

# Limitations on the Effect of the Express Offset Clause and a Suggested Duty to Unitize

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light of United States Supreme Court determinations that *control* over the the property subjects one to tax liabilities arising from this property. The only suggestion by the Supreme Court of relief for the good faith spouse was an appeal to the legislature. Under a recent amendment to the Internal Revenue Code,<sup>49</sup> the good faith spouse may not be liable for taxes due as a result of filing a joint return.<sup>50</sup> For the good faith spouse to obtain relief under this law, a joint return must have been filed and other requirements met. This relief would not be available if no returns were filed, as was the case in *Mitchell*, or if the husband filed a separate return reporting only one-half of the total income. Since the Court's position regarding the wife's liability was quite firmly put forth, it is suggested that the above legislation be expanded to protect the good faith spouse in future *Mitchell*-type situations which may arise.<sup>51</sup>

*Warner H. Anthony, Jr.*

LIMITATIONS ON THE EFFECT OF THE EXPRESS OFFSET CLAUSE  
AND A SUGGESTED DUTY TO UNITIZE

Plaintiff landowners executed a mineral lease with defendant lessee, which also owned the lease on the adjoining tract. The lease contained a provision obligating the lessee to drill offset wells when producing wells were located on adjoining tracts within 150 feet of the leased premises, should the drilling of such wells prove to be economically feasible. Upon plaintiff's allegation of drainage of the leased premises through the defendant's operations on adjoining premises, defendant contended that it had not been put in default and that, in any event, its obligation to protect against drainage was limited by the express offset clause. The federal district court,<sup>1</sup> sitting as an *Erie* court,<sup>2</sup> and basing its decision on what it perceived to be the applicable

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49. 84 Stat. 2063 (1971), amending INT. REV. CODE of 1954, §§ 6013(e), 6653(b).

50. See Emory, *New Law Alleviates Innocent Spouse—Joint Return Problem on Omitted Income*, 34 J. TAXATION 154 (1971).

51. It has been suggested that a concept of mismanagement of community property similar to theft, INT. REV. CODE of 1954, § 165, be applied to absolve the innocent wife of liability, Note, 49 TEX. L. REV. 562, 567 (1971).

1. Federal jurisdiction was based on diversity of citizenship, according to 28 U.S.C. § 1332 (1970).

2. *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938). The "*Erie* Doctrine" basically requires that federal courts apply the law of the forum state in cases not involving a federal question.

Louisiana law, denied defendant's motion for summary judgment concerning the cause of action for damages.<sup>3</sup> On appeal, the Fifth Circuit Court of Appeals affirmed and *held*, the acts of the lessee were an active breach of the lease so that no putting in default was necessary. *Williams v. Humble Oil & Refining Co.*, 432 F.2d 165 (5th Cir. 1970), *rehearing denied*, 435 F.2d 772 (5th Cir. 1970). The impact of this portion of the case having been dealt with in an earlier edition of this publication,<sup>4</sup> this Note will emphasize two other important facets of the court's opinion: the holding that the express offset clause did not limit the lessee's implied obligation to protect against drainage<sup>5</sup> and the suggestion in dicta that a duty exists on the part of the lessee to unitize the leased premises with adjoining producing areas when drilling offset wells is not economically feasible.<sup>6</sup>

### *The Express Offset Clause*

Any discussion of the effect of an express clause in a mineral lease, purporting to limit an implied obligation of the lease, must necessarily begin with a brief analysis of the nature of these implied obligations. The standard imposed upon the lessee in a majority of states requires that he act as a prudent operator in his administration of the lease.<sup>7</sup> In evaluating cases of an alleged breach of this duty, courts tend to examine each situation and credit not what the operator in question determines was reasonable under the given circumstances, but rather what course of action the prudent operator, using reasonable care and giving due regard to the interests of both lessor and lessee, would have chosen under existing conditions.<sup>8</sup> Manifestations of this standard of care have resulted in the creation of a number of implied covenants or obligations arising out of the basic obligation to act as a prudent operator, including the duty to drill an exploratory well, to protect the leasehold from drainage, to reasonably develop the premises, to conduct further exploration, to market the product, and to conduct with

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3. 290 F. Supp. 408 (E.D. La. 1968).

4. Note, 31 LA. L. REV. 527 (1971). For an analysis of subject matter relevant to the instant decision, see *The Work of the Louisiana Appellate Courts for the 1963-1964 Term—Mineral Rights*, 25 LA. L. REV. 360 (1965); Hardy, *Drainage of Oil and Gas From Adjoining Tracts—A Further Development*, 6 NAT. RES. J. 45 (1966); Note, 18 LA. L. REV. 354 (1958).

5. *Williams v. Humble Oil & Ref. Co.*, 432 F.2d 165, 173 (5th Cir. 1970).

6. *Id.* at 174.

7. 5 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 806.3 (1964).

8. *Id.* at 41.

reasonable care and due diligence all operations on the leasehold that affect the lessor's royalty interest.<sup>9</sup>

The Louisiana courts have long recognized that the lessee must act as a prudent administrator in his dealings with the lessor, which entails his acting in the interest of both himself and his lessor.<sup>10</sup> As part of this duty, he must take steps to prevent drainage of oil and gas from the leased premises by wells on adjoining tracts where the reasonably prudent operator would find it economically feasible to do so. Measures such as drilling offset wells or causing offset completions of existing wells in order to counteract such drainage are common in the industry.<sup>11</sup>

The question of the effect to be given an express stipulation in the lease contract purporting to limit the obligation of the lessee to protect the leased premises from drainage due to operations on adjoining tracts is one which has not yet been resolved by the Louisiana courts. A typical clause of this type<sup>12</sup> states that the lessee is obligated to drill offset wells when operations are conducted on adjoining premises within a certain distance

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9. *Id.* at 26-27.

10. "Whatever ordinary knowledge and care would dictate, as to the proper thing to be done for the interest of the lessor and lessee, under any given circumstances, is that which the law requires to be done, as an implied stipulation of the lease." *Caddo Oil & Mining Co. v. Producer's Oil Co.*, 134 La. 701, 717, 64 So. 684, 690 (1914). See also *Sohio Petroleum Co. v. Miller*, 237 La. 1015, 1026, 112 So.2d 695, 699 (1959); *Eota Realty Co. v. Carter Oil Co.*, 225 La. 790, 802, 74 So.2d 30, 35 (1954); *Carter v. Arkansas-Louisiana Gas Co.*, 213 La. 1028, 1034-35, 36 So.2d 28 (1948); *Gennuso v. Magnolia Petroleum Co.*, 203 La. 559, 563, 14 So.2d 445, 446 (1943); *Stubbs v. Imperial Oil & Gas Products Co.*, 164 La. 689, 695, 114 So. 595, 597 (1927); *Prince v. Standard Oil Co. of Louisiana*, 147 La. 283, 287-88, 84 So. 657, 659 (1920); *Nunley v. Shell Oil Co.*, 76 So.2d 111, 114 (La. App. 2d Cir. 1954).

11. *Billeaud Planters, Inc. v. Union Oil Co.*, 245 F.2d 14 (5th Cir. 1957); *Swope v. Holmes*, 169 La. 17, 124 So. 131 (1929); *Breaux v. Pan American Petroleum Corp.*, 163 So.2d 406 (La. App. 3d Cir. 1964).

12. Typical of such agreements are Bath's Form 42 CPM-New South La. Revised Six (6)—Pooling, clause 5, which reads as follows: "If, prior to or after the discovery of oil or gas on the lands held hereunder, a well producing oil or gas in paying quantities for 30 consecutive days should be brought in on adjacent lands not owned by Lessor and not included in a pooled unit containing all or a portion of the lands herein described, Lessee shall drill such offset well to protect the land held hereunder from drainage as and within the time that a reasonable and prudent operator would drill under the same or similar circumstances; it being provided, however, that Lessee shall not be required to drill any such offset well unless the well on adjacent land is within 330 feet of any line of the lands held hereunder, nor shall such offset well be necessary when said lands are being reasonably protected by a well on the leased premises or land pooled therewith (or with any part thereof)."

(i.e., 150 feet or 330 feet, depending on the particular lease form used and the date conformed).<sup>13</sup>

The effect of express clauses on the implied obligations in mineral leases has been noted in several jurisdictions. West Virginia courts have faced the problem of whether a lessee may limit his obligation to protect against drainage by terms of a lease providing that upon payment of delay rentals lessee will be allowed to drill or not to drill, as he sees fit.<sup>14</sup> Lessee, by his operations on adjoining lands, caused substantial drainage to the leasehold in question and relied on the delay rental clause to excuse him from offset drilling. The court held that the clause did not take effect where "fraudulent conduct"<sup>15</sup> (the lessee's operations on adjoining land) caused the drainage.

A federal district court in Illinois<sup>16</sup> considered an express drilling covenant in a community lease.<sup>17</sup> The clause limited the lessee's obligation to the drilling of only two wells.<sup>18</sup> Lessee's operations on adjoining land had caused drainage of the community leasehold. When confronted with the problem of whether the express drilling clause relieved the lessee of his duty to protect against drainage by offset drilling, the court was of the opinion that the purpose of the clause was to avoid the drilling of offset wells for the benefit of the separate property interests of parties to the community lease, and that it was not the intent of the parties to "obviate any implied covenants governing the offsetting of wells drilled on lands adjoining the communitized

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13. The lease clause at issue in the *Williams* case provided: "In the event a well or wells producing oil or gas in paying quantities should be brought in on adjacent land and within one hundred fifty (150) feet of and draining the leased premises, lessee agrees to drill such offset wells as a reasonable prudent operator would drill under the same circumstances." 290 F. Supp. 408, 413 (E.D. La. 1968).

14. *Dillard v. United Fuel Gas Co.*, 114 W. Va. 684, 173 S.E. 573 (1934); *Trimble v. Hope Natural Gas Co.*, 113 W. Va. 839, 169 S.E. 529 (1933).

15. *Dillard v. United Fuel Gas Co.*, 114 W. Va. 684, 688-89, 173 S.E. 573, 575 (1934). Similar reasoning was used to negative the effect of the delay rental clause in *Trimble v. Hope Natural Gas Co.*, 113 W. Va. 839, 169 S.E. 529 (1933).

16. *Geary v. Adams Oil & Gas Co.*, 31 F. Supp. 830 (E.D. Ill. 1940).

17. This is a lease in which several landowners or mineral rights owners combine their mineral interests and collectively negotiate the terms of a lease with a lessee. The general effect of such a lease is to combine several tracts and enable them to be treated as one for mineral development purposes.

18. *Geary v. Adams Oil & Gas Co.*, 31 F. Supp. 830 (E.D. Ill. 1940).

lease."<sup>19</sup> Language in an Illinois state court decision<sup>20</sup> indicates that express offset clauses may possibly be viewed in a similar manner.<sup>21</sup>

The tenor of the above cases—that the lessee may not rely on clauses governing his development obligations to alleviate his obligation to protect against drainage—does not deal with the express offset clause. However, they do demonstrate that express clauses purporting to limit the application of implied covenants in mineral leases will be closely examined, keeping in mind the intention of the parties at the time of the confection of the lease contract.

Three states have dealt specifically with the effect of the express offset provision upon the implied obligation of the lessee to protect against drainage. These three states—California, Mississippi, and Texas—have all considered the problem when the lessee himself caused the drainage. Examination of the California position begins with *Hartman Ranch Co. v. Associated Oil Co.*,<sup>22</sup> where the controversy involved an express drilling clause obligating the lessee to drill no more than ten wells on the leased premises.<sup>23</sup> Lessee's operations on adjoining tracts were draining the leased premises. The lessee contended that, as in the above noted cases, the express lease provision precluded

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19. *Id.* at 832.

20. "The lessee is not the sole or controlling arbiter of the extent to which operations should be carried, and the express or implied covenants of the lease should be construed by the standards of what is reasonable, considering the duty of both lessee and lessor." *Elliott v. Pure Oil Co.*, 10 Ill.2d 146, 152, 139 N.E.2d 295, 299 (1956).

21. Worthy of note at this point are *Endicott v. DeBarbieri*, 189 Kan. 301, 303-04, 369 P.2d 241, 243-44 (1962), and *Hanscome v. Coppinger*, 183 Kan. 623, 626, 331 P.2d 590, 594 (1958). Both cases involved a provision whereby lessee was to drill within 120 days of the effective date of the lease or the lease would become null and void. In the event the first well was completed as a commercial producer, the lessee was bound to commence additional drilling operations within six months after the first well or release all the leased premises except a ten-acre square surrounding the producing well. The lessee alleged, in effect, that a reasonably prudent operator would not drill a well in this instance (minimal production, but still considered a commercial producer). The court held the lessee to the terms of the contract.

It must be noted that here the lessee had by contract placed upon himself a higher duty than the prudent operator standard. Whether or not the courts will enforce the terms of the contract strictly where the lessee has contracted to perform in a fashion less extensive than that of a prudent operator remains to be seen.

22. 10 Cal.2d 232, 73 P.2d 1163 (1937)

23. *Id.* at 238, 73 P.2d at 1166.

the implied covenant to protect against drainage. It was ruled that:

"It certainly should not be held to have been within the contemplation of the parties that one who is in possession of the Hartman leasehold . . . should by its own affirmative operations on adjoining land drain oil from beneath the Hartman property. The express covenant cannot be construed as an authorization for so doing."<sup>24</sup>

A long line of cases<sup>25</sup> were cited which stand for the principle that where there is no clear expression of intent, express clauses defining the duty of the lessee in regard to development do not relieve the lessee from the implied obligation to protect against drainage by drilling additional offset wells.<sup>26</sup> *Hartman*, then, simply appears to follow the line of cases mentioned earlier which construed the express drilling clause as not precluding a duty to protect against drainage.

The opinion in *R. R. Bush v. Beverly-Lincoln Land Co.*,<sup>27</sup> however, expanded the concept set forth in the *Hartman Ranch* case. This case involved an express provision the terms of which the court neglected to mention in its opinion.<sup>28</sup> Here the lessee had caused drainage of the leased premises by his own operations on adjoining tracts. The lessee contended that he was relieved from liability by the content of the express offset clause. The court held that this contention might have some effect if the operations on the adjoining lands had been performed by some third party, but that,

"[i]t certainly should not be held to have been within the

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24. *Id.* at 241-42, 73 P.2d at 1167-68.

25. *Jackson v. Texas Co.*, 75 F.2d 549, 550 (10th Cir. 1935); *Texas Co. v. Ramsower*, 7 S.W.2d 872 (Tex. Civ. App. 1928); *Hughes v. Busseyville Oil & Gas Co.*, 180 Ky. 545, 203 S.W. 515 (1918); *J. M. Guffey Petroleum Co. v. Jeff Chaison Townsite Co.*, 107 S.W. 609 (Tex. Civ. App. 1908); *Stanley v. United Fuel Co.*, 78 W. Va. 793, 90 S.E. 344 (1916); *Carper v. United Fuel & Gas Co.*, 78 W. Va. 443, 89 S.E. 12 (1916).

26. *Hartman Ranch Co. v. Associated Oil Co.*, 10 Cal.2d 232, 241, 73 P.2d 1163, 1167 (1937).

27. 69 Cal. App. 2d 246, 158 P.2d 754 (1945).

28. *Meyers & Williams, Implied Covenants in Oil and Gas Leases: Drainage Caused by the Lessee*, 40 TEX. L. REV. 923, 928 n.24: "[I]t may be inferred that the lease contains two express drilling clauses commonly found in California lease forms. One clause specifies the development obligations of the lessee, stating the number of wells he is required to drill for development purposes. The other clause is the express offset well covenant, requiring the lessee to drill an offset well if a draining well within a specified distance produces oil in paying quantities."

contemplation of the parties that the lessee should by its own affirmative operations on adjoining land drain oil from beneath respondent's property."<sup>29</sup>

These provisions could not be used to justify "that which the parties never contemplated and which injures the respondent."<sup>30</sup> The *Bush* court, then, announced that even where an express offset clause purports to limit his obligation to protect against drainage, the lessee could not rely on such a clause where lessee himself was causing the drainage.

Mississippi has in effect followed the reasoning behind the *Bush* decision. In *Millette v. Phillips Petroleum Co.*,<sup>31</sup> the court faced a situation wherein the lessee contended that the express offset clause limited his obligation to protect against drainage from operations on adjoining tracts to situations where the draining wells were within 150 feet of the leased premises.<sup>32</sup> The lessee was causing the drainage through his operations on adjoining premises. The express offset provision was thought to preclude "resort to an implied covenant in respect of a development by the drilling of an offset well on the lands of appellant."<sup>33</sup> However, the court further stated that the lessee was under an obligation not to do anything to destroy the land of the lessor; the lessee was violating this obligation by causing substantial drainage. "This responsibility," the court reasoned, "is separable from a duty to drill offset wells, and an express covenant which absolves the lessee from this method of development does not relieve the lessee of liability for substantial drainage by him."<sup>34</sup> Upon final disposition of the case, the Mississippi Supreme Court announced: "We are impressed with and adopt the reasoning in the *Bush* case notwithstanding the fact that some other jurisdictions have adopted a contrary view."<sup>35</sup>

The Texas Supreme Court has adopted a position similar

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29. *R. R. Bush Oil Co. v. Beverly-Lincoln Land Co.*, 69 Cal. App. 2d 246, 253, 158 P.2d 754, 758 (1945).

30. *Id.*

31. 209 Miss. 687, 48 So.2d 344 (1950).

32. *Id.* at 700, 48 So.2d at 347.

33. *Id.* at 701, 48 So.2d at 346.

34. *Id.* at 704, 48 So.2d at 347.

35. *Phillips Petroleum Co. v. Millette*, 221 Miss. 1, 22, 72 So.2d 176, 182 (1954). The contrary view referred to was that expressed in *Hutchins v. Humble Oil & Ref. Co.*, 161 S.W.2d 571 (Tex. Civ. App. 1942). *Shell Oil Co. v. Stansbury*, 410 S.W.2d 187 (Tex. 1966), expressly disapproved of any language in *Hutchins* which was in contradiction with that decision. This, in effect, overruled *Hutchins* in the context with which this casenote deals.

to that of California and Mississippi in *Shell Oil Co. v. Stansbury*.<sup>36</sup> In this case the wells in question were located beyond the offset distance contained in the lease.<sup>37</sup> The court found that the express provisions in the lease which obligated the lessee to drill an offset well only where the draining well was within a specified distance from the leased premises did not limit lessee's obligation to protect against drainage where the lessee himself was causing the drainage.<sup>38</sup>

It has thus been long recognized that express clauses purportedly limiting development obligations do not limit the lessee's implied obligation to protect against drainage. It has been further held in three states that a clause specifically designed to limit the lessee's obligation to protect against drainage to specified situations will not be of any effect where the lessee himself is causing the drainage.

In the instant case, the court, upon entering the examination of the problems relating to the express offset clause, declared that there was no Louisiana jurisprudence concerning an express provision in lease forms seeking to excuse the lessee from offset drilling except in certain specified situations. Decisions of other jurisdictions<sup>39</sup> wherein the same problems had been faced were found to indicate "an increasing reluctance to allow displacement of the implied protection covenant by express offset provisions, especially where the lessee is also the operator . . . causing the drainage."<sup>40</sup> The court further relied on the Civil Code,<sup>41</sup> which requires that the lessee enjoy the thing leased as a good administrator.<sup>42</sup> This "is the basic obligation of the lessee and all of the implied obligations already drawn are merely elaborations of it."<sup>43</sup> It was concluded that an obligation as basic as that of the lessee to protect the premises from impairment of value by his affirmative act cannot be assumed to have been waived by the lessor when the lease merely contains an express provision requiring offset wells under certain circumstances.<sup>44</sup> Three factors led to this conclusion:

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36. 410 S.W.2d 187 (Tex. 1966).

37. *Id.* at 188.

38. *Id.*

39. See notes 27-38 *supra* and accompanying text.

40. *Williams v. Humble Oil & Ref. Co.*, 432 F.2d 165, 175 (5th Cir. 1970).

41. LA. CIV. CODE art. 2710. See also note 73 *infra*.

42. *Williams v. Humble Oil & Ref. Co.*, 432 F.2d 165, 176 (5th Cir. 1970).

43. *Id.*

44. *Id.* at 177.

1. Lease provisions limiting implied obligations are to be construed strictly. The express obligation to drill offset wells under specified conditions does not relieve the lessee of his duty to act as a prudent administrator in other circumstances.
2. There is an element of unfairness in leases where the offset distance is set at a figure equal to or shorter than that permitted by the Commissioner of Conservation's general spacing orders.
3. The lease agreement was made in 1933. At that time, an offset distance of 150 feet may have been scientifically acceptable; however, such a distance is no longer reasonable.<sup>45</sup>

If the Louisiana courts adopt the position limiting the effectiveness of the express offset clause, the impact upon mineral lease transactions will be significant. Construing express offset provisions strictly will mean that the present standard clause will not be allowed to limit the lessee's liability to the drilling of offset wells within the stated distances. Leases containing the maximum distances under which the lessee is obligated to protect against drainage may now be construed by considering what modern geologic knowledge considers a reasonable distance. Statewide spacing limitations may be examined in determining a reasonable offset distance. A prudent administrator, then, should weigh all available scientific and geological data to determine whether his operations on adjoining premises are actually causing drainage to the leased premises and then determine whether he should drill an offset well or seek unitization.

The lessee, especially in situations where he is causing drainage through his affirmative act, is in a position of superior access to technical information. He is well aware of the progress of his operations and should be aware of possible drainage. Where the drainage is caused by a third party, the lessee's technical advantage is not as great, but he usually will have a trained staff of experts available to study the possibility of such drainage. Thus, it is most unlikely that a lessee will be unaware that the leasehold is being drained.

In summary, it seems that express offset clauses should not

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45. *Id.* at 177-78.

be allowed to achieve the effect of limiting the implied obligation to protect against drainage. The clause itself is sometimes misleading: It often seems to the lessor that the lessee is actually assuming an additional obligation rather than attempting to limit an existing one. Presumably such an attempt was made by the lessee in the instant case.<sup>46</sup> Unknown to the average lessor, however, the implied obligation to protect against drainage contains no distance limitation. What appears as an added inducement would then result in a limitation of an already-existing obligation. Where the express offset clause is not clear in its attempt to dilute the implied obligation to protect against drainage, it should not be given that effect.

On the other hand, where the clause clearly shows that the lessee definitely does not intend to protect against drainage other than under specified conditions<sup>47</sup> and the lessor knowingly accepts such terms, the question becomes more difficult. It seems, however, that the lessor, when agreeing to such terms, could not possibly construe it to mean that the lessee will be excused from having to protect the leased premises from the latter's affirmative acts on adjoining premises. Louisiana Civil Code article 1901 requires that agreements legally entered into must be performed with good faith.<sup>48</sup> Where the terms of the clause are clear in light of the already-existing obligation to protect against drainage, then, it should be given the effect of limiting that obligation. However, a party who contracts an agreement and later ignores the spirit of that agreement may not be viewed as acting in good faith, and should not be allowed to damage his lessor under the protection of the lease terms.

No consideration of express offset clauses can be complete without reviewing the applicable well spacing regulations. The Commissioner of Conservation in Louisiana is authorized to regulate the spacing of wells through administrative orders.<sup>49</sup> Lessees are bound to abide by these regulations. Gas wells may not be drilled within 330 feet of any property line, nor closer than 2000 feet to any other well completed in or drilled to the same pool.<sup>50</sup> Oil wells drilled to pools initially penetrated

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46. See note 13 *supra*.

47. As in Bath's Form 42. See note 12 *supra*.

48. LA. CIV. CODE art. 1901.

49. LA. R.S. 30:4C(13) (1950).

50. La. Dep't of Conservation Order No. 29-E(3) (1957).

prior to May 24, 1960,<sup>51</sup> may not be located any closer than 330 feet from any property line, nor closer than 900 feet from any well drilled to the same pool.<sup>52</sup> Oil wells drilled into pools subsequently penetrated<sup>53</sup> must be located no less than 600 feet from the property line of a separately owned tract wherein a well drilled to such a pool lies no less than 1320 feet from any other well drilled to that pool.<sup>54</sup> These requirements may be dispensed with by order of the Commissioner under certain circumstances.<sup>55</sup>

Express clauses which purport to limit the duty to drill offset wells to circumstances where a well could not be drilled without violating the Commissioner's orders should be considered contrary to public policy. The lessor certainly cannot enforce such a clause, since the lessee need only assert as a defense that he is bound by the Commissioner's orders. This is not to imply that parties may not validly agree to dispense with the protection covenant altogether where such is the clear and knowledgeable intent of all parties concerned. In any event, where the lessee attempts to achieve that purpose by seeking protection under a clause which apparently grants the lessor a valuable right, but in light of existing well regulations actually denies him any recourse under most circumstances, the clause clearly cannot be given any effect.

#### *Suggestion of a Duty to Unitize*

Unitization is the consolidation of diverse property interests in a geographic area in order to conduct drilling operations. The purposes of unitization are to prevent physical and economic waste caused by drilling unnecessary wells, to protect the rights of the landowners over a reservoir,<sup>56</sup> to protect interests of lessors and lessees, to conserve reservoir energy, and to curtail unnecessary drilling expenses.

The Conservation Act of 1940<sup>57</sup> was designed to eliminate waste<sup>58</sup> caused by unrestricted drilling. Unrestricted drilling

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51. *Id.* No. 29-H(4)(b) (1960) defines such pools as "old" pools.

52. *Id.* No. 29-E(2) (1957).

53. *Id.* No. 29-H(4)(a) (1960) defines such pools as "new" pools.

54. *Id.* No. 29-H(7)(a) (1960).

55. *Id.* No. 29-E (1957); *id.* no. 29-H(8), (9), (10) (1960).

56. 6 H. WILLIAMS & C. MEYERS, OIL & GAS LAW § 901 (1968).

57. LA. R.S. 30:1 (1950).

58. *Id.* § 2.

results in premature depletion of the reservoir's natural drive, increase in the cost of production, decrease in the amount of petroleum recoverable per reservoir, and a local oversupply of petroleum producing a decrease in local demand for crude petroleum and a supply greater than storage facilities can handle. Unitization is one of the most important processes provided by the act to prevent these forms of waste. Costs are minimized through efficient well placement and management; the total amount recoverable is increased due to conservation of reservoir energy, which stabilizes production costs to a certain extent; and the supply is controlled so as not to cause a glutted market. The interests of mineral lessors and royalty owners are furthered by each being assigned a proportional share of the production allocable to their respective interests under the unitization order. Under the Conservation Act, unitization may be accomplished by the creation of single-well units,<sup>59</sup> pool-wide units,<sup>60</sup> and units encompassing a combination of two pools in the same field.<sup>61</sup> The parties to a mineral lease may consent to unitization agreements as they see fit, from the creation of single-well units<sup>62</sup> to the creation of units including any number of pools.<sup>63</sup> The usual practice in mineral leases is to include a clause in the contract enabling the lessee to unitize<sup>64</sup> under limited circumstances.

Jurisdictions other than Louisiana have not often faced the problem of the existence of a lessee's duty to unitize his leased premises to protect from drainage.<sup>65</sup> Further, it has never been the specific holding of a Louisiana court that the mineral lessee is under an obligation to unitize the leased premises with adjoining tracts to protect the former from drainage where drilling

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59. *Id.* § 9B.

60. *Id.* § 5C (1960).

61. *Id.*

62. *E.g.*, *Humble Oil & Ref. Co. v. Jones*, 157 So.2d 110 (La. App. 3d Cir. 1963), *aff'g original decision* in 125 So.2d 640 (La. App. 3d Cir. 1960), *writs refused*, 245 La. 568, 159 So.2d 284 (1964).

63. *E.g.*, *Texaco Co., Inc. v. Vermilion Parish School Bd.*, 145 So.2d 383 (La. App. 3d Cir. 1962), *modified on other grounds*, 244 La. 408, 152 So.2d 541, *writs refused*, 245 La. 568, 159 So.2d 184 (1963).

64. A typical pooling agreement is found in Bath's 42 CPM-New South La. Revised Six(6)—Pooling, clause 2 (a standard South Louisiana Form) and Bath's Form La. Spec. 14 BRI-2 A, Clause 6 (a standard North Louisiana form).

65. 6 H. WILLIAMS & C. MEYERS, *OIL AND GAS LAW* § 935 (1968); Hardy, *Drainage of Oil and Gas from Adjoining Tracts—A Further Development*, 6 NAT. RES. J. 49 (1966). Dictum in *In re Shaller's Estate*, 266 P.2d 613, 616-17 (Okla. 1954), hinted at its existence.

of offset wells could be proved to be economically unfeasible. While there is no widespread recognition of a duty to unitize, the existence of such a duty has been rather strenuously indicated in Louisiana. In *Breaux v. Pan American Petroleum Corp.*,<sup>66</sup> the court suggested that a lessor might be entitled to recover damages by alleging and proving that the lessee could have created a pooling unit but failed to do so.<sup>67</sup> This case suggests an affirmative duty to unitize where a reasonably prudent operator might.<sup>68</sup> The duty to pool or to unitize is a reasonable manifestation of the prudent administrator standard, in accord with recent conservation goals and processes. The recognition of this duty would greatly benefit mineral lessors, while mineral lessees still would not be required to do anything which a reasonable prudent operator would not do under the circumstances.

It has been asserted that a duty to unitize "is a logical extension of the covenant to protect."<sup>69</sup> The advent of compulsory unitization and conservation practices has given the lessee another means which he, as a reasonable, prudent administrator, may utilize to protect his lessor.<sup>70</sup> The prudent administrator standard requires that the lessee act in the best interests of both lessor and lessee,<sup>71</sup> so that the lessee is not required to act against his own self-interest where the drilling of offset wells would not be profitable. It would thus seem conceivable that unitization would aid those lessors who are suffering significant drainage but cannot receive protection because of the economic feasibility requirements. This is not to say, however, that a duty to pool or unitize would be required where the amount of drainage was insignificant, since the reasonable prudent administrator would not find it economically feasible to unitize in such a situation.<sup>72</sup>

In the instant case, the district court defined the duty of a mineral lessee to be that of a prudent administrator of the leased premises,<sup>73</sup> which includes the implied obligations to

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66. 163 So.2d 406 (La. App. 3d Cir. 1964).

67. *Id.* at 415.

68. See note 4 *supra*.

69. Hardy, *Drainage of Oil and Gas from Adjoining Tracts—A Further Development*, 6 NAT. RES. J. 49, 51 (1966).

70. *Id.*

71. See note 10 *supra*.

72. See note 55 *supra*.

73. *Williams v. Humble Oil & Ref. Co.*, 432 F.2d 165, 176 (5th Cir. 1970). Cf. LA. CIV. CODE art. 2710. This article requires the lessee "to enjoy the thing leased as a good administrator." Louisiana courts have not con-

drill offset wells, to effect offset completions, or to seek unitization of the leased premises with the draining tract. In short, the lessee must do anything that a reasonable prudent administrator would do under the circumstances to protect the leased premises from drainage.<sup>74</sup> After consideration of the prior Louisiana jurisprudence, particularly *Breaux*,<sup>75</sup> the court of appeal decided that the opinion of the district court—that the lessee must take whatever steps may be reasonably necessary to fulfill its implied obligation to prevent drainage—correctly stated the Louisiana law on the subject.<sup>76</sup> A cause of action for damages could be based upon the lessee's failure to drill offset wells or to effect offset completions on the leased premises, failure to seek unitization, or, should it prove unprofitable to drill offset wells or to unitize, failure to disclose to the lessor the fact that drainage was occurring.<sup>77</sup> Such notice to the lessor is required in order that he might be afforded the opportunity to apply to the Commissioner of Conservation for a hearing to seek establishment of a drilling unit.<sup>78</sup>

Policy was a major factor supporting the proposition that the lessee's duty to protect against drainage should not be limited to drilling offset wells.<sup>79</sup> Reasoning that conservation laws, and more specifically the provisions for unitization, have afforded the lessee a new method with which to prevent drainage, the court felt that unitization would be especially valuable where the drilling of offset wells would be unprofitable or impossible

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sistently applied the Civil Code in mineral rights litigation. That the redactors had not contemplated the complexities of questions concerning oil and gas is nowhere more evident than in the leading case of *Frost-Johnson Lumber Co. v. Salling's Heirs*, 150 La. 756, 91 So. 207 (1920). Here the court struggled with different provisions of the Civil Code in trying to determine the question of ownership of minerals, and whether they were owned in place or were objects of a mineral servitude. Each opinion found a substantial theoretical basis in the Civil Code. Thus, the Civil Code failed to give a definitive answer even as to the nature of mineral ownership. Subsequent decisions further illustrate the status of the Civil Code and the mineral servitude, with the courts generally giving force only to Civil Code articles in mineral rights litigation when their application afforded a practical solution. Amidst the confusion, however, there have been some statements to the effect that LA. CIV. CODE art. 2710 does not apply to mineral leases. See, e.g., *Melancon v. Texas Co.*, 230 La. 593, 613, 89 So.2d 135, 142 (1956); *Tyson v. Surf Oil Co.*, 195 La. 248, 266, 196 So. 336, 342 (1940).

74. *Williams v. Humble Oil & Ref. Co.*, 432 F.2d 165, 171 (5th Cir.), quoting from 290 F. Supp. 408, 411-12 (E.D. La. 1968).

75. 163 So.2d 406 (La. App. 3d Cir. 1964).

76. *Williams v. Humble Oil & Ref. Co.*, 432 F.2d 165, 172 (5th Cir. 1970).

77. *Id.* at 173.

78. This could be achieved under LA. R.S. 30:5c (1950).

79. *Williams v. Humble Oil & Ref. Co.*, 432 F.2d 165, 173-74 (5th Cir. 1970).

due to spacing regulations.<sup>80</sup> This requirement would not be an unfair burden upon the lessee in cases of minimal or questionable drainage, as he might show that a prudent administrator would not seek unitization. The court pointed out that in *Breaux*<sup>81</sup> the opinion specifically stated that the action in damages was not limited to cases where the plaintiff's lessee was causing the drainage.<sup>82</sup> Where the lessee himself is causing the drainage, the court reasoned, the argument for unitization where offset drilling is not feasible is even stronger.

Recognition by Louisiana courts of a duty to unitize would be of major significance. If the duty to pool or to unitize is adopted, the lessor will be further protected against negligent or inadequate administration by his mineral lessee. The lessee will be protected in situations where it may prove not to be economically feasible to drill offset wells, although drainage in significant amounts is in fact occurring. Furthermore, the lessor, in his action for damages, will not face as strenuous a burden of proof as was required in *Breaux*, which listed the three elements that the lessor must prove to be entitled to damages. The first is that oil and gas could have been produced from the same reservoir by offset wells located on the drained premises. It must also be alleged and proved that it would have been economically feasible to drill the offset wells. Finally, the quantity of oil and gas which would have been produced from an offset well had it been drilled at the proper time must be proved with a degree of certainty.<sup>83</sup> If the lessee is under an obligation to unitize, the lessor would no longer have to carry the substantial burden of proving the economic feasibility of drilling. Substituting unitization into the above formula, the lessor would then be required to prove substantial drainage which could have been alleviated by unitization, the economic feasibility of unitization and the amount of oil and gas attributable to the leased premises had a unit been formed at the proper time.

The recognition of an affirmative duty on the part of the lessee to unitize in situations where significant drainage is occurring, but where the cost of offset drilling would be prohibitive,

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80. Spacing regulations may be established by the Commissioner of Conservation as authorized by LA. R.S. 30:4(13) (1950). See note 49 *supra* and accompanying text.

81. 163 So.2d 406 (La. App. 3d Cir. 1964).

82. *Williams v. Humble Oil & Ref. Co.*, 432 F.2d 165, 173 (5th Cir. 1970).

83. *Breaux v. Pan Am. Petroleum Corp.*, 163 So.2d 406, 416 (La. App. 3d Cir. 1964).

is in keeping with the spirit of the implied covenant. The lessee should not be allowed to ignore drainage and thereby either harm his lessor or allow him to continue being harmed merely because the lessee is not obligated to drill an offset well. Pooling or unitization can adequately protect the lessor and is a method which should be utilized.

In situations where the drainage is caused by someone other than the lessee, the lessor should be required to prove the economic feasibility of unitization. Lessees seeking to establish a unit may be required to provide the share of capital outlay used to drill the draining well proportional to the share of the leased premises in production.<sup>84</sup> Where such a capital outlay would prove to be economically unfeasible, just as in a situation where the lessee could never hope to regain his investment in an offset well, the lessee should not be obligated to unitize.

If the lessee himself is the operator of the well and has caused the drainage, no such showing should be required. The lessee, in completing the draining well, has already committed his investment. No additional outlay need be made to protect the leased premises via unitization. The economic feasibility of unitization, then, need not be shown where the lessee himself is causing the drainage.

### Conclusions

Although the decision in the instant case was rendered by a federal court and can have no binding effect on Louisiana courts, its reasoning is highly persuasive. Express offset provisions, which appear to grant the lessor a valuable right but which in effect deny him one, or which are virtually unenforceable because of existing spacing regulations, should not be allowed to limit the implied obligation to protect against drainage. This is especially so where the lessee has caused the drainage by his acts on nearby lands. If the lessee harms his lessor through his own actions, he cannot be considered as performing his obligation in good faith. The lessor would not conceivably

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84. LA. R.S. 30:10 (1950). See also *Superior Oil Co. v. Humble Oil & Ref. Co.*, 165 So.2d 905 (La. App. 4th Cir. 1964), *writs refused*, 246 La. 842, 167 So.2d 668 (1964). For a more complete analysis of unit well costs, see Jorden, *Unit Well Costs*, 14 INST. MIN. L. 15 (1967).

have consented to a construction of the express offset clause which would permit the lessee to escape his duty. The express offset clause should thus have no effect where the lessee himself is causing the drainage. Such a clause should be effective against acts of third parties only in a situation where the lessor has knowingly consented to a waiver of his right to compel the lessee to protect against drainage and the terms of such clause would be enforceable under applicable spacing regulations.

A duty to unitize is a logical manifestation of the basic obligation to act as a prudent administrator of the leased premises. The prudent administrator standard requires the lessee to act both in the interest of himself and in the interest of his lessor. The lessee should not be allowed to totally disregard his lessor after it has been determined that he need not drill an offset well. The lessee has unitization available to him as a means of protecting his lessor from drainage in such a situation and should be obligated to utilize it.

*Robert J. Prejeant*