

Louisiana Law Review

Volume 39 | Number 3

*The Work of the Louisiana Appellate Courts for the
1977-1978 Term: A Faculty Symposium
Spring 1979*

Private Law: Mineral Rights

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Repository Citation

Patrick H. Martin, *Private Law: Mineral Rights*, 39 La. L. Rev. (1979)

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MINERAL RIGHTS

*Patrick H. Martin**

ACQUISITIVE PRESCRIPTION OF MINERAL RIGHTS FOR LEVEE DISTRICT

In *Board of Commissioners v. S. D. Hunter Foundation*,¹ plaintiff levee district brought a petitory action claiming title to two strips of land in possession of the defendants. The defendants claimed ownership of the disputed tracts on the basis of acquisitive prescription of ten and thirty years. The supreme court, reversing the Second Circuit,² held that ten year prescription could not apply because the necessary good faith was precluded when warranty was expressly disclaimed to the disputed tract yet given with respect to the other land included in the same transaction.³ Ten year prescription could not apply, the court held, to the second disputed tract because the construction of a pipeland right of way under a grant by plaintiff levee district interrupted the defendant's possession.⁴ Thirty year prescription did not apply⁵ because by law acquisitive prescription could not run against levee districts between 1938 and 1944 and since 1964.⁶ The court held that the effect of the statutes was to interrupt prescription, not merely suspend it in the years 1938 to 1944, so that the land had to have been possessed for thirty years prior to 1938 to be able to rely on thirty year acquisitive prescription.⁷ Defendants were unable to show such possession. The significance for the law of mineral rights of this decision is a footnote⁸ which indicates that even if defendants had established title to the land by ten or thirty year acquisitive prescription, they would not have

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1. 354 So. 2d 156 (La. 1978).

2. 342 So. 2d 720 (La. App. 2d Cir. 1977).

3. 354 So. 2d at 162.

4. *Id.* at 165-66.

5. *Id.* at 167.

6. 1938 La. Acts, No. 76; 1964 La. Acts, No. 408, adding LA. R.S. 38:295 (Supp. 1964).

7. 354 So. 2d at 168-69.

8. *Id.* at 167 n.8.

acquired title to the mineral rights unless title had been perfected prior to 1921. That is, article IV, section 2, of the 1921 constitution prevented the alienation of state mineral interests after its effective date, and a levee district for purposes of this article was a state agency. Although it may be dictum, the court has apparently endorsed the holding of a case for which it had denied certiorari the previous term.⁹

The court specifically declined to overrule *Haas v. Board of Commissioners*¹⁰ which held that for purposes of article XIX, section 16, of the 1921 constitution a levee district was not a state agency and thus could lose title to land by a plea of acquisitive prescription. Accordingly, it appears that it may be possible to acquire title to some lands once owned by a levee district through acquisitive prescription but not to the minerals beneath such land if title was not perfected prior to 1921.

CONSERVATION COMMISSION PROCEEDINGS: NOTICE AND HEARING

In *Brown v. Sutton*,¹¹ an overriding royalty interest owner sought to enjoin enforcement of an order of the Commissioner of Conservation approving a unitized operation and secondary recovery project for the Cotton Valley reservoir of the Minden Field in Webster Parish. Application for the project had been made by Franks Petroleum, Inc. Plaintiff Brown was not listed as an interest owner in the application and was not given individual notice by the Commission of the hearing to be held on the application scheduled for July 13, 1976 in Baton Rouge, although a general notice was published in a Baton Rouge newspaper. However, plaintiff did learn of the hearing through a newspaper report followed by a call by plaintiff's employee to the offices of the Conservation Commission. The hearing was

9. *Shell Oil Co. v. Board of Comm'rs of Pontchartrain Dist.*, 336 So. 2d 248 (La. App. 1st Cir.), *cert. denied*, 338 So. 2d 1156 (La. 1976). See Ellis, *The Work of the Louisiana Appellate Courts for the 1976-1977 Term—Mineral Rights*, 38 LA. L. REV. 379-80 (1978).

10. 206 La. 378, 19 So. 2d 173 (1944). Chief Justice Sanders in dissent noted that both article IV, section 2, and article XIX, section 16, of the 1921 constitution speak only of "the State" and argued that neither should apply to state boards and agencies. 354 So. 2d at 177 (Sanders, C.J., dissenting).

11. 356 So. 2d 965 (La. 1978).

postponed at the request of Franks Petroleum; when the hearing was finally held in Shreveport on September 15, 1976 plaintiff's counsel contended that the Commissioner was without authority to conduct the hearing because the plaintiff had not received notice of it and had not had an opportunity to make a presentation. Despite the objection, the Commissioner completed the hearing, made the necessary findings, and approved the unitization and proposed secondary recovery plans.

Thereupon plaintiff filed two suits; the first unsuccessfully¹² sought a declaration of rights that would establish that he owned more than twenty-five percent of the total leasehold or working interest in the unit area,¹³ and the second sought an injunction against enforcement of the Commissioner's order. The injunction was denied by the trial court, but on appeal the First Circuit reversed, holding that the Commissioner's order was void; this, in turn, was reversed by the supreme court.¹⁴ It was the supreme court's opinion that the lack of formal notice was cured by actual notice, and it thereupon became incumbent upon the plaintiff to keep informed about the actions of the Commission.¹⁵

The plaintiff also challenged the Commissioner's order on the ground that the four conditions required by the statute for entry of an order were not found by the Commission.¹⁶ The court held that evidence in the record established that the conditions were satisfied although not specified in the order itself. Plaintiff's counsel had apparently attempted at the

12. The petition was dismissed on the grounds that it was a collateral attack on an order of the Commissioner for which the exclusive venue and jurisdiction was in East Baton Rouge Parish. This was affirmed on appeal. See *Brown v. Alice-Sidney Oil Co.*, 343 So. 2d 745 (La. App. 2d Cir.), *cert. denied*, 344 So. 2d 1056 (La. 1977).

13. Under Louisiana law, there must be approval by at least three-fourths of the owners and three-fourths of the royalty owners for a forced field wide unitization. LA. R.S. 30:5(c)(3) (Supp. 1960).

14. *Brown v. Sutton*, 349 So. 2d 898 (La. App. 1st Cir. 1977), *rev'd*, 356 So. 2d 965 (La. 1978).

15. 356 So. 2d at 971-72.

16. In addition to three-quarters approval, there must be a finding that the order is reasonably necessary for the prevention of waste and will increase recovery, that the unit operation is economically feasible, and that the owners of each tract unitized will receive their just and equitable share of production from unit operations. LA. R.S. 30:5(c) (Supp. 1960).

Commission's hearing to establish that the plaintiff in fact owned more than a twenty-five percent interest in the proposed unit, and therefore the requisite seventy-five percent interest approval could not be shown. However, the plaintiff offered only an unconformed act of assignment as evidence of the ownership, which the Commissioner found was not in the record. The court held that this finding was not arbitrary or capricious and would not be overturned.¹⁷

This decision is troublesome because it says, in effect, that once a person learns that his property rights might be affected by a Commission hearing, it becomes his duty to be present at the hearing fully prepared to present any and all claims that might be at issue there or possibly forever lose valuable rights. As it is doubtful that such a proposition would be tolerated of a court proceeding, it should not be accepted for an agency action which does not have the inherent safeguards of a judicial proceeding. Of course administrative proceedings should not be unduly delayed by the carelessness of counsel, but that factor was not clearly present in this case, and the sanction imposed far exceeds the gravity of the perceived error, particularly in light of the failure of the Commission to give adequate notice of the hearing. While the decision is perhaps technically correct, the result is unsatisfactory.

THE SUBLEASE-ASSIGNMENT DISTINCTION

In *Cameron Meadows Land Co. v. Bullard*,¹⁸ the court was faced with a situation that commonly arises in mineral transactions. When the original lessee of minerals has transferred all or part of his interest to a third party under a provision of the lease which allows such a conveyance, questions may arise as to the relationship between the third party and the lessor, the relationship between the lessee and lessor, and the rights of the lessee under the lease. Louisiana has long recognized a distinction between a sublease, in which the lessee (sublessor) has retained an interest in the production that the sublessee might obtain, and an assignment, in which the lessee (assignor) has

17. 356 So. 2d at 973-74.

18. 348 So. 2d 193 (La. App. 3d Cir. 1977).

retained no continuing interest and the assignee has assumed all the rights and duties of the assignor in the original lease.¹⁹

In the instant case Cameron Meadows Land Company granted a lease to Henshaw over a large tract of land in 1927. Within two weeks Henshaw conveyed the leasehold right to Vacuum Oil Company but retained an overriding royalty interest in any production that might occur. After years of production and transactions that placed the leasehold interest in the hands of Mobil and Exxon, the holders of the lease interest released parts of the land under lease. Cameron Meadows then executed new leases to parties who had not been involved in any of the foregoing events. The successors in interest to Henshaw had no interest in the new leases, their interest deriving solely from the original lease, and they brought suit claiming that the original lease was still valid and could not be terminated without their consent.

The district court held for the plaintiffs on the ground that the conveyance executed by Henshaw to Vacuum Oil was a sublease and, therefore, that the release by Vacuum's successors in interest resulted in a reversion of the leasehold rights to the sublessor, Henshaw. The Third Circuit reversed.²⁰ Because of the retention of the overriding royalty, the conveyance by Henshaw to Vacuum had to be classified under the existing jurisprudence as a sublease.²¹ However, the court found that Henshaw's sublease impliedly granted the sublessee the right to release all or any part of the leased acreage.²² To find this grant, the court looked to several factors: the sublease imposed no obligation on Vacuum to pay rentals or develop the leased acreage; Henshaw retained no right to control the manner in which operations were conducted; he reserved no right to reassign the lease in the event Vacuum decided not to continue the lease in effect; and he (and his successors) had taken no active interest in the lease for forty-three years.²³ Thus, the release of

19. The jurisprudence drawing this distinction is discussed in the comments to article 127 of the Mineral Code. LA. R.S. 31:127, comment (Supp. 1974). See also Scott, *More on Assignment and Sublease*, 12TH INST. MIN. L. 39 (1965).

20. 348 So. 2d 193 (La. App. 3d Cir. 1977).

21. *Id.* at 198.

22. *Id.* at 199.

23. *Id.*

the lease by Vacuum's successors was effective without the consent or approval of Henshaw's successors.

The decision is correct. While perhaps not entirely in keeping with strict civilian concepts of the status of a sublessee,²⁴ the decision reflects the expectations of the parties in lease and sublease transactions and the necessities of the petroleum business. Leases are very often taken and reconveyed by the lessee with a retention of an overriding royalty for speculative purposes without the lessee ever intending to have any involvement in development and operations under the lease. It would be unnecessarily formalistic and excessively burdensome on the landowner and sublessee to require agreement from the lessee for release of the lease. The lessee does need protection from the so-called "wash-out" transaction, which involves a deliberate effort on the part of the sublessee to destroy the sublessor's interest to the sublessee's advantage, but this protection can be provided by allowing him an action against the sublessee for breach of the duty of good faith and fair dealing imposed by the sublease agreement itself.²⁵ The sublessor can, of course, provide explicitly in the sublease that the interest may not be released or conveyed without his approval. In the absence of such a stipulation by the sublessor it is entirely correct to conclude that no such power was intended and that the sublessee has the right to release the lease.

PRESCRIPTION—CREATION OF MINERAL SERVITUDES

In *Mire v. Chevron*²⁶ an owner of two tracts of land in 1957 conveyed to each of his children an undivided one-eighth interest in a servitude covering eight-ninths of the minerals on the first tract and one-half on the second. On June 4, 1965 the landowner donated the property (the surface rights) to the same children in indivision, reserving to himself the minerals which had not already been conveyed, *i. e.*, one-ninth and one-half respectively. On the same day, the children partitioned the

24. See A. YIANNPOULOS, PROPERTY § 95 in 2 LOUISIANA CIVIL LAW TREATISE 275-78 (1966).

25. See H. WILLIAMS & C. MEYERS, 2 OIL AND GAS LAW § 420.2 (1977).

26. 353 So. 2d 462 (La. App. 3d Cir. 1977), *cert. denied*, 355 So. 2d 256 (La. 1978).

property, dividing it into eight separate lots. However, the partition agreement specified that:

The parties hereto do not divide or partition the oil, gas, or other minerals and mineral royalties in, under, and relating to said tract of land but on the contrary leave same indivision with each party hereto retaining his or her virile and prorata [sic] interest therein without change.²⁷

Three years later the children and their father executed a lease on the property which was subsequently acquired by Chevron and Exxon. Production was obtained on nearby land, and in 1970 a part of the property in question was included in a compulsory drilling unit. Controversy ensued because the lessees paid each of the children the same amount of royalties, even though differing amounts of the surface had been included in the unit. Those with larger amounts included in the unit sued, claiming that the servitude created in 1957 had expired for ten years non-use in 1967. Defendants claimed that the 1957 servitude had been extinguished by confusion in the 1965 donation by their father and that a new servitude had been created at the time of the partition among the children.

Reversing the district court, the Third Circuit held for the defendants. The court found that confusion had taken place in 1965 despite article 805 of the Civil Code, which states that "it is necessary that the whole of the two estates should belong to the same owner; for if the owner of one estate only acquires the other [in] part or in common with another person, confusion does not take effect."²⁸ The court reasoned that a single servitude was created in 1957—the father's one-ninth interest not being a separate servitude—and, thus, when the children acquired the surface the two estates belonged to the same owner; it stated: "[T]he mineral reservation in favor of Erise Mire [the father], and extinguishment of the mineral servitude in favor of his children when they acquired surface rights, occurred simultaneously and hence the second paragraph of Article 805 did not prevent their mineral servitude from being ex-

27. *Id.* at 464.

28. LA. CIV. CODE art. 805.

tinguished by confusion, as a matter of law."²⁹ Therefore, the payment of royalties to the children on an equal basis was proper.

ROYALTY INTEREST—LESSOR'S RENT ROYALTY

*Cities Service Oil Co. v. Hilburn*³⁰ was a concursus proceeding provoked by a lessee because of a dispute as to whom a certain royalty interest was due. In 1968 Carl Morris assigned a lease, the Burke "A" lease, and other properties to Central Facility, who subsequently assigned the same to Petrol, one of the two claimants to the royalty in question. When Morris made the assignment he owned a working interest (seven-eighths less one-eighth overriding royalty), an individual one-half interest in the land (entitling him to a one-sixteenth royalty), and an overriding royalty (one-sixteenth of seven-eighths). In 1972 Morris sold his interest in the land covered by the Burke "A" lease to Hilburn, the other claimant in the case.

Hilburn claimed that he was entitled to the one-sixteenth royalty which was the lessor's rent royalty since he was now the owner of the land. Petrol claimed that this royalty had been conveyed to it by virtue of the 1968 assignment from Morris to Central Facility.

The one-sixteenth royalty was not specifically mentioned in a list of ninety-six items conveyed by Morris to Central Facility but the "Mother Hubbard" or "cover all" clause of the agreement stated in part:

It is the intention of the Assignor to convey herein all of his interest in the leases . . . and all of his interest in and to the wells and equipment located thereon, together with all of his interest in any and all overriding royalty interest or production payments of any kind or nature whatsoever affecting said leases or wells. In the event the net pipeline interest figure set forth after each lease description . . . does not accurately reflect the total interest

29. 353 So. 2d at 467.

30. 351 So. 2d 860 (La. App. 2d Cir. 1977).

(including working interest, overriding royalty interest, production payments or any other type of interest) owned by Assignor in the lease, the same is to be disregarded and the total interest of the Assignor in said lease is to be conveyed hereby.³¹

Relying on this clause, the trial court held for Petrol. The Second Circuit reversed.

It was the opinion of the court of appeal that:

A mineral royalty interest such as that claimed by Petrol is an interest created by a mineral owner in production of the minerals whether obtained from drilling operations conducted solely by the mineral owner or through a mineral lease. Therefore, in a literal sense, it is not an interest in a lease, but only a right to share in a portion of the production from whatever method it is derived.³²

Because the agreement conveyed only Morris's interests in the lease and overriding royalty, the court held that the lessor's royalty was not conveyed but instead passed with the land itself to Hilburn.

The decision of the Second Circuit appears to be incorrect. First, looking to the quoted passage, a landowner who produces his own minerals is not receiving a royalty by any definition of the term. To determine the probable intent of the parties in the conveyance by Morris to Central Facility it is necessary to consider the types of royalty recognized in Louisiana law and the kind of agreements into which they might have entered. Article 80 of the Mineral Code (and pre-Code jurisprudence) defines a royalty created out of the landowner's interest or servitude owner's interest as "the right to participate in production of minerals from land owned by another or land subject to a mineral servitude owned by another."³³ Such a royalty is independent of any particular lease. The one-sixteenth royalty was clearly not of this type because Morris owned the land, and

31. *Id.* at 861-62.

32. *Id.* at 862.

33. LA. R.S. 31:80 (Supp. 1974). The provisions of title 31 of the Revised Statutes are referred to as the Mineral Code.

the royalty was created when the lease was granted; it was dependent on the lease. The parties clearly did not wish to create an interest of the type defined by article 80, and this may be the reason why they avoided use of the term royalty; they did not wish to transfer any interest to Central that would survive beyond the life of the lease. The only other type of royalty that appears to be contemplated in Louisiana law is dependent on a lease, whether as a "rent royalty" or an overriding royalty.³⁴ The lessor's royalty exists because of his ownership of the minerals and may be the rent for the property, but the right to receive the rent arises from the lease contract itself. This right is freely transferable by the lessor even though he may retain the right to own any minerals remaining after the expiration of the lease. A lessor wishing to convey this right, but not the remaining rights to produce the minerals or to receive income beyond the existence of the particular lease, might well speak in terms of transferring his interest in the lease and not his royalty rights. If a lessor owned no other rights and conveyed his interest in a particular lease, it would be obvious he was conveying the lessor's rent royalty for that lease. The difficulty in this case was that the transferring party owned rights of both lessor and lessee. While it is true that a lessee normally conveys only the rights of a lessee, the reason for this is that normally a lessee owns only a lessee's rights. Here the conveyer owned both. In any event it would appear that at the very least the lessor's royalty is a "production payment" or "other type of interest" in the lease. Article 213 of the Mineral Code gives the following definition of "Royalty":

"Royalty" as used in connection with mineral leases, means any interest in production, or its value, from or attributable to land subject to a mineral lease, that is deliverable or payable to the lessor or others entitled to share therein. Such interests in production or its value are

34. The Mineral Code is silent on the nature of the lessor's royalty. Article 126 of the Mineral Code states, "An interest created out of the mineral lessee's interest is dependent on the continued existence of the lease and is not subject to the prescription of nonuse." LA. R.S. 31:126 (Supp. 1974). This apparently only refers to an overriding royalty.

“royalty,” whether created by the lease or by separate instrument, if they comprise a part of the negotiated agreement resulting in execution of the lease.³⁵

Surely the lessor’s royalty is a production payment attributable to the lease in question.

IMPLIED LEASE OBLIGATIONS—RESTORATION OF SURFACE

In addition to express obligations in a lease, a lessee is subject to a number of duties that are implied from the lessor-lessee relationship when the lease is silent on a point.³⁶ Whether these are implied in law or fact has been a matter of controversy, but in Louisiana, more so than elsewhere, a stronger argument can be made that these obligations are implied in law because of the existence of the Mineral Code and Civil Code.

*Broussard v. Waterbury*³⁷ raised the question of the lessee’s implied obligation to restore the property after it has completed its exploration and development activities. The lessee had taken the property in a new lease from the lessor after a prior lessee had drilled several wells and had left the property. The defendant lessee operated the wells for several years and then abandoned them, leaving the property “in the same condition it was in when he took over the operations.”³⁸ Lessor brought suit for damages for not restoring the property to the condition it was in before there had been any drilling and production. The Third Circuit affirmed a district court judgment for the plaintiff.

It is very difficult to understand how the Third Circuit arrived at its decision. The court properly looked to article 122 of the Mineral Code and to articles 2719 and 2720 of the Civil Code. From these it properly concluded that the “obligation under both articles is to return the thing leased in the ‘same state’ as received.”³⁹ But it applied this standard to impose a

35. LA. R.S. 31:213(2) (Supp. 1974).

36. See Martin, *A Modern Look at Implied Covenants to Explore, Develop, and Market under Mineral Leases*, 27th OIL & GAS INST. 177 (Matthew Bender 1976).

37. 346 So. 2d 1342 (La. App. 3d Cir.), cert. denied, 350 So. 2d 674 (La. 1977).

38. *Id.*

39. *Id.* at 1344.

duty on the lessee to restore the property to its condition before any drilling or production had begun (*i.e.*, some time in the early 1960's when the wells were first drilled and the damage done by a *prior lessee*) and not to its condition in 1970 when received by the defendant. Thus, the court required the defendant to pay for damage caused by a prior lessee with whom he had apparently had no dealings. The decision would be correct if the defendant had assumed the lease obligations of the prior lessee, but there is no indication in the opinion that this was the case.

Waterbury v. Broussard, it is hoped, will not be followed in subsequent decisions for it will have the effect of discouraging new operators from taking over the development of property where another party has already caused damage. The new operator, unless the lease specifically stipulates otherwise, will be faced not only with the costs of its own operation but those of previous operators. To follow a rule contrary to that of *Waterbury* would work no hardship on lessors for they have recourse against their prior lessees who are the proper parties to pay for any damage that they may have caused.

IMPLIED LEASE OBLIGATIONS—DEVELOPMENT

The plaintiff lessor in *Dupree v. Relco Exploration*⁴⁰ demanded that his lessee undertake further development of the leased premises and brought suit for partial cancellation of the lease when the lessee declined to drill immediately. The district court held, and the court of appeal affirmed, that the lessee had fulfilled its duties under the lease and article 122 of the Mineral Code.

At the time of suit, the lessee had drilled a dry hole into the Rodessa formation. A company leasing adjacent property then completed a producing gas well in the same zone at 5,260 feet and drilled further with no success to 10,800 feet. Eighty acres out of the 485-acre lease involved in the suit were included in a drilling unit for the gas well on the adjacent property. Plaintiff was paid nearly \$9,000 in royalties between 1974

40. 354 So. 2d 1083 (La. App. 2d Cir. 1978).

and the time of suit for his share of the production from the unit well. In January, 1976, defendant lessee commenced an offset well and tested all known producing zones in the area without success. Five months after the offset well was abandoned, plaintiff filed suit to cancel the lease as to that portion outside the unit.

Distinguishing *Nunley v. Shell Oil Co.*,⁴¹ in which the court had cancelled the portion of a lease outside a unit when the lessee refused to develop that portion, the court observed that in the instant case the lessee was conducting studies with a view to drilling deeper if information from a planned test well in the vicinity was favorable.⁴² The lessee had done all that a reasonably prudent operator would do under like circumstances.

In most other states a distinction is made between the implied covenant of reasonable development and the implied covenant of further exploration. Recognized as required by the lessor-lessee relationship in all producing states, the reasonable development covenant is concerned with additional development in known producing formations where the lessor can establish the likelihood of profitable production.⁴³ The implied covenant of further exploration is not generally accepted, though much discussed in the literature on implied covenants. Where established it would require the lessee to undertake additional operations in unexplored strata when the lessor can show that it is potentially productive and that it is unreasonable not to drill an exploratory well, even though he cannot prove that drilling would probably be profitable.⁴⁴

The jurisprudence in Louisiana does not distinguish between these two implied covenants. The comments to article 122 of the Mineral Code, which establishes the prudent operator standard, note that a distinction between the two concepts exists, but they also note that both covenants have been found in those cases in which there is an obligation on the lessee to "explore and test all portions of the leased premises after dis-

41. 76 So. 2d 111 (La. App. 2d Cir. 1954).

42. 354 So. 2d at 1084.

43. See Martin, *supra* note 36, at 180-86.

44. *Id.* at 186-90.

covery of minerals in paying quantities."⁴⁵ That Louisiana does not have a relatively clear standard is unfortunate for there is little to guide lessees in determining if they have complied with their implied lease obligations or to guide courts in applying the prudent operator standard. It serves as a virtual invitation to litigation such as the *Dupree* case.

Most other states have found the reasonable development covenant adequate to protect the interest of the lessor and to prevent the lessee from acting as the "dog in the manger." The "test every sand" standard announced in a few Louisiana cases is both improper and inadequate as a standard for the courts because it ignores the factor of time in the development of a lease; this standard is particularly inappropriate at a time when many development decisions turn on complex issues of price controls on both crude oil and natural gas. There is nothing in article 122 of the Mineral Code, nor in the Civil Code, that compels the approach Louisiana cases have taken on the implied covenant of development; it would be desirable for the courts to adopt the position taken in most other states and to distinguish between the reasonable development and the further exploration covenants.

45. LA. R.S. 31:122, comment (Supp. 1974).