁹ From the tone of these decisions it may properly be inferred that should the Public Utilities Commission set unreasonable rules in an effort to keep Michigan's gas for Michigan's use, its efforts would be legally ineffective, although they would probably be a deterrent in some cases. This of course would affect only the particular ruling of the commission, leaving the statute untouched.

There is a further provision in the gas act which does not appear in the oil act. It gives the Utilities Commission the power to raise or lower the percentage of the natural flow of gas which any producer or carrier may take from a field. The act sets the limit at 25%.⁴⁰ It is not entirely clear just what this section is aimed at. It seems probable that it is designed incidentally to prevent a development of monopoly and primarily to prevent waste and too sudden exhaustion of the gas deposits. This provision will if valid, tend to obviate the evils caused by allowing natural gas to flow too rapidly (i.e. the creation of a back-pressure on oils in the immediate vicinity). Whether this section is valid is problematical. It is clear enough that a state may constitutionally prevent the waste of its natural resources.⁴¹ It has been held that a statute forbidding the use of pumps to increase the flow of gas⁴² is valid.⁴³ Michigan purports to go much farther than this however. An act limiting the use which may be made of natural gas to one which utilizes the heat produced in burning was declared void,⁴⁴ but a statute identical except that the act did not apply unless the gas wells were within ten miles of a manufactory or town,⁴⁵ was declared to be a valid exer-

³⁸128 Ind. 555, 28 N.E. 76.

³⁹*Benedict v. Columbus Construction Co.*, 49 N. J. Eq. 23, 23 Atl. 485.

⁴⁰Mich. P. A. 1929, No. 9, Sec. 7.

⁴¹*Supra* note 12.

⁴²Indiana Acts 1891, p. 89.

⁴³*Mfgs. Gas & Oil Co. v. Indiana Natural Gas & Oil Co.*, *supra*, note 37.

⁴⁴*Gas Products Co. v. Rankin*, 63 Mont. 372, 207 Pac. 993, 24 A. L. R. 294.

⁴⁵Wyoming Laws 1919, c. 125.

cise of a state's power to conserve its natural resources.⁴⁶ The difference in the acts seems only a matter of degree, and inasmuch as the latter decision was handed down by the United States Supreme Court, the presumption appears to be in favor of the state's power. Both statutes were designed to prevent the making of carbon black from natural gas without utilizing the heat generated when the gas was burned. The decision in the latter case is an indication that Michigan's whole conservation program, including the limitation of the flow of gas wells which may be taken by a producer, will stand when questioned.⁴⁷

The various provisions of the acts are declared to be separable and independent of one another. This is largely true from the nature of most of the provisions. Should the provision in the gas-pipe line act which denies the use of state highways and the power of eminent domain to those operating interstate pipe-lines be held unconstitutional, as seems inevitable, it will be interesting to note whether the result will be that such persons or companies will have that power or whether the power will be automatically taken away from those who operate intra-state lines. Since the denial of the power of eminent domain to inter-state lines companies is in form a proviso, the probability is that when it is held void the effect will be to give this power to inter-state companies.

⁴⁶Walls v. Midland Carbon Co., 254 U. S. 300, 41 Sup. Ct. 118, 65 L. ed. 276.

⁴⁷See Quinton Relief Oil & Gas Co. v. Corp. Com., supra note 12.