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Private Law: Mineral Rights

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MINERAL RIGHTS

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NON-PAYMENT OF ROYALTY

In *Bouterie v. Kleinpeter*,[1] the First Circuit Court of Appeal rejected a lease cancellation claim involving two royalty payment delays of eleven months and one delay of twenty months. No putting in default had occurred. While purportedly recognizing the rule that "any appreciable length of time without justification amounts to an active breach which terminates the lease without the necessity of putting in default,"[2] the court reasoned that failure to pay, to justify cancellation, must be for an "appreciable period of time and must be without justification *and in bad faith*."[3] Citing clearly distinguishable federal decisions,[4] the court held that between the completion of a well and the first royalty payment thereon, there must be some time lag to effect payments. The trial court finding that there was no delay sufficient to justify cancellation was therefore affirmed.

The history of lease cancellation jurisprudence based on nonpayment or delay in payment of lease royalty has been more fully reviewed in an excellent comment under article 137 of the new Mineral Code of Louisiana.[5] It reflects a shift in judicial concern from correction of supposed lessee abuses[6] to concern over lessor abuse in unreasonably seeking cancellation for minor injury and petty wrongs in the absence of a putting in default.[7]

The *Bouterie v. Kleinpeter* decision, in overstating bad faith as a prerequisite to cancellation, is at one end of the pendulum's sweep. Articles 137 to 141 of the Mineral Code have been enacted at this historical moment. In requiring a written putting in default,[8] furnish-

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1. 289 So. 2d 163 (La. App. 1st Cir. 1973).

2. *Id.* at 169, *quoting* Bouterie v. Kleinpeter, 258 La. 605, 247 So. 2d 548 (1971) (italics omitted).

3. 289 So. 2d at 169 (emphasis added).

4. Bonsall v. Humble Oil & Ref. Co., 201 F. Supp. 516 (W.D. La. 1961), *aff'd*, 300 F.2d 150 (5th Cir. 1962) (20 month delay justified by legal uncertainties over effect of compulsory unit on prior voluntary unit and efforts to obtain division order to overcome problem); Touchet v. Humble Oil & Ref. Co., 191 F. Supp. 291 (W.D. La. 1960) (3 months delay).

5. LA. R.S. 31:137 (Supp. 1975).

6. *See, e.g.*, Melancon v. Texas Co., 230 La. 593, 89 So. 2d 135 (1956) (coercive conduct).

7. *See, e.g.*, Hebert v. Sun Oil Co., 223 So. 2d 897 (La. App. 3d Cir. 1969) (clerical error and small royalties).

8. LA. R.S. 31:137 (Supp. 1975).

ing a highly conditioned remedy of double damages,[9] and expressly disfavoring cancellation,[10] the Mineral Code has all but buried the remedy of cancellation for delay in payment of royalties. Indeed, its very limited damage remedy raises a question whether there has been a meaningful substitute remedy furnished to the lessor for substantial neglect in payment of royalties. Dean George W. Hardy, III had correctly discerned that the "real problem" is to furnish some "meaningful remedy" while avoiding the harshness of a cancellation remedy affecting large investments as a consequence of non-payment of insignificant sums.[11] Requiring a lessor (who may be totally ignorant of new production on an already producing lease) to notify in writing a lessee (who probably knows of his non-payment and may be enjoying every high interest minute of it) may sometimes suggest injustice. Limiting the remedy to interest (absent fraud or willful conduct) and then making damages for fraud a discretionary matter[12] further suggests possible want of "meaningfulness." Even if a lessee is fraudulent, willful, and ignores demands, still the lessor does not have a remedy guaranteed as a matter of right, given the discretionary form of language employed in articles 139 and 140.[13] For other cases, including oversight or neglect, all the Mineral Code has provided as a new "meaningful" remedy is the old meaningless remedy of interest, plus a weak attorney's fee provision which may require a *second* putting in default. Thus, it has furnished an illusory remedy for the lessor who may not always be the villain of a legal ambuscade, but who can sometimes be the victim of negligent delay at best, and difficult-to-prove bad faith delay at worst.

This has a familiar ring. It is fundamentally the same situation that the supreme court faced when it developed the "active breach" jurisprudence to overcome supposed ill practices in non-payment of royalty for which the Civil Code regime was inadequate to do justice. However, there is a critical difference at present. The industry does not now have the same reputation of unreasonable delays it labored under in the 1950's and early 1960's. The cases of the past decade have generally not involved harsh lessee abuses nor negligence sufficiently gross to outweigh the frequent appearance of lessors "lying in

9. LA. R.S. 31:139-40 (Supp. 1975).

10. LA. R.S. 31:139, 141 (Supp. 1975).

11. *See* comment to LA. R.S. 31:137 (Supp. 1975). To a small landowner, the sums may not seem insignificant.

12. LA. R.S. 31:139 (Supp. 1975).

13. Both articles provide only that a court "may," not that a court "shall" award double the royalty due as damages. LA. R.S. 31:139-40 (Supp. 1975).

wait" to benefit from jackpot remedies.[14] Nonetheless, old cases from the other end of the pendulum's sweep, for example, *Pierce v. Atlantic Refining Co.*,[15] should remain required reading for legal and managerial staff. However, their mere memory may not suffice to give balance to short term business judgments on whether it is in a company's interest to expend resources on reducing the length of time that company may enjoy its lessor's funds. If a more meaningful remedy is not legislatively provided to be respected in business decisions, the past could become the prologue of court decisions. The Mineral Code article 137 notice provision could be judicially eroded just as the Civil Code putting in default rules were eroded.

JOINT OPERATING AGREEMENTS

Superior Oil Co. v. Cox[16] posed a joint operating agreement problem. Due to the comparative infrequency of this type of litigation and the widespread use of operating agreements, the decision has a certain importance for contract drafting, although it did not decide any weighty legal questions. The case principally involved a liberal interpretation given an "acreage contribution" sharing clause in the cost participation provisions, which is the heart of most farmout and operating agreements. The decision may suggest a judicial tendency in factfinding to construe doubtful clauses in favor of those who have borne the costs of a venture, although it does not expressly articulate such a rule.

PIPELINE CONTRACTS

Louisiana Intrastate Gas Corp. v. Muller[17] presented several minor questions involving delays in payment by a pipeline company to a producer and the use of concursus proceedings. All questions were resolved in favor of the pipeline company, including a contract

14. *Wilson v. Sun Oil Co.*, 290 So. 2d 844 (La. 1974) presented a good example of the kind of factual situations which have caused the courts of this state, and ultimately the legislature, to develop a distaste for the remedy of lease cancellation for delay in payment of royalty. Correspondence in regard to division orders was not answered. Only two to four months of delay were involved. The plaintiffs were already in litigation on another lease. The alleged nonpayment only related to six percent of the royalties due. The delay was associated with problems over the extent of acreage involved. Needless to say, cancellation was denied.

15. 140 So. 2d 19 (La. App. 3d Cir. 1962) (lease cancellation granted for seven months delay in payment of royalties, caused by innocent confusion in a corporate reorganization).

16. 290 So. 2d 916 (La. App. 3d Cir. 1974).

17. 290 So. 2d 888 (La. 1974).

interpretation question on liability for interest for funds not unreasonably withheld. As in the matter of delays in payment, it seems unjust for anyone to benefit from the holding of another's funds, even though there is just reason or agreement that the funds may be withheld, if the monies are clearly not the property of the holder. Otherwise, "reasons" to hold funds are likely to abound. Principles of unjust enrichment or agency might be considered for an appropriate case[18] and attorneys should devote care to this problem in contract drafting.

LESSOR-SUBLESSEE RELATIONS

Scurlock Oil Co. v. Getty Oil Co.[19] treats several problems in a lease cancellation controversy between a lessor and sublessee. The decision follows established general precedent as to the *stricti juris* application of res judicata rules. It refused to apply as controlling a prior decision governing the lessee's rights. As indicated in a concurring opinion by Justice Barham, the opinion of the court implicitly and correctly upholds horizontal segregation of mineral lease rights as permissible.[20] The most important aspect of the case relates to obiter dictum that a release by a lessee-sublessor destroys the rights of a sublessee. Such a result was avoided by interpreting the intent of the instrument of release. It would have been "irrational," the court reasoned, for such a result to have been intended. Presumably, the law is irrational under the court's view, for the court reasoned that absent the intent it construed out of this release, the law would have required a sublessee's rights to be extinguished by an act of release clearly contrary to the sublessor's obligations of warranty to his sublessee.

It is essential that there be security of title for a sublessee. The sublessee is normally the operator and risks large capital in exploratory and development work. It would be "irrational" for his title security to a real right to be dependent only upon the purely personal

18. *See* LA. CIV. CODE art. 3005.

19. 294 So. 2d 810 (La. 1974).

20. *Id.* at 821 (Barham, J., concurring). Actually, Justice Barham noted the majority opinion stated it had pretermitted the question of horizontal segregation, while in fact deciding in favor of horizontal segregation. This is not perfectly precise. In fact, the majority stated that it was not reaching the question of whether horizontal segregation effects an assignment or a sublease. 294 So. 2d at 819. But Justice Barham was essentially correct in observing the effect of the opinion is to uphold a horizontal segregation. The true question may be whether a particular horizontal segregation is an assignment or sublease, as it is conceivable that there might be horizontal assignments and horizontal subleases. *See* LA. R.S. 31:130 (Supp. 1975).

obligations of a sublessor. Irrationality was not intended by the legislature. If an unreasonable result flows from mechanically logical deductions from a legalistic premise, then the premise ought to be examined to see if it is indeed a *universally* valid premise. The premise that a sublease is dependent on the continued existence of the lease[21] should not be construed as permitting a sublessor to terminate real rights[22] theretofore transferred to others, whether by assignment or sublease, notwithstanding that the traditional view has been that the lessor's direct legal relationship is with the lessee, not a sublessee. Legalistic analysis of lease vs. sublease rules to the contrary notwithstanding, a lessor commonly knows that a lease broker, taking a lease, by the very nature of his occupation, will not be the real operator to whom the lessor will be looking for future contract performance. Thus, the parties know the real venturer will often be a person other than the original lessee. To imagine that a lease brokerage firm which had retained a small override, thus making an "assignment" a sublease, had thereby retained the power to destroy the sublessee's investment, is to imagine unconscionable results ordinary people could never understand.

The new Mineral Code realistically recognizes the true economic relationships, by recognizing a direct lessor-sublessee relationship.[23] It should furnish a means to avoid the rule implied in the dictum under discussion, since the power to grant a release would be one of the rights and powers of the original lessee acquired by a sublessee under the new Code.

OYSTER DAMAGE CLAIMS

The court in *Jurisich v. Louisiana Southern Oil and Gas Co.*[24] gave a state mineral lessee and its dredging contractor a Pyrrhic victory over an oyster lessee. The court squarely held that a mineral lessee is not responsible for oyster damages from necessary and prudent mineral operations reasonably conducted with proper precautions. Having given this legal victory to the defendants, a $12,000 oyster bed damage claim was nonetheless affirmed on the ground that the damages were caused by fault in the mineral operations. The fault consisted of failure to notify the oyster lessee and failure to use

21. Now codified as LA. R.S. 31:126 (Supp. 1975).

22. *See* LA. R.S. 31:16 (Supp. 1975).

23. LA. R.S. 31:128 (Supp. 1975). This article provides that to the extent of the interest acquired, an assignee or sublessee becomes directly responsible to the original lessor, and "acquires the rights and powers of the lessee."

24. 284 So. 2d 173 (La. App. 4th Cir. 1973).

a circuitous route which would have avoided damage to oyster beds. Realistically, oil well canals are also future navigational routes and need to follow straight lines, unless crew boat operators' safety is worth less than oysters. Boyd Professor Wex Malone once commented about a similar oyster damage decision:[25] "One might conjecture whether such a case as this really rests upon negligence. . . ."[26]

AREA OF INTEREST CLAUSES

In *Wurzlow v. Placid Oil Co.*,[27] the court interpreted the word "prospect" in a lease brokerage contract providing for an overriding royalty on new leases taken in a named "prospect." It had not been precisely defined and the ambiguity was construed against the oil company which had drafted the agreement, thus affording recognition to the lease broker's claim to overriding royalty interest in certain oil and gas leases. The facts of the case are lengthy and complex. They illustrate the kind of complex controversy which can arise if precision of description is not employed in area of interest agreements. However, definition with exactitude may be impossible until fruits of the transaction—information from drilling—materializes. The court recognized this difficulty and used Civil Code article 1947 to sustain its holding that a "prospect" is a term of art or technical phrase to be interpreted according to its meaning with those who are in the art or profession. Parol evidence was accordingly considered. The decision seems both just and legally correct, assuming validity of the factual findings reached through use of parol. Very importantly, the court pointed to careful distinctions in ambiguous description cases where rights of third persons were or were not involved. Thus, the decision may have limited future application only to cases where third party rights are not affected.

25. Doucet v. Texas Co., 205 La. 312, 17 So. 2d 340 (1944).

26. *The Work of the Louisiana Supreme Court for the 1943-1944 Term—Torts*, 6 LA. L. REV. 204, 213 (1945).

27. 279 So. 2d 749 (La. App. 1st Cir. 1973).