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Private Law: Mineral Rights

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MINERAL RIGHTS

*Patrick H. Martin**

The tempo of litigation concerning mineral rights appears to have increased in the past year. Undoubtedly the state bar can expect this trend to continue for several reasons. Drilling activity for oil and gas has increased in recent years. This is attributable to increased demand and to greatly increased prices allowed under federal regulations for both crude oil and natural gas. And with the price increases, it has become profitable to rework older fields or undertake enhanced recovery techniques that a short time ago would have been economically or technically unfeasible.

As a result, the rights to produce minerals and enjoy their revenues have become more valuable, giving property claimants an ever greater incentive to establish their rights. Claims will increase as some lessors come to feel their leases are unfair, many of them executed at a time when a one-eighth royalty and low bonus and delay rental prevailed, while their neighbors with more recent leases enjoy much higher income. Additionally, landowners whose properties are burdened by servitudes reserved or granted under far different economic circumstances are likely to assert the invalidity of those rights.

The next several years will be very important ones in the development of Louisiana mineral law. The Mineral Code, effective January 1, 1975, is still quite new, and relatively few cases have arisen under it. In the background, and heavily affecting traditional property rights issues, is a complex mass of federal regulations presenting problems for all parties to which a state court should be sensitive. There will be many significant cases, and the courts will have the opportunity to render decisions that can provide for certainty and stability in an area of the law that is acutely important for this state. If they fail, the effects will be felt for a generation, not only by mineral rights owners and claimants but also by the other citizens of the state and, indeed, the country.

ACQUISITIVE PRESCRIPTION—LEVEE DISTRICT

In *Dynamic Exploration, Inc. v. LeBlanc*¹ the Louisiana Supreme

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1. 362 So. 2d 734 (La. 1978).

Court decided an issue that had been touched upon in several cases in recent years, *i.e.*, whether a levee district can be divested of mineral rights through acquisitive prescription. Article IV, section 2 of the 1921 constitution provided that "[i]n all cases the mineral rights on any and all property sold by the State shall be reserved . . ." Is a levee district an agency of the state for purposes of this provision of the 1921 constitution? The supreme court held that it was a state agency for this purpose; in so holding, the court followed a First Circuit Court of Appeal decision of 1976, *Shell Oil Co. v. Board of Commissioners*,² and dictum in a supreme court opinion of last term, *Board of Commissioners v. S.D. Hunter Foundation*.³

CONVEYANCE PROBLEMS

A number of problems dealing with the creation and transfer of mineral rights have recently reached the courts. The decided cases are not remarkable for the issues of law which they resolve; but they do serve to indicate, in several cases particularly, the need for careful draftsmanship in the conveyance of mineral rights and a clearer indication of the intentions of the parties to such conveyances.

Lease: Necessity of a Writing

Must a mineral lease be in writing to be effective? The third circuit in *Bills v. Fruge*⁴ held that it must and that it is subject to the parol evidence rule. This case arose when the plaintiff sent a lease to a co-owner of land, who was in prison at the time, together with a bank draft as bonus for granting the lease. The defendant endorsed the draft to another, and it was paid, but he neglected to sign the lease or return it to the plaintiff. The defendant, however, executed a mineral lease on the land to another, but only after the plaintiff had filed in the conveyance records of St. Landry Parish a copy of the draft and the unsigned lease, together with an affidavit setting forth the facts surrounding his effort to get a lease. The court held that the plaintiff did not acquire a lease by the defendant's endorsing the draft for payment because there was no written lease signed by the defendant; and the signed draft did not constitute a written lease because it did not show the essential element of consent to lease.

2. 336 So. 2d 248 (La. App. 1st Cir.), *cert. denied*, 338 So. 2d 1156 (La. 1976).

3. 354 So. 2d 156 (La. 1977).

4. 360 So. 2d 661 (La. App. 3d Cir. 1978).

Warranty Deed

In *Dillon v. Morgan*⁵ the Second Circuit Court of Appeal was asked to consider the effect of a warranty deed given under the following circumstances. An owner of land, Dean, sold land to the defendant, Morgan, reserving to himself a servitude as to one-half the minerals. Morgan thereafter sold the same land by warranty deed to the plaintiff, Dillon, reserving to himself one-half the minerals. When the plaintiff learned of Dean's existing servitude, he brought suit claiming a breach of warranty by Morgan. Dillon claimed that he was acquiring the land subject only to a mineral servitude as to one-half the minerals; Morgan, on the contrary, claimed that he was reserving the one-half not already reserved by Dean.

Reversing a trial court opinion that Dean owned a servitude as to one-half and Dillon and Morgan each owned one-fourth, the second circuit held that the deed warranted ownership of one-half to Dillon, and the effect of Morgan's reservation was simply to reserve from the sale that which had already been reserved to Morgan's vendor, Dean. Explaining its result in terms of an estoppel,⁶ the court stated:

By whatever name, the principle is sound that a seller should not be allowed to obligate himself to deliver and to warrant title and peaceable possession to a buyer of a thing and then by his own act or claim to derogate from, or to assert rights to the thing contrary to, his obligations.⁷

The court further rejected Morgan's contention that, if the servitude in favor of Dean should expire, the reservation of one-half the minerals in his own favor should then become effective; the after-acquired title doctrine, the court said, could not operate to a party's own benefit.⁸ As to both principles the court has ruled properly and in accordance with the weight of authority.⁹

Top Lease

Where there is no warranty of title, express or implied, in the conveyance of an interest, there is no recovery of damages for failure to convey the interest. Frequently a lessor of mineral rights will be asked to execute a top lease, a lease to become effective in

5. 362 So. 2d 1130 (La. App. 2d Cir. 1978).

6. The court cited and relied upon *Hodges v. Long-Bell Petroleum Co.*, 240 La. 198, 121 So. 2d 831 (1960), and *Gaines v. Crichton*, 187 La. 345, 174 So. 666 (1937).

7. 362 So. 2d at 1132.

8. *Id.* at 1133.

9. H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 311 (1977).

the event that an existing (or base) lease is, or will become, invalid. Generally, the lessee of the top lease knows he is paying a bonus for the mere possibility that the base lease will expire; and, should it not expire, there is no basis for him to sue his lessor.

In *Scoggin v. Bagley*¹⁰ the plaintiff had taken a top lease on certain land from the defendant through brokers. The base lease had a primary term of five years from December 8, 1972. It could only be extended beyond December 7, 1977, by production, by drilling operations occurring at the time, or by inclusion of the lands, or a portion of them, in a unit from which there was production. The plaintiff took the top lease on December 5, 1977, knowing that there was no production from the leased land and no shut-in wells and that no drilling rig would be available to begin drilling by December 7. The top lease specifically provided: "All monies paid are nonrefundable." What the plaintiff did not know was that an October 1977 unitization order placed the acreage in question into a unit where production was in existence, thereby extending the lease beyond the primary term so long as there was production from the unit.

The plaintiff brought suit to invalidate the top lease and gain a return of his money. He claimed that his purchase was premised on the assumption on his part, or on the representation by the brokers, that only drilling would extend the base lease. The court held that the brokers were not agents of the lessor and statements by them were not attributable to the defendant, that the language of the top lease was unambiguous and contained no limitation based on drilling, and that defendant had no reason to believe that the plaintiff wrongly assumed that only drilling would extend the lease.¹¹

Partition

In *Patrick v. Johnstone*¹² the second circuit was presented with a question involving partition of land burdened by a mineral servitude. Patrick and J. Johnstone owned a tract in indivision which was burdened by a mineral servitude owned by W. Johnstone created out of J. Johnstone's undivided one-half interest. In earlier litigation the trial court had ordered a partition by licitation, but the second circuit had ordered the trial court to reconsider its decision and instructed it to look to not only the appropriate articles of the Civil Code but also of the Mineral Code which had just become effective.¹³ The trial court again ordered partition by licitation, and this time the second circuit affirmed.

10. 368 So. 2d 763 (La. App. 2d Cir. 1979).

11. *Id.* at 767.

12. 361 So. 2d 894 (La. App. 2d Cir. 1978).

13. *Patrick v. Johnstone*, 312 So. 2d 662 (La. App. 2d Cir. 1975).

Adopting the opinion of the district court, the second circuit held that, with respect to partition of immovable property, there is a presumption in favor of partition in kind.¹⁴ This presumption may be rebutted by showing that the land is burdened by a mineral right created by fewer than all of the co-owners of the land to be partitioned. After this showing there arises a presumption that the property is to be partitioned by licitation, a presumption that can be rebutted only by proof that the requirements of article 178 of the Mineral Code have been met.¹⁵ This article provides that in such circumstances there can be a partition in kind only if

it can be accomplished in such fashion that the allocation of tracts to the co-owners assures that both surface and mineral values of each tract are in the same proportion to the total value of the surface and the mineral rights respectively as each co-owner's interest bears to the whole of the surface and the mineral rights respectively.¹⁶

Such proof will, in most cases, be very difficult to make, and thus the presumption in favor of partition by licitation will be difficult to overcome. Most cases will be decided in favor of partition by licitation, as was the present controversy. This may work hardships on some parties, but the provisions of the Mineral Code for appraisal and sale¹⁷ are as fair and equitable a procedure as can be undertaken. Despite the fact that the second circuit's opinion is somewhat at variance with its prior disposition of the case, the court has adopted the proper approach to partition under the Mineral Code.

Multiple Servitudes on a Single Tract of Land

The typical grant or reservation of a mineral servitude in Louisiana is accomplished in a manner more like the common law than the civil law. The typical reservation, for example, will provide that "A conveys to B Blackacre, reserving to A, his heirs and assigns, all of the oil, gas and other minerals in and under Blackacre." Under the Mineral Code, the effect of such language is to create a right to produce the minerals, one which runs throughout Blackacre. It must be used within ten years or it will prescribe for nonuse, but any use of the servitude will interrupt liberative prescription as to the whole of the servitude. Yet, it is often overlooked that the parties to the creation of a servitude do have flexibility to alter the normal

14. 361 So. 2d at 896. See *Babineaux v. Babineaux*, 237 La. 806, 112 So. 2d 620 (1959).

15. LA. R.S. 31:178 (Supp. 1974).

16. *Id.*

17. LA. R.S. 31:180-85 (Supp. 1974).

consequences of a servitude. Thus, the Mineral Code specifically allows the creation of a mineral servitude which will cease to exist if not used within a shorter period than ten years or which requires more to interrupt prescription than merely drilling to a depth at which one would reasonably expect to find oil or gas.¹⁸ And, as the next case illustrates, parties may create separate servitudes at different depths on a single tract of land, each of which must be used in order to interrupt prescription as to that servitude.

In *Roemer v. Caplis*¹⁹ the plaintiff, Roemer, was the owner of land upon which a producing well was drilled to a depth below 3100 feet in 1972. The defendants claimed that they owned a mineral servitude upon the land which had been created in 1949 and continued in existence by production from the land, the wells for which were above 3100 feet. It was the plaintiff's claim that the production referred to by the defendants only interrupted prescription for a servitude on the land above 3100 feet, that there had been a separate servitude created in 1949 as to the minerals below 3100 feet, and that the latter had prescribed for nonuse in 1959, as there had been no drilling or production below 3100 feet until 1972.

Analyzing several instruments of sale, the court concluded that they clearly created two separate servitudes, one for the minerals lying above 3100 feet and one for the minerals lying below 3100 feet. It was improper for the court to consider unrecorded documents that suggested a contrary intent since the plaintiff was not privy to them. In rejecting the defendants' contention that Louisiana law does not allow the creation of separate horizons or levels ("horizontal" servitudes), the court noted that article 72 of the Mineral Code provides that the parties to an act creating a mineral servitude may alter the applicable legal rules subject to limitations specified in articles 73-79. Although article 68 provides that a single mineral servitude is established on a continuous tract of land notwithstanding that certain horizons are excluded, it is not prohibited by articles 73-79 to provide otherwise, and it is implicit in article 68 that one may do so. This holding is consistent with prior jurisprudence,²⁰ and there was no intent to change the existing law in the Mineral Code.

Once recognizing that separate horizontal servitudes may exist with respect to the same tract of land, it logically follows that use of the servitude above 3100 feet would not constitute use of the servi-

18. LA. R.S. 31:74-75 (Supp. 1974).

19. 369 So. 2d 1186 (La. App. 2d Cir. 1979).

20. See *White v. Frank B. Treat & Sons, Inc.*, 230 La. 1017, 89 So. 2d 883 (1956); *Goldsmith v. McCoy*, 190 La. 320, 182 So. 519 (1938); *Iberville Land Co. v. Texas Co.*, 4 La. App. 221, 128 So. 304 (1st Cir. 1930).

tude below 3100 feet. There must be development of each servitude to prevent prescription from running against it.

The court appears entirely correct in its holdings as to the points of law. Parties should have flexibility in creating rights in property, and there is no good reason to doubt that the Mineral Code allows for separate horizontal servitudes on a tract of land. Yet, it is no criticism of the court to acknowledge that other problems may arise in the future as a result of the approach. For example, where there are servitudes created above and below 5000 feet, suppose that drilling takes place by the owner of the servitude below 5000 feet through the servitude above it. May the owner of the upper servitude adopt the operations of the owner of the lower servitude when there was no intent to attempt to complete a well in the upper servitude? What legal effects might flow if there were multiple owners of the servitudes and one or more persons had an interest in both servitudes? The mere possibility of such problems is, of course, no reason to suggest that the court has created more difficulties than it has solved.

LEASE MAINTENANCE AND IMPLIED COVENANTS

The standard oil and gas lease in Louisiana, as in other states, provides expressly for its continuation beyond the primary term so long as either oil or gas is produced from the leased land. Two questions frequently arise in the "secondary" term of the lease with regard to this express provision. What constitutes production, or cessation of production, for purposes of continuation of the lease? Under what circumstances will compliance with the express provision of the lease be inadequate to maintain the lease as to its entirety? Cases on both issues have been decided in the past term.

The requirement of a mineral lease that there be production to continue the lease is universally interpreted to mean "production in paying quantities."²¹ In *Smith v. West Virginia Oil & Gas Co.*²² the second circuit held that a lease had terminated for failure of the lessee to maintain production in paying quantities in the secondary term. In so doing, the court may well have used an inappropriate standard to reach its decision.

The tract in question in *Smith* was about 680 acres which had been part of a much larger area leased in 1919. Although a number of wells had been drilled on the tract, only one remained in produc-

21. In Louisiana this is specifically required by statute. LA. R.S. 31:124 (Supp. 1974).

22. 365 So. 2d 269 (La. App. 2d Cir. 1978), *rev'd*, 373 So. 2d 488 (La. 1979).

tion by 1977. The lessee, West Virginia Oil & Gas, had undertaken in 1974 to secure more development by entering into a farmout agreement. By September and October of 1977, the farmoutee and his assignees had drilled four more wells capable of producing gas on the tract, but they were shut in for lack of a market. The plaintiffs demanded cancellation of the lease in December, 1977, alleging it had terminated for failure to produce in paying quantities. The trial court refused to grant a preliminary injunction restraining the company from constructing a gas pipeline on the property and from alienating gas from the property, but the second circuit held that the lease had terminated and that the defendants should be enjoined.²³

The court, in finding that the lease had failed to produce in paying quantities, considered the revenue, the costs, and a shut down of the well during 1977. The revenue for 1977 was \$593 on a volume of 6599 Mcf being sold under contract at nine cents per Mcf. Expenses for the well totalled \$1,592.07. The well was completely shut in in November, 1977, because of a gas leak, but was repaired and production resumed in March, 1978. It is not indicated in the opinion if the expenses included amounts spent to repair the leak.

Did the second circuit properly apply articles 124 and 125 of the Mineral Code? Article 124 specifies that in order to maintain a lease by production, the production must be in paying quantities.²⁴ The article states, however, that production is in paying quantities "when production allocable to the total original right of the lessee to share in production under the lease is sufficient to induce a reasonably prudent operator to continue production in an effort to secure a return on his investment or to minimize any loss."²⁵ The purpose of this is to separate the lessee who is operating prudently from the one who is sitting on the lease for speculative purposes, doing little or nothing to earn a return but denying its use to anyone else. A temporary shut down of a well for maintenance or repair does not mean that production has ceased, nor does a period in which costs exceed revenues necessarily indicate that production in paying quantities has ceased.

From the reported facts, it appears the lessee was not retaining the lease for mere speculation. It was working to repair the well and

23. *Id.* The supreme court reversed because a preliminary injunction was inappropriate as the plaintiffs had failed to establish that irreparable injury would result, and the validity of the mineral lease was not at issue in the trial of the rule for a preliminary injunction. The case was remanded to the district court.

24. LA. R.S. 31:124 (Supp. 1974).

25. *Id.*

to keep gas flowing. Four more wells, capable of producing gas, had been completed. The lessee was not standing idle, and the cessation of production here would appear to fall within the well-recognized principle of a "temporary cessation," under which a lease does not terminate.²⁶ Further, the court seems to resurrect the pre-Code approach to "production in paying quantities." The court noted that the lessor's royalty amounted to only twenty-one cents per day during 1977 and commented that, in a 1941 case, "royalty averaging less than fifty cents per day was considered not to be in paying quantities."²⁷ The comments to article 124 clearly indicate that the pre-Code approach is no longer applicable.²⁸ Article 125, which the second circuit neglected to cite or discuss, specifically states that "in applying Article 124, the amount of the royalties being paid may be considered only insofar as it may show the reasonableness of the lessee's expectation in continuing production."²⁹ It would appear, then, that the court perhaps would have reached a different result in this case had it more closely observed the pertinent provisions of the Mineral Code.

Two cases, both in the second circuit, have arisen in the past term on the subject of the obligation to develop the leased property as a prudent operator. Even though a lease may be held beyond its primary term by its express requirement of production or production in paying quantities, the lessee must undertake such other drilling and development as would a prudent operator. In other jurisdictions, the obligations of the lessee are referred to as implied covenants of the lease; in Louisiana, these obligations are found in article 122 of the Mineral Code.³⁰

To determine what a prudent operator acting in the best interests of both his lessor and himself would do, the courts of most jurisdictions have asked whether the lessor who has demanded additional development has proved the substantial likelihood of production in paying quantities from the proposed development.³¹ Since such proof is generally possible only in proven formations, most courts have recognized only an implied covenant of reasonable

26. See, e.g., *Stimson v. Tarrant*, 132 F.2d 363 (9th Cir. 1942), *cert. denied*, 319 U.S. 751 (1943); *Saulsberry v. Siegel*, 252 S.W.2d 834 (Ark. 1952); *Clifton v. Koontz*, 325 S.W.2d 684 (Tex. 1959).

27. 365 So. 2d at 274, citing *Parten v. Webb*, 197 La. 197, 1 So. 2d 76 (1941).

28. LA. R.S. 31:124 comments (Supp. 1974).

29. LA. R.S. 31:125 (Supp. 1974).

30. LA. R.S. 31:122 (Supp. 1974).

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

development and not one of "further exploration," which would, if accepted, require a lessee to undertake exploratory or speculative operations. Louisiana courts, however, have not sharply distinguished between these two but have simply required lessees to act as prudent operators. In concept, this is entirely appropriate; but, in practice, it has left each court to shape on its own the contours of conduct of a prudent operator. As a result, lessees have lost leases or portions of leases in Louisiana that probably would have continued had the property been located in other jurisdictions.

One of the two implied covenant cases considered here, *Vetter v. Morrow*,³² concerned a 385 acre lease in Red River Parish which was held beyond the primary term by production from several unit gas wells off the tract. More than 100 acres were included in units established between 1972 and 1976; after having demanded additional drilling by the defendant in May, 1977, however, the lessors brought suit in August, 1977, seeking cancellation of the lease as to 250 acres not included in the units. At trial the plaintiffs gave evidence that the westward trend of the Hosston formation indicated drilling would be profitable on the leased tract. The defendant gave evidence that a well was proposed to the north of the 250 acres and that a prudent operator would await the outcome of that well before drilling on the acreage in question. The second circuit affirmed the trial court's judgment for plaintiffs in cancelling the lease.³³

The second case, *Waseco Chemical & Supply Co. v. Bayou State Oil Corp.*,³⁴ appears to be the first reported case in the country in which a lease has been cancelled for failure of the lessee to undertake a form of enhanced oil recovery known as "fireflooding."³⁵ Although its holding has not been unanticipated,³⁶ it does break new ground in requiring a lessee to utilize technical methods of recovery still in the developmental stage and is likely to cause concern among producers in other jurisdictions.

The lease in *Waseco* covered 80 acres in the Bellevue field in Bossier Parish, a field of about 900 surface acres. The oil in the field

32. 361 So. 2d 898 (La. App. 2d Cir. 1978).

33. *Id.* at 901.

34. 371 So. 2d 305 (La. App. 2d Cir. 1979).

35. For a discussion of fireflooding and other methods of enhanced recovery, see NATIONAL PETROLEUM COUNCIL, ENHANCED OIL RECOVERY (1976); INTERSTATE OIL COMPACT COMMISSION, SECONDARY AND TERTIARY OIL RECOVERY PROCESSES (1974); ENHANCED OIL RECOVERY: SECONDARY AND TERTIARY METHODS (M. Schumacher ed. 1978).

36. Martin, *Enhanced Recovery: Institutional and Other Aspects* (presented at 24th Mineral Law Institute (1977)), reprinted in TWENTY-SIXTH ANNUAL INSTITUTE ON MINERAL LAW (1980).

is a heavy, asphaltic, high viscosity oil. When defendant Bayou State took over the lease in 1952 and 1953—it had been executed in 1934—there were about 50 wells on the 80 acres, and most of these were producing. By 1976 only nine wells were producing, at an average of about six barrels a day. In twenty-four years the defendant made no capital expenditure on the lease and drilled no wells.

On a neighboring lease, Getty Oil Co. undertook fireflood operations as early as 1963 and expanded these operations in subsequent years to other nearby or adjacent tracts. Cities Service Co. also had fireflood operations in the Bellevue field.

In fireflooding, the operator ignites a part of the oil in place and water and air are injected in the formation. The viscosity of the oil is reduced and a portion is vaporized. The oil is then driven forward to a production well by a combination of steam, hot water and gas drive. Only a very tiny percentage of all oil produced in this country is produced using fireflooding, and many of the projects using this method are regarded as experimental.

Suit for cancellation of the lease was filed by the lessors in 1977, although the court observed that demands and inquiries were made by the lessors for several years before that. The trial court held for the lessors and the second circuit affirmed.³⁷

In its opinion the second circuit looked to article 122 and relied on *Vetter* for precedent as to the duty on the lessee. It noted the extensive fireflood operations of both Getty and Cities Service in the same field and that "royalty owners under fireflood recovery receive more than \$1200 per acre per month while those under a stripper recovery receive less than \$3 per month."³⁸ Further, it discussed the fireflood operations of the defendant on another nearby lease that over time proved profitable.

As to both law discussed and facts recited by the second circuit, the *Waseco* opinion has a certain persuasiveness to it. Yet, upon closer scrutiny, this writer is left with the conclusion that the decision is deficient in several important respects.

As to the legal standard, article 122 is certainly the pertinent Mineral Code article. It requires that the lessee develop and operate the property as a reasonably prudent operator for the benefit of himself and his lessor. To establish a breach of the duty, the lessor must show by a preponderance of the evidence that development not performed would have benefited both the lessor and the lessee.

37. 371 So. 2d at 313. The Louisiana Supreme Court has denied writs. 374 So. 2d 656 (La. 1979).

38. 371 So. 2d at 312.

The fact that royalty owners on other fireflood operations receive many times as much money as those on the land in question is irrelevant to the issue of overall profitability of an operation because the lessor's royalty is completely cost-free; the royalty owner profits from any additional production even if the operator takes a tremendous loss. There is little in the *Waseco* opinion to show that the lessor proved that fireflooding would have been profitable on the acreage in question at the time when the lessee was alleged to have breached its development duty. The court completely ignored the tremendous jump in the value of oil after 1973 if it qualified for a high price category under the Emergency Petroleum Allocation Act of 1973.³⁹ There is nothing in the opinion regarding Getty's profitability in its operations, and its methods of recovery are largely confidential, *i.e.*, its knowledge on this highly sophisticated method of recovery is not generally available to other prudent operators. This is underscored by Cities Service's involvement in the field when it is noted from a recent report in the *Oil and Gas Journal*⁴⁰ that the Department of Energy is underwriting a sizeable portion of the company's cost of development because of the experimental nature of certain operations. Federal subsidization of development would hardly seem appropriate if it were clear that fireflooding in the field would be profitable to a prudent operator. The fact that federally funded development is taking place in the same field should not be used to establish that the lessee had not acted as a prudent operator; indeed, it should suggest that a prudent operator might await the outcome of experimental operations before adopting similar techniques.

Finally, it should be stated that in both *Vetter* and *Waseco*, the court's remedy, immediate cancellation of the lease, was inappropriate. In neither case was drainage of oil or gas from the lessor's property shown. What, then, was the loss to the lessor, accepting the court's determination that the lessee breached a duty to develop? The lessor may have had to wait a period of several years to enjoy income he might have had earlier had development taken place. Since he had not lost the oil, it will yet be produced; at most

39. 15 U.S.C. §§ 751-60h (1973); 10 C.F.R. § 212.54 (1979) (stripper well). The price of a barrel of crude oil has gone from about \$5 on the average in 1973 to about \$32 for "stripper well" crude and other special categories in 1979.

40. OIL AND GAS J., June 4, 1979, at 66. A Department of Energy report on the project is available. DEP'T OF ENERGY, BODCAU IN SITU COMBUSTION PROJECT (SAN/1189-2, February 1979). A 1976 report in the *Oil and Gas Journal* indicated that the number of active *in situ* combustion projects in the United States had dropped from 38 in 1970 to 21 in 1975. OIL AND GAS J., April 5, 1976, at 107. Getty's Bellevue project was described as the nation's "pacesetter."

he lost the interest that could have been earned had he invested the royalty.⁴¹ This loss could easily be satisfied by payment of damages without lease cancellation, where the lessee is given the opportunity to develop the lease. Outright cancellation is thus seen in its true light: it is punitive in character. This was especially true in *Waseco*. In *Vetter* the lessee kept at least the developed portions of the lease which had been included in units. In *Waseco* the lessee lost the production that it had been maintaining for some years.

The second circuit's application of Civil Code articles 2046 and 2047 in *Waseco* is unsatisfactory. These establish the existence of an implied resolutive condition in all commutative contracts. They pose little difficulty where the duties of the parties to the contract are express and clear and the obligation remains executory. The duties of a lessee under article 122 of the Mineral Code are not of this character in many or most circumstances, and it is generally impossible to place "matters in the same state as though the obligation had not existed," as Civil Code article 2045 specifies is the purpose of the resolutive condition. The usual remedy in other jurisdictions for breach of the duty to develop is, at most, conditional cancellation of the undeveloped portion of the lease, allowing the lessee to undertake the proposed development if he so chooses.⁴² Not only is this not allowed in *Vetter* and *Waseco*, but in *Waseco* the lessee does not even get to keep the production it was maintaining at the time of the suit. The immediate cancellation granted is a harsh remedy, more punitive in nature than an attempt to give the damaged party the benefit of the "promised" performance. Continued decisions of this sort only encourage litigation by lessors who, after all, bear no cost of development, stand to lose nothing but the cost of the litigation, and stand to reap huge benefits by having returned to them land in which the lessee has, in many instances, spent much money in exploration and development.

41. H. WILLIAMS & C. MEYERS, *supra* note 9, at § 834.

42. *Id.* Article 2047 does contain the provision that "the party in default may, according to circumstances, have a further time allowed for the performance of the condition." Professor Litvinoff has observed, as the court acknowledged in *Waseco*, that in applying this provision "the court takes into consideration the extent and gravity of the failure to perform alleged by the complaining party, the nature of the obligor's fault, the good or bad faith of the parties involved, and also the surrounding economic circumstances that may make the dissolution opportune or not." 2 S. LITVINOFF, OBLIGATIONS § 270, in 7 LOUISIANA CIVIL LAW TREATISE 509 (1975). In light of the great risks to the lessee and the lack of disincentives to demands for additional development by a lessor and the impossibility of returning the parties to the time before drilling and development under a lease, it seems to this writer that the court has improperly weighed the factors.

GAS PURCHASE CONTRACT LITIGATION

Another area of the law that has produced significant litigation in the past term is gas purchase contract problems. Such contracts are complex and are today significantly affected by federal regulation under the Natural Gas Act of 1938⁴³ and now the Natural Gas Policy Act of 1978.⁴⁴ A division between "interstate gas" and "intra-state gas" has profoundly influenced production and marketing in the past, and on "interstate gas," gas purchase contract terms have been dictated by the Federal Power Commission (recently succeeded by the Federal Energy Regulatory Commission).

Payment of Royalty; Purchase of Gas; Favored Nation Clause

The Louisiana Supreme Court issued a significant decision in one gas purchase contract case, *Hall v. Arkansas-Louisiana Gas Co.*⁴⁵ The controversy arose from a contract pertaining to the Sligo field in Bossier Parish for the purchase of gas by the defendant Arkansas-Louisiana Gas (Arkla) for a term of twenty-eight years, beginning in 1952. The agreement contained a "two party favored nation" clause in which Arkla promised that, should it purchase gas from any other seller in the field at a higher price, it would escalate the purchase price to the sellers (plaintiffs here) under the 1952 agreement to the same price. In 1961 Arkla acquired, through an assignment, a fifteen percent working interest in an oil and gas lease granted by the United States on land in the Sligo field. As a lessee under this lease, Arkla was bound to pay a royalty to the United States; the United States could elect to be paid its royalty in kind or on the basis of the fair market value attributed to its percentage of production. The government chose the latter method; and, unlike other lessors, the government had the power under the lease to specify the value of the gas for purposes of royalty computation. The value specified by the government for Arkla's royalty was higher than the purchase price paid by Arkla to the plaintiffs under the 1952 gas purchase contract. The plaintiffs brought suit claiming the royalty payment was a purchase within the meaning of the favored nation clause, thus triggering an escalation of the price. Although remanding the case for recomputation of damages, the supreme court affirmed the second circuit's affirmation of a trial court judgment for plaintiffs.

There are several troublesome aspects to the *Hall* case, but the most significant is the court's determination that a payment of

43. 15 U.S.C. §§ 717-17w (1976).

44. 15 U.S.C.A. §§ 3301-432 (1979).

45. 368 So. 2d 984 (La. 1979).

royalty, in which the lessor has the option of taking the gas in kind and the power to specify the value upon which the royalty is paid, is a purchase of gas by the lessee. If the option of taking or not taking the gas was the lessee's, the taking of gas and the paying of a royalty would seem more clearly a purchase. And if the "price" paid for that gas were set by some factor other than the determination by the lessor of the gas's value, that would lend itself to the conclusion that there had been a "purchase." But such was not the case.

Consider the dilemma of the purchaser of gas who is also a producer in similar circumstances under the court's approach. Its only choices are to pay the royalty specified by the United States, and thus trigger the escalation clause, or to give up the lease when the government demands a royalty for gas valued at a higher level than the sale price of other gas in the field, and thus lose not only the royalty gas of the lessor but also all the working interest gas. Neither of these seems a very sound choice, and it brings out the point that the election of the lessor not to take gas in kind is not a purchase of the gas by his lessee. This is not to suggest that a regulatory agency could not for some purposes treat it as a sale of gas (or oil under a similar provision in a lease) or that the parties themselves could not define it to be a purchase. The issue is whether these parties meant to treat it as a purchase for purposes of the gas purchase contract escalation clause, and it is doubtful that most people in the industry would regard it as a purchase. Accordingly, it strikes this writer as a questionable proposition. Nevertheless, the supreme court allowed recovery for damages all the way back to the time when defendant first paid the higher royalty to the United States, even though the Federal Power Commission, which had jurisdiction over the purchase price, would have had to allow the operation of the escalation clause for there to have been damage.⁴⁶ The court felt it was the defendant's fault that prevented a determination on that issue by the F.P.C. at the time of the "purchase."⁴⁷

Price Increase Under Contract: Well Commencement

In *Olinkraft, Inc. v. Gerard*⁴⁸ the plaintiff Olin was a purchaser of

46. The Federal Power Commission would allow price escalation clauses in very narrow circumstances after April 3, 1961, Order 242, 18 C.F.R. § 154.93, 27 Fed. Reg. 1356 (1962), and limited their operation in contracts in effect on June 7, 1954, Order 174-B, 18 C.F.R. § 154.94, 19 Fed. Reg. 8809 (1954).

47. The court relied on Civil Code article 2040 which provides: "The condition is considered as fulfilled, when the fulfillment of it has been prevented by the party bound to perform it." The only way in which the defendant "prevented" fulfillment of the "condition" (filing of a new rate schedule in hopes of getting F.P.C. approval of a higher rate) was failing to inform plaintiffs of the "purchase" by the defendant.

48. 364 So. 2d 639 (La. App. 2d Cir. 1978).

gas from defendant Gerard. Olin wanted additional wells drilled on property covered by a natural gas purchase contract. To get these drilled rapidly, it promised defendant an additional 13-1/2 cents per Mcf if the drilling of the two wells were "commenced (spudded) on or before December 31, 1974." One well was spudded on November 22, 1974, but the contractor for the defendant indicated he could not begin his work until a month after the December 31, 1974 deadline. After attempting unsuccessfully to get an extension from Olin, the defendant agreed with the contractor for a January 31, 1975 commencement date for the second well, but then had a water well rig drill a twenty-two-foot hole at the second well site and inserted a conductor pipe on December 31. Olin refused to pay the higher price on the grounds that the well was not commenced by December 31 because there had been no actual spudding of the well. The hole drilled by the water well rig was not, contended Olin, to be considered actual spudding. Both the trial court and the second circuit agreed.⁴⁹ With respect to leases, well commencement is generally interpreted to include actual steps at the site that are preparatory to drilling; actual spudding is not required.⁵⁰ But where the parties to a contract specify spudding to be the commencement, that should be the standard applied. The drilling of the hole by a water well rig was not the spudding of the gas well and was not even useful to the gas well. Hence, the court was correct in concluding that the requirements of the contract had not been satisfied.

Venue for Litigation Concerning Gas Purchase Contract

What is the proper venue for litigation over the terms of a gas purchase contract? That was the issue presented in *Hawthorne Oil & Gas Corp. v. Continental Oil*.⁵¹ The third circuit held that where the agreement granted not only the right to purchase gas but also the right of ingress and egress to lay pipelines and construct facilities, the agreement had multiple objects, and since the right to go on the land was a right in, to, or against immovable property, the proper venue was the parish where the immovable rights were located, not the principal place of business of the foreign corporation.⁵²

By identifying the multiple objects of the agreement, the court avoided some difficulties that might arise from other language in its

49. *Id.* at 645-46.

50. See *Allen v. Continental Oil Co.*, 255 So. 2d 842 (La. App. 2d Cir. 1971); *Breaux v. Apache Oil Corp.*, 240 So. 2d 589 (La. App. 3d Cir. 1970).

51. 368 So. 2d 726 (La. App. 3d Cir.), *rev'd* No. 64,429 (La. Nov. 1, 1979).

52. LA. CODE CIV. P. art. 80.

opinion. The court indicated that the nature of the gas purchase contract, when not considering the right of ingress and egress, is such as to create incorporeal, movable, *real* rights.⁵³ This classification may pose conceptual problems in a different context that should only be noted here.

SAND AND GRAVEL LEASES

Agreements pertaining to sand and gravel ownership and production are governed by the Mineral Code just as are oil and gas matters. However, the business is rather dissimilar, involving different production techniques and marketing arrangements; hence, the leases for sand and gravel development differ from those for oil and gas in some aspects. It is not surprising, then, that one finds litigation on points of law touching on sand and gravel leases that already appear to be well established in oil and gas lease cases.

Several points should be noted in regard to *Quality Materials of Tangipahoa, Inc. v. Labarama*,⁵⁴ a decision from the First Circuit Court of Appeal. The plaintiffs sought to dissolve a sand and gravel mining lease they had granted to Labarama. They tried first to maintain that a lease with a primary term of five years, but with indefinite continuation at lessee's option so long as the lessee maintained mining, provided however that the lessee could be inoperative for as long as 180 days, was invalid for a potestative condition. The court held this was not potestative, a point well established for similar oil and gas lease provisions.⁵⁵

A second contention of the plaintiffs was that, while the lessee could be inoperative for up to 180 days under the lease, the defendant had passed a fifteen month period with total royalty payment of only \$46.68, and this amounted to a lack of operations, thereby justifying cancellation of the lease. The court, overturning the trial court's decision, said that this was merely a question of diligent operation under the lease and low production could be excused by the lack of a market. Further, the court held that the "law does not favor cancellation of leases" and found cancellation inappropriate here.⁵⁶ As to both matters, this is a strikingly different approach from that taken by the second circuit in *Vetter*⁵⁷ and *Waseco*.⁵⁸ Why is this, and why does the court make no reference to the Mineral

53. 368 So. 2d at 735-36.

54. 361 So. 2d 1285 (La. App. 1st Cir. 1978).

55. *Id.* at 1289, citing LA. CIV. CODE art. 2036.

56. 361 So. 2d at 1290.

57. See text at notes 32-33, *supra*.

58. See text at notes 34-38, *supra*.

Code or analogous cases involving oil and gas leases? This is not to suggest the court is in error in this case but only to raise the point that there is no sound reason for the courts to be so quick to cancel oil and gas leases, yet very reluctant when a lease of a different mineral is at issue.

The third circuit was also asked to invalidate a sand and gravel lease agreement on the basis of an alleged potestative condition. In *Bullock v. Louisiana Industries*⁵⁹ the plaintiff had granted the defendant an option to take a sand and gravel lease. Suit was filed to set it aside and the defendant sought to exercise its option which plaintiff and his assignees refused to allow. The court held that the mere fact that it was an option to be exercised by the defendant did not make it a unilateral contract. The fact that the defendant was not bound to mine once it exercised the option did not make it subject to a potestative condition because rental had to be paid until there was mining and then royalty had to be paid once mining was under way. Nor did the defendant's right to terminate the lease on twenty day notice amount to a potestative condition. Each of these points has been well established for many years with respect to oil and gas leases, and one wonders why they were even carried to the court of appeal. The defendant was granted specific performance on its reconventional demand seeking to exercise its option.

Slay v. Smith,⁶⁰ also a decision of the third circuit, held that ownership of a sand and gravel lease cannot be established by parol evidence. As with the oil and gas lease, it must be in writing. However, the plaintiff was not precluded from recovering in quantum meruit for expenses and use of his trucks and equipment in operating under the oral agreements.

59. 370 So. 2d 148 (La. App. 3d Cir. 1979).

60. 368 So. 2d 1144 (La. App. 3d Cir. 1979).