Representing the Land and Mineral Owner in the Haynesville and Bossier Shales

Randall S. Davidson
Representing the Land and Mineral Owner in the Haynesville and Bossier Shales
Randall S. Davidson
Davidson, Jones & Summers
Shreveport, Louisiana

I. Introduction

According to published media and industry reports Northwest Louisiana sits atop natural gas reserves worth billions of dollars. The recession of 2008-09 knocked back natural gas prices and slowed development of the Haynesville Shale somewhat, but the prospect for future development of these resources appears very bright. This kind of economic activity generates quite a few legal issues, particularly between landowners, mineral owners and oil and gas developers. Lawyers who practice in this area should expect inquiries from their clients who own land and mineral rights about a number of legal issues. This area of the law is complex, and litigation with oil and gas companies can be very difficult, but for those lawyers who choose to represent land and mineral owners in shale developments, the prospects for legal business over the long term look very good. This paper is intended to highlight some of the issues with which lawyers will need to be familiar if they choose to represent land and mineral owners. Such a practice can be very interesting but be sure you do your homework!

II. Mineral Servitudes, Executive Rights, Mineral Royalties

A. Mineral Servitudes.

A client comes to you with what looks like a few simple questions:

Do I own the minerals under my land? Or, what is the status of mineral rights I reserved when I sold land several years ago? Or, if I don’t own the minerals, can they drill on my land anyway?

Here are some things you will need to think about:

1. One servitude or two? If your initial title review of the client’s property shows a possible outstanding mineral servitude, what is created by the grant or reservation? The first step is to review the grant or reservation language carefully. Does the instrument create one servitude or two? Be aware of contiguity issues: A mineral servitude must cover contiguous lands - if it does not you have two servitudes which are subject to prescription for non-use independently. Always check for public roads or railroads and whether they are owned in fee, i.e. not merely servitudes themselves. For example, a public road owned by a Parish which existed prior to a mineral reservation or deed covering lands on both sides of the road will divide the servitude created in the reservation or deed into two servitudes requiring drilling on both parts to interrupt prescription. See Anderson v. Police Jury of East Feliciana

- 112 -
Parish' for the effect of a common type of road dedication used by Parishes in the 1920s era when a number of public roads were built.

Mineral Code Art. 63:

A single mineral servitude is created by an act that affects a continuous body of land although individual tracts or parcels within the whole are separately described.

Mineral Code Art. 64:

An act creating mineral servitudes on noncontiguous tracts of land creates as many mineral servitudes as there are tracts unless the act provides for more.

Mineral Code Art. 65:

The division of a tract burdened by a mineral servitude does not divide the servitude.

2. What minerals are covered? Does the mineral deed or reservation cover oil, gas and other minerals? All minerals? What minerals? See Continental Group v Allison, 404 So. 2d 428 (La. 1981) (phrase “all mineral rights” in mineral reservation included right to surface mine for lignite coal but surface mining rights prescribed for non-use after 10 years (pre-Mineral Code law applied to the mineral reservation at issue.) See also, River Rouge Minerals v Energy Resources of Minn., 331 So. 2d 878 (La. App. 2nd Cir. 1976) (phrase “all other minerals” in Bath form mineral lease does not include lignite coal). See also, Arceneaux, Tom, Lignite Redux: New Technologies Ignite Interest in Lignite, 55th Annual Louisiana Institute on Mineral Law, 2008, which contains a very good summary of issues relating to coverage of mineral servitudes and leases, and conflicts between development of surface minerals and oil and gas development.

3. Are there issues of fugacious vs. solid minerals?

Mineral Code Art. 6:

Ownership of land does not include ownership of oil, gas and other minerals occurring naturally in liquid or gaseous form, or of any elements or compounds in solution, emulsion, or association with such minerals. The landowner has the exclusive right to explore and develop his property for the production of such minerals and to reduce them to possession and ownership.

Water? Sand, clay, gravel? What is covered by the instrument under review? What was the law in effect when the instrument was created?
Mineral Code Art. 4:

The provisions of [the Louisiana Mineral] Code are applicable to all forms of minerals, including oil and gas. They are also applicable to rights to explore for or mine or remove from land the soil itself, gravel, shells, subterranean water, or other substances occurring natural in or as a part of the soil or geological formations on or underlying the land.

4. Production history: If a lawyer is asked to determine the title to minerals and the surface title examination reveals mineral reservations or conveyances, it becomes necessary to check the mineral drilling and production history of the property to determine if prescription of nonuse has run on the mineral servitudes in the title, in addition to reviewing the public record title. The Office of Conservation SONRIS website has several helpful search tools in this regard.

5. Prescription:

(a) General rule: Mineral rights revert to landowners after 10 years nonuse, Mineral Code Article 27.

(b) However, see a modification of this rule for public agency transfers permitting perpetual servitudes under Mineral Code Art. 149. Mineral Code Art. 149(B):

When land is acquired from any person by an acquiring authority through act of sale, exchange, donation, or other contract, or by condemnation or expropriation, and a mineral right subject to the prescription of nonuse is reserved in the instrument or judgment by which the land is acquired, prescription of the mineral right will be considered interrupted as long as title to the land remains with the acquiring authority, or any successor that is also an acquiring authority.

The instrument or judgment must reflect the intent to reserve or exclude the mineral rights from the acquisition and must be recorded in the conveyance records of the parish in which the land is located.

(1) Article 149 goes on to provide that if part of the land subject to the mineral right and eligible for on-going interruption under the statute is divested by the acquiring authority to another who is not an acquiring authority, the mineral right is not divided but prescription of the mineral right as to the land divested commences to accrue unless it is interrupted by use of the mineral right.

(2) Article 149 also provides that if a mineral right subject to prescription has already been established (i.e. is outstanding) over land at the time it is acquired by an acquiring authority, the mineral right shall continue to be subject to prescription for nonuse. Upon the accrual of ten years non-use, the transferor of the land shall become vested with the mineral rights if (1) the instrument or judgment by which the land was
acquired expressly reserves or purports to reserve the mineral right to the transferor, whether or not the transferor actually owned the mineral right reserved, and (2) the land is still owned by an acquiring authority at the time of the accrual of prescriptions. This rule has not always been consistently applied in prior legislation. See Mineral Code Art. 149 (E).

(3) Another interesting point under Article 149: Rights or interests in land originally acquired by an acquiring authority through expropriation subject to a mineral reservation shall not be transferred by the same or subsequent acquiring authority to another who is not an acquiring authority, unless prior to the transfer the acquiring authority first offers to sell or transfer the same right or interest back to the person or his heirs or successors, from whom the right or interest was originally acquired.

(4) The text of Article 149 and its related articles were amended several times. Be sure to check the language in effect when your client's rights were created or otherwise vested. See Viator v. Tri-Parish Investors, Ltd., 618 So. 2d 36 (La. App. 3rd Cir. 1993) (mineral rights rendered imprescriptible by law could not be subjected to prescription by later statute).

(c) Interruption of prescription

(1) Mineral Code Art. 29: The prescription of nonuse running against a mineral servitude is interrupted by good faith operations for the discovery and production of minerals. The Article states that, “By good faith is meant that the operations must be: commenced with reasonable expectation of discovering and producing minerals in paying quantities at a particular point or depth, continued at the site chosen to that point or depth, and conducted in such a manner that they constitute a single operation although actual drilling or mining is not conducted at all times.” A determination of good faith drilling when the well in question results in a dry hole depends on the facts of each case. Always check the drilling permit to see what the target zone was and then research other drilling activity in the same general area. If the well was shallow (i.e. inexpensive) and there is no production in that zone in the area around your client’s land, the well may have been drilled in bad faith to interrupt prescription. See Indigo Minerals, LLC v. Pardee Minerals, LLC.2

(2) Effect of unitization: See Mineral Code Art. 33, which provides that operations conducted on land other than that burdened by a mineral servitude and constituting part of a conventional or compulsory unit including only a part of the land burdened by the servitude will, if otherwise sufficient to interrupt prescription, interrupt only as to that

2 Indigo Minerals, LLC v. Pardee Minerals, LLC 45,160 (La. App. 2nd Cir. 2010), 37 So. 3d 1122, writ denied, 2010-1669 (La. 2010), 46 So. 3d 1274 (general discussion on good-faith drilling and traditional factors used in analysis of the issue.)
portion of the servitude included in the unit, provided such operations are for the discovery and production of minerals from the unitized sand or sands.

6. Effect of unitization on unleased land owners under Nunez: For a history of compulsory unitization and its effect on individual property and contract rights and obligations, see Nunez v. Wainoco Oil & Gas Co., 488 So. 2d 955 (La. 1986) (Non-consenting owner does not have a claim for sub-surface trespass of unit well-bore drilled through non-consenting owner’s property included in the unit.) Nunez may be used as support to extend the idea that unleased land within a compulsory unit can be crossed or otherwise used in unit operation without the owner’s agreement. Is this a “Nunez Doctrine” for unleased interests? Evidently the Third Circuit may think so, when Nunez case went back on remand they held the unit operator could conduct operations on the surface of unleased lands within the compulsory unit.3

7. Correlative rights under the Mineral Code:

Mineral Code Art. 11(A):

The owner of land burdened by a mineral right or rights and the owner of a mineral right must exercise their respective rights with reasonable regard for those of the other. Similarly the owners of separate mineral rights in the same land must exercise their respective rights with reasonable regard for the rights of other owners. (Emphasis supplied.)

(a) See also Mineral Code Art. 11(B) which is a legislative effort to require a statement of mineral owner’s rights of surface use in reservations and mineral deeds:

(1) A reservation of mineral rights in an instrument transferring ownership of land must include mention of surface rights in the exercise of the mineral rights reserved, if not otherwise expressly provided by the parties.

(2) In the absence of particular provisions in the instrument regulating the extent, location and nature of the rights of the mineral owner to conduct operations on the property, the requirements of this Subsection are satisfied by inclusion of the following language in the reservation of mineral rights: “The transferor (Seller) shall exercise the mineral rights herein reserved with reasonable regard to the rights of the landowner, and shall use only so much of the land, including the surface, as is reasonable necessary to conduct his operations. Such exercise of mineral rights shall be subject to the provisions of Articles 11 and 22 of the Louisiana Mineral Code. The transferee (Buyer) recognizes that by virtue of the mineral reservation herein made, the mineral owner shall

have the right to use so much of the land, including the surface, as is reasonably necessary to explore for, mine and produce the minerals.

(b) Article 11 is the source statute for the so-called doctrine of correlative rights, i.e. the rules for disputes between surface owners and mineral owners over surface use. Two points: Mineral development usually trumps surface use. Ohio Oil Co. v. Ferguson, 213 La. 183, 34 So. 2d 746 (1947) (owner of land cannot do anything to the property which would lessen the value of a mineral servitude owner’s right to explore for and develop minerals, citing Patton v. Frost Lumber Industries, 176 La. 916, 147 So. 33 (1933)). However, if the surface owner’s existing use would be so adversely impacted that it prevents such use there is a legal basis (albeit less than clear) in Article 11 for demanding a modification of the mineral owner’s plans for development.

(c) See also, Ashby v. IMC Exploration Co. 496 So. 2d 1334 (La. App. 3rd Cir. 1986) affirmed, 506 So. 2d 1193 (La. 1987) holding that a mineral lessee’s use of land must be reasonable, but the mineral lessee was not liable for diminished value of leased property as a result of reasonable drilling operations; and Edwards v. Jeems Bayou Production Co., 507 So. 2d 11 (La. App. 2nd Cir. 1987) holding that a surface owner was entitled to damages from a lessee whose surface use was found to be unreasonable under the facts of the case.

B. Executive Rights, Mineral Royalties and Related Matters

1. Executive rights: Who may grant a mineral lease? See Mineral Code Arts. 105, 114, and 116 which provide that executive rights are the exclusive rights to grant mineral leases of specified land or mineral rights. Unless restricted by contract, executive rights include the right to retain mineral lease bonuses and rentals. It is not uncommon for instruments creating mineral servitudes owned by more than one person to reserve or grant the executive rights to one co-owner. The owner of the executive rights may lease the land or mineral rights over which he has power to the same extent and on such terms and conditions as if he were the owner of one hundred percent (100%) of a mineral servitude. A mineral lease may be granted only by a person having the executive rights in the mineral rights on the property leased. See also Mineral Code Art. 111 which describes the possibilities and effects of non-executive mineral servitudes and executive mineral royalty interests.

2. Mineral royalties vs. lease royalties:

(a) A mineral royalty is a separate mineral right subject to 10 year prescription for non-use. Mineral Code Art. 80, 85(1). Beware of instruments which transfer “royalty” interests with reference to a particular lease described in the instrument. Sometimes it can be difficult to determine which type of royalty is intended, a Mineral Code royalty or a portion of the lessor’s royalty under a lease. The same is true of mineral deeds which refer to the transfer of “royalty acres” but also have
language which indicates a transfer of mineral rights in a way which implies the intent to create a mineral servitude. If you draft or review a mineral deed or reservation before execution be sure to learn the parties’ intent and be explicit as to royalty interest or mineral servitude with executive rights.

(b) Lease royalties and overriding royalties are carved out of an oil and gas lease and terminate with the lease. Mineral Code Arts. 123, 126; Fontenot v. Sun Oil Co., 243 So. 2d 783 (La. 1971). These interests last as long as the lease from which they derive. Both types of royalty interests can be sold or assigned under Mineral Code Art. 127.

III. Common Issues for Land and Mineral Owners as Lessors Under Existing Leases

A. Points to review in an existing lease:

1. Grant and legal description: Check the granting clause and legal description carefully – what is and what is not covered? Leases are not all the same. Not surprisingly, the cases usually enforce the granting clause and most form leases use very broad language. However, errors in legal description are common and when present may be leverage in cancelling a lease or negotiating new lease terms (but check for a possible Mother Hubbard clause or obligation to correct a defective legal description).

2. Primary term extension: Check the primary term. If the lease is beyond its primary term, how has it been extended:

   (a) By production? Check the production history on SONRIS; and from your client’s royalty payment check stubs; try to ascertain if production beyond primary term has been in paying quantities (generally, sale proceeds exceed lease operating expenses and yield a “small profit”).

   (b) Extension of term by drilling operations? Check SONRIS for operations reports indicating spud dates. Beware of cases holding site preparations are “drilling operations.” See Section IV.E.3 below.

   (c) By continuous operations? Match lease provision on operations maintaining the lease with SONRIS operations information. A lease can be extended beyond its original (primary) term only by production or continuous operations. Most leases contain time periods (e.g. 60, 90 days) which govern how long the lessee can permit the well holding a lease to be non-producing without operations to restore production or drill another well. Check SONRIS for gaps in the reported production history which exceed the time permitted under the lease and operations reports indicating reworking or recompletion dates.

   (d) Check the lease to see if it contains a Pugh clause or depth limitation provision which would release at least some of the lease after
primary term and when such provisions are triggered (i.e. end of primary term, and of continuous operations, a set date in future etc.)

(e) Leases can and frequently do cover non-contiguous tracts; absent lease provisions like a Pugh clause production from or operations on any part of the lease extend all of the lease Mineral Code Art. 114. But, see lease division discussions below.

B. If the lease is held by shallow production without a depth release, how does your client get his deep rights released or developed? Some things to check:

1. Lease division – pre v. post Mineral Code:

Mineral Code Art. 130:

A partial assignment or partial sublease does not divide a mineral lease.

The comments reflect that parties can contract around this Article.

(a) While the comments to Article 130 state that the intent of the article was “to preserve what is understood to be established law,” the pre-Codal cases cited in the comments reflect that a partial assignment with certain language renders a mineral lease divisible. See Tyson v. Surf Oil Co., 195 La. 248, 196 So. 336 (1940), holding that partial assignment of mineral lease with the following language renders the lease divided:

If the estate of either party hereto is assigned, and the privilege of assigning in whole or in part is hereby expressly allowed, the covenants hereof shall extend to their heirs, executors, administrators, successors, or assigns, but no change in ownership of the land or assignment of rentals or royalties shall be binding on the lessee until after the lessee has been furnished with a written transfer or assignment, or a true copy thereof; and it is hereby agreed in the event this lease shall be assigned as to part or as to parts of the above described lands and the assignee or assignees of such part or parts shall fail or make default in the payment of the proportionate part of the rents due from him or them, such default shall not operate to defeat or affect this lease in so far as it covers a part or parts of said lands upon which said lessee or any assignee thereof make due payment of said rental.

195 La. at 271-272, 196 So. at 334 (Emphasis supplied.)

(b) The significance of lease division issues:

There are a lot of pre-Mineral Code leases covering significant tracts of land which do not contain Pugh clauses or similar provisions. If part of such a lease is held by production the entirety of the lease will be maintained unless the lease was at some point divided by assignment under the rule announced in Tyson. If the lease is divided each part must be maintained separately by drilling or production, thus lease division
can be a tool to free land from old leases which are not paying royalty to the landowner.

(c) General Rules Governing Divisibility of Leases.

(1) In reviewing the issue of divisibility for older pre-Mineral Code leases, it is important to apply the law and jurisprudence in effect prior to the adoption of the Louisiana Mineral Code. The law existing at the time a lease was signed is incorporated into and forms a part of the contract as though expressly written therein. *Green v. New Orleans Saints*, 2000-0795, *6 (La. 2000), 781 So. 2d 1199, 1203; *Dantoni v. Bd. of Levee Comm'rs*, 227 La. 575, 582, 80 So. 2d 81, 83 (1955). If the lease under review was divided under pre-Code jurisprudence, the lessee's rights in the outside undeveloped acreage may have terminated and re-vested in the land or mineral owner(s). To the extent the Mineral Code varies from prior law, the Code cannot be applied retroactively to disturb the vested rights of landowners and their predecessors. Mineral Code Art. 214.

(2) Before the Mineral Code was adopted, the established rule was that a mineral lease may be rendered divisible by contract. *Noel Estate v. Murray*, 223 La. 387, 391-92, 65 So. 2d 886, 887-88 (1953); *Roberson v. Pioneer Gas Co.*, 173 La. 313, 316, 137 So. 46, 47 (1931); *Swope v. Holmes*, 169 La. 17, 21, 124 So. 131, 132 (1929). The Mineral Code has carried forward this rule. Although Article 130 of the Code provides that mineral leases are generally not divided by sublease or assignment, the Code further provides that parties are free to vary the codal rules by contract. The comments to Article 130 recognize that these articles carry forward the pre-Code rules allowing for divisibility of leases to be provided by contract. 4

(3) The question of whether a mineral lease is divisible is therefore a matter of contract interpretation. One type of clause that makes a lease divisible was explained by the Second Circuit in *Odom v. Union Producing Co.*, 129 So. 2d 530 (La. App. 2nd Cir. 1961):

Practically every modern oil and gas lease has several provisions under which the lessee, at its option, may divide the lease; perhaps the oldest and most common is the provision that the lease may be assigned in whole or in part, and in the event of assignment as to a segregated portion of the land, default by one leasehold owner will not affect the rights of any other.

4 See Article 130, comment, stating: “There are several cases dealing with partial assignments of leases containing a clause permitting assignment in whole or in part and providing that in the case of a partial assignment failure of an assignee to make payment of his proprionate part of the rentals will not result in termination as to the remainder of the lease…. In all of these, the court has held that such a clause makes a lease divisible so that when there is a partial assignment, there are two leases with different sets of rights and obligations between lessor and lessee … . It is, therefore, the intent of Article 130 to preserve what is understood to be established by law.” (citations omitted).
129 So. 2d at 535. Thus, a clause providing for the mutual exculpation of the transferee and the transferor from the effects of each other's defaults indicates a lease is divisible. Id.

(4) Such an exculpatory clause was at issue in one of the earliest cases to find a mineral lease divisible, Swope v. Holmes, 169 La. 17, 124 So. 131 (1929). In Swope, the issue was whether a lessor could obtain partial cancellation of a 2,500-acre mineral lease as to 440 lease acres assigned by the lessee to another party. The court held that failure of the production on the 440 acres was enough to cancel the lease as to that acreage. In holding the lease “divisible” by assignment, the Swope court explained:

What makes the contract of lease a divisible one is the following provision:

'It is hereby agreed that in the event this lease shall be assigned as to part or as to parts of the above described lands, and the assignee or assignees of such part or parts shall fail or make default in the payment of the proportionate part of the rents due from him or them, such default shall not operate to defeat or affect this lease in so far as it covers a part or parts of said lands upon which said lessee or assignee thereof shall make due payment of said rental.'

169 La. at 132, 124 So. at 21 (emphasis added). Thus, the key term that created divisibility was the clause providing that a lessee's default on one portion of the assigned lease would not affect the other portion.

(5) Following Swope, divisibility was found in Roberson v. Pioneer Gas Co., 173 La. 313, 137 So. 46 (1931). Relying on Swope, the Roberson court concluded that the following lease language made the mineral lease divisible:

If the estate of either party hereto is assigned – and the privilege of assigning in whole or in part is hereby expressly allowed – the covenants hereof shall extend to their heirs, executors, administrators, successors, or assigns; but no change in ownership of the land or assignment of rentals or royalties shall be binding until after the lessee has been furnished with a written transfer or assignment, or a true copy thereof; and it is hereby agreed that the event this lease shall be assigned as to part or as to parts of the above described lands, and the assignee or assignees of such part or parts shall fail or make default in the payment of the proportionate part of the rents due from him or them, such default shall not operate to defeat or affect this lease in so far as it covers a part or parts of said land upon which said lessee or assignee thereof shall make due payment of said rental.
Again, the language that created divisibility was a provision mutually exculpating the assignee and the assignor from the effects of each others’ defaults. Because the lease was divisible, the Roberson court held that production obtained on the assigned portion of the lease could not hold the lease as to the portion retained by the lessee.

(6) The holdings of Swope and Roberson that equate exculpation with divisibility are consistent with current codal authority distinguishing divisible and indivisible obligations. See LA. CIV. CODE arts. 1815-1820. Excusing the lessor and his transferee from the effect of defaults on each others’ lease acreage is inconsistent with the liability of multiple obligors on an indivisible obligation under the Civil Code. The Civil Code treats multiple obligors of an indivisible obligation, including successors of the original obligor, as solidary obligors. “An indivisible obligation with more than one obligor or obligee is subject to the rules governing solidary obligations.” LA. CIV. CODE Art. 1818. “An indivisible obligation may not be divided among the successors of the obligor or of the obligee, who are thus subject to the rules governing solidary obligors or solidary obligees.” LA. CIV. CODE Art. 1819 (emphasis added). Obviously, a lease term that relieves an original lessor from any obligation whatsoever on the assigned portion of the lease cuts off solidarity and makes the obligation divisible.

(7) It should be emphasized, however, that mutual exculpation clauses are not the only lease terms that show divisibility. As the Second Circuit noted in Odom, supra, such clauses are one of “several provisions” allowing division of a mineral lease. 129 So. 2d at 535. For example, in Johnson v. Moody, 168 La. 799, 123 So. 330 (1929), a mineral lessee subleased a portion of his lease acreage to a sublessee, who timely drilled and produced the sublease acreage. The Supreme Court held that the mineral lessee forfeited the lease as to the retained acreage when it did not drill on the retained acreage after the sublessee's discovery of oil. The court noted there were “provisions in the contract showing that the lease was not indivisible, and might be forfeited as to a part only of the land.” 168 La. at 801, 123 So. at 330.

(8) Likewise, in Stacy v. Midstates Oil, 214 La. 173, 181, 36 So. 2d 714, 716-17 (1948), the Supreme Court held that a lessee's transfer of a portion of a lease divided the lease even though the lessee had reserved an overriding royalty interest royalty interest in the transferred property. The lessee argued that the override reservation indicated the transaction was a sublease. In its initial opinion the court ignored the reservation, however, noting that the transfer gave the transferee the power to forfeit the lease as to his transferred portion. Based on this forfeiture power, the court treated the lessee's transfer as an assignment and held that that the transaction divided the lease. In Stacy, the court's first opinion...
considered an exception of no cause of action and held that the plaintiff had stated a cause of action for division of a mineral lease by pleading that the lessee had transferred a partial interest in a lease and by pleading the transfer instrument contained a clause granting the transferee the power to release or forfeit the lease. On rehearing, the court found that the plaintiffs' petition had not adequately pled that the lease was divisible according to its own terms, and dismissed the case. The plaintiff refiled, leading to Bond v. Midstates Oil Corp., 219 La. 415, 53 So. 2d 149 (1951). In Bond, the Supreme Court reviewed the instruments attached to the plaintiffs' petition, apparently determined that the lease provided for division only in the event of "assignment," and dismissed the petition because the retention of an overriding royalty interest made the transfer a "sublease" instead of an assignment. The Court also found it significant that the power to forfeit was hedged by an "added protection" granting the transferor the right to an override in any new leases. It does not appear that either the Stacey rehearing or the Bond decision rejected the notion set forth in the original Stacey opinion that granting a transferee the power to forfeit his portion of the lease supports divisibility.

(9) Johnson and Stacy seem to stand for the proposition that a lease may be rendered divisible by provisions that grant a sublessee or assignee the power to release or forfeit lease rights as to his subleased/assigned acreage. These two cases, along with the exculpation clause holdings in Swope and Roberson, were clear pronouncements of the Louisiana Supreme Court, and they formed a part of the background law incorporated into pre-Mineral Code leases. Accordingly, they should govern the interpretation of such leases today. If a lawyer is advising a land or mineral owner whose interest is burdened by an older lease which the client desires to terminate, the lawyer should carefully review the clauses of the lease regarding transfer of interest and check all recorded assignments of the working interest in the lease to determine if a lease division argument is available. For pre-Mineral Code leases one can reasonably take the position that the case law prior to 1975 was that assignments (and at least some subleases) in fact divided leases which may result in expiration of the undeveloped portions of the lease. Be aware of the cases which treat subleases differently but also more recent cases which point out that even an instrument called a sublease or which contains a reservation of an overriding royalty interest can evidence an intent to create an assignment and should be treated as an assignment.5

2. Using the implied duty to explore and develop under Article 122:

(a) Louisiana Mineral Code Article 122 provides the basis for the implied duty of a lessee to explore for and develop minerals:

5 E.g. Dore Energy Corp. v. Carter-Langham, Inc. 2008-645 (La. App. 3rd Cir. 2008), 997 So. 2d 826
A mineral lessee is not under a fiduciary obligation to his lessor, but he is bound to perform the contract in good faith and to develop and operate the property leased as a reasonably prudent operator for the mutual benefit of himself and his lessor. Parties may stipulate what shall constitute reasonably prudent conduct on the part of the lessee.

The comments to this Article suggest the following implied duties have been recognized by Louisiana courts:

- The obligation to develop known mineral producing formations in the manner of a reasonable, prudent operator;
- The obligation to explore and test all portions of the leased premises after discovery of minerals in paying quantities in the manner of a reasonable, prudent operator;
- The obligation to protect the leased property against drainage by wells located on neighboring property in the manner of a reasonable, prudent operator; and
- The obligation to produce and market minerals discovered and capable of production in paying quantities in the manner of a reasonable, prudent operator. Additionally, the obligation of the lessee to restore the surface of the lease premises on completion of operations may be viewed as a part of this general standard.

Mineral Code Art.122, comments (West 2000). The duty to develop minerals and the duty to explore for them are interrelated but distinct; the former assumes that a geologic interval has been discovered as productive of minerals near, on or under a leased property but that the lessee is not taking adequate steps, if any, to develop them, while the latter assumes that a certain geographic area or geologic interval is being produced but that there may be other areas or intervals that may be productive which need be explored.

(b) As a practical matter, mineral lessors frequently make demand on their lessees for both. For example, in the context of the Haynesville Shale formation, large parts of Northwest Louisiana have being drilled to the Haynesville and are producing natural gas. A mineral lessor's land may be located in a general area of Haynesville Shale development. In such a case, the lessor would ask that its lessee develop his land for shale development to the extent the lessor believes it to be present as indicated by other drilling activity, or, in the alternative, to explore the leased property to see if it is productive there.

(c) An interesting twist to development with regard to shale formations arises from the public comments by operators indicating the typical shale lateral completion will drain only about eighty (80) acres. The units permitted so far by the Louisiana Office of Conservation (LOC) are based on six hundred forty (640) governmental sections. Once
unitized and the unit well completed, do mineral lessors have the right to demand drilling of alternate unit wells to fully develop the gas reserves in each section? Article 122 appears to permit such a demand, but there is as yet no case law on this point. The economic effect of delaying development on royalty owners is huge. Some Haynesville operators are drilling alternate unit wells and several others have made public statements regarding their intent to do so. Is this evidence of an emerging reasonably prudent operator standard applicable to unit development? See Section VI.C below.

(d) Remember to give notice to the lessee: Unlike some duties or obligations, a mineral lessor must give notice to its lessee of the breach to further explore and develop before filing suit for damages or dissolution. Mineral Code Article 136 provides, in pertinent part, as follows:

If a mineral lessor seeks relief from his lessee arising from drainage of the property leased or from any other claim that the lessee has failed to develop and operate the property leased as a prudent operator, he must give his lessee written notice of the asserted breach to perform and allow a reasonable time for performance by the lessee as a prerequisite to a judicial demand for damages or dissolution of the lease.

The sufficiency of notice is often the subject of dispute. For example, in Taussig v. Goldking Properties Co., 495 So. 2d 1008 (La. App. 3rd Cir. 1986), the Third Circuit found that a demand for a release because of a lack of development or exploration was not sufficient to constitute a demand for development under Article 136. A host of other issues, old and new, have arisen in this regard:

(1) Recently, the Louisiana Supreme Court has addressed the often confusing notice and demand requirements of the Louisiana Mineral Code. In Broussard v. Hilcorp Energy Co., 2009-0449 (La. 2009), 24 So. 3d 813, the court found that Article 136 applies to two (really three) scenarios: drainage and “development or operation.” Thus, in Broussard, the court found no requirement to make demand for remediation. Id. at 820. Unfortunately, the court did not decide specifically if “further exploration” is within the general ambit of “development,” although it noted that the word “develop,” when used in the oil and gas industry, “contemplates any step taken in the search for, capture, production and marketing of hydrocarbons.” Id. (emphasis added) (quoting Patrick H. Martin & Bruce M. Kramer, Williams & Meyers: Manual of Oil and Gas Terms, p. 272 (%0th ed. 1997)).

---

6 A strict reading of Article 136 would allow a suit merely seeking specific performance without prior demand, although, practically speaking, mineral lessors under older, lower royalty leases frequently desire dissolution as opposed to performance.
(2) Another question concerning notice is whether failure to provide prior notice raises the peremptory exception of no cause of action or the dilatory exception of prematurity. The Second Circuit in *McDowell v. PG&E Resources Co.*, 26,321 (La. App. 2nd Cir. 1995), 658 So. 2d 779, *writ denied*, 95-1847 (La. 1995) 661 So. 2d 1382, found that Article 136 demand is required and, without a formal putting in default, "no cause of action is disclosed." *Id.* at 783 (citing *Pipes v. Payne*, 156 La. 791, 101 So. 144 (1924)). The court's reliance on the pre-Mineral Code *Pipes*, however, may have been misplaced, as *Pipes* was applying the Civil Code provisions regarding "default" (not Article 136), which have since been heavily revised. The comments to Louisiana Civil Code Article 1989 and Mineral Code Article 136 state that these changes were not a repeal of default provisions contained in the Mineral Code. Interpreting Article 136 as a non-waivable demand requirement may require more analysis by the courts; failure to comply with other demand or notice requirements elsewhere required by law have been treated as a dilatory issue, not a peremptory issue. See e.g. White v. St. Elizabeth B.C. Board of Directors, 43,329, *3* (La. App. 2nd Cir. 2008), 986 So. 2d 202, 204, *writ denied* 2008-1440 (La. 2008), 993 So. 2d 1284.

(3) Similarly, but perhaps less persuasive, the Louisiana Code of Civil Procedure's has rejected pleading specific relief. La. C. Civ. Pro. Art. 862. Because the Louisiana Mineral Code provides for a particular situation in Article 136, it would prevail over other laws which would have been otherwise applicable. La. Rev. Stat. 31:2. At least one court, *Kyle v. Wadley*, 24 F. Supp. 884, 887-888 (W.D.La. 1938), applying pre-Mineral Code law, rejected *Pipes*. However, one can imagine the scenario in which a mineral lessor has failed to give notice or adequate notice to its lessee, and the lessee, for whatever reason, wishes to waive written demand and proceed with having a court decide the issue. A court applying the *McDowell* case could then ignore the agreement of the parties, notice the exception, and dismiss the suit. La. C. Civ. Pro. Art. 927(B).

(e) Criteria for prudent operations in the context of demands for additional development: The limited modern jurisprudence concerning the implied duty of a lessee to explore for and develop minerals under a mineral lease has enunciated six criteria to examine in determining

---

8 (Defendants failed to comply with La. Rev. Stat. 12:237(B) by giving prior notice of a meeting, which "must be transmitted to the members [of a nonprofit corporation] not less than thirty days prior to the meeting).
9 The Louisiana Code of Civil Procedure was enacted in 1960, and the Louisiana Mineral Code was enacted in 1974.
10 For a brief history of the concept of default, see *Broussard v. Hilcorp*, supra.
whether a lessee has acted as a prudent operator in developing and exploring the leased premises:

(1) Geophysical data;
(2) Number and location of the wells drilled both on leased lands and adjoining property;
(3) Productive capacity of producing wells;
(4) Costs of drilling operations as compared with profits;
(5) Time interval between completion of the last well and the demand for additional operations; and
(6) Acreage involved in the disputed lease.

Vetter v. Morrow, 361 So. 2d 898 (La. App. 2nd Cir. 1978) (en banc). The criteria used in Vetter, which have been repeated in jurisprudence, has been the subject of scholarly critique. Professor Harrell noted that Vetter "uncritically" cited "a student article in the Tulane Law Review" to provide "mechanical factors one could use" in analyzing a development case. Thomas A. Harrell, A Mineral Lessee's Obligation To Explore Unproductive Portions Of The Leased Premises In Louisiana, 52 La. L. Rev. 387, fn. 5 (1991). However, the Vetter court couched its factors with the premise that "jurisprudence has usually considered" them, which is arguably non-mechanical. Vetter, supra.

(f) In some situations, lessees take a guarded approach to discovery based on the Vetter factors. For example, many lessees consider geological data, costs, and internal profits to be irrelevant, confidential and proprietary, and will resist disclosure of these matters. This raises a series of unanswered questions:

(1) Does a lessor need expert testimony to prove the "geology"? In a pure "development" case, is factual evidence of unitization, drilling and production in the area around the leased property by other, presumably prudent operators enough to make a prima facie case? In an "exploration" case, the facts may be that there is little information from other drilling activities, such that direct evidence may be non-existent. In the shale developments in Northwest Louisiana, at least in several parishes where the productive zones have been shown to be laterally continuous, there seems little room left for a lessee to argue that the shale

---

11 Cf. Noel v. Amoco Production Co., 826 F. Supp. 1000 (W.D. La. 1993), finding that the Vetter decisions do not apply to exploration duty cases (fn.22) but applied the Vetter factors anyway. While the Vetter court found that the lessee breached its duty to "develop" the leased property, it frequently combined the "development" and "exploration" duty. See Vetter, at 899-990 ("To fulfill his duty under the law a lessee has the obligation to develop known mineral producing formations in the manner of a reasonable, prudent operator and to explore and test all portions of the leased premises after discovery of minerals in paying quantities in the manner of a reasonable, prudent operator").
zones are not present and economically viable and expert testimony would not add much that is not evident on the ground.

(2) Does an objection to the discovery of information directly related to one of the *Vetter* factors warrant the lessor-plaintiff being relieved of the obligation to “prove” it? To illustrate this issue, suppose a lessor wanted information related to the average cost and average profit of a well for a certain producing formation in a suit concerning the failure of its lessor to develop that formation. This would seem like important information (at least to lessor’s counsel): If the profit margin in a given area for a certain formation is too low, a lessee would more likely be found prudent in not developing; if the profit margin in a given area for a certain formation is sufficiently high, a lessee would be more likely found imprudent in not developing. If the mineral lessee objects that such economic information is irrelevant, it would appear logical that the lessee should be held by the court to concede that profit-margin is irrelevant, *i.e.* it would not be a factor in determining what a prudent operator would do regarding additional development.

(g) The pending suit and the “suspension doctrine”: In response to a development demand suit, mineral lessees will frequently assert that obligations under the lease are suspended during the period of time the lessor is asserting the lease has terminated or should be cancelled for a default by the lessee. The last Louisiana Supreme Court case concerning this so-called “suspension doctrine” is *Baker v. Potter*, 223 La. 274, 65 So. 2d 598 (La. 1952). *Baker* explained the rule as follows:

> It has been decided, with regard to oil and gas leases, that, if the lessee is prevented by a lawsuit from beginning operations within the time stipulated, he is entitled to an extension for the time of such hindrance, if he is successful in the lawsuit.

223 La. at 284, 65 So. 2d at 601 (quoting *Williams v. James*, 188 La. 884, 178 So. 384, 386 (1938)). The *Baker* court further explained that the logic behind an extension “is that the lessee has been deprived of his exercise of the rights granted to him by the lease by the act of the lessor in having filed and prosecuted the lawsuit against him ....” 223 La. at 285, 65 So. 2d at 601.

The following are some questions concerning the “suspension doctrine” which to my knowledge no recent appellate court has addressed:

(1) Whether the “suspension doctrine” survived the enactment of the Mineral Code. For a pre-Mineral Code rationale of this argument see *Tyson v. Surf Oil Co.*, 195 La. 248, 268-269, 196 So. 336, 343 (La.1940) (“Having declined to enact laws for the regulation of the oil industry and, particularly, having declined to adopt a Mineral Code, the Legislature has placed the stamp of approval upon the system of interpretation of oil and gas contracts which this court has followed for so many years”). The
legislature adopted a Mineral Code in 1975 which did not include a “suspension doctrine” arising automatically when suit is filed.

(2) Whether the doctrine should apply in a development demand case where the lessor is seeking enforcement of the lease rather than a declaration the lease was void from the outset.

(3) Whether a lessee has an affirmative burden to show it has been prevented by the suit to drill or produce. For a rationale of this argument see Baker, 65 So.2d at 601 (“The logic on which the action of the court in granting the extention [sic] in cases of this kind is based, is that the lessee has been deprived of his exercise of the rights granted to him by the lease by the act of the lessor in having filed and prosecuted the lawsuit...”), and Fomby v. Columbia County Development Co., 155 La. 705, 99 So. 537, 542 (1924) (“By filing and prosecuting these suits, plaintiffs have made it utterly impracticable for the assignees of the lessee to exercise the rights granted by the leases. Having made it thus impracticable by their own acts, plaintiffs are not in position to contend that the leases have expired”). If a lessee is not prevented from drilling by the complaining lessor, should the “suspension” argument be available to the lessee?

(4) Whether invocation of the “suspension doctrine” is warranted before the lessee prevails in a lawsuit by which it was (arguably) prevented from drilling or producing. For a rationale of this argument see Baker, 223 La. at 284; 65 So. 2d at 601, “There is no reason why the lessor should be allowed to deprive the lessee of a part of the term of his lease by withholding possession of the leased premises without just cause. It has been decided, with regard to oil and gas leases, that, if the lessee is prevented by a lawsuit from beginning operations within the time stipulated, he is entitled to an extension for the time of such hindrance, if he is successful in the lawsuit.” (Emphasis supplied)

(5) Whether the “suspension doctrine” applies to a suit filed after the primary term of the lease at issue has terminated. See, e.g., Hanszen v. Cocks, 246 So. 2d 200, 204 (La. App. 1st Cir. 1971).

(6) Can the “suspension doctrine” be converted into an evidentiary rule such that a lessee can move to exclude evidence, such as other drilling activity in the area of the lease in dispute after suit is filed, on a theory that the lessee’s obligation to drill after suit is suspended and thus other drilling post-suit is not relevant to a prudent operator determination pre-suit? To illustrate, if there were six Haynesville units formed in the same township as the leased lands in dispute before demand for additional development was made, and twenty more were formed in the township by the time of trial, should the court exclude evidence of twenty (20) units in the same township and decide the “prudent operator” issue on only evidence of six (6) units? I submit there is no authority supporting the conversion of an equitable remedy intended to apply to
the primary term of a lease to an exclusionary rule of evidence. The best "evidence" of a prudent operator is what other operators are actually doing, and courts should not ignore evidence of that, pre- or post-petition.12

(h) If a lessee refuses the demand for development and asserts defenses when sued, at what point does the lessor's right to lease cancellation vest? Said another way, can a lessee wait until trial of a demand for development to announce its plans to drill a well on the disputed lease or a unit including the lease? Art. 122 does not provide a clear answer, but it seems unfair that a lessor can be put to so much trouble and expense to obtain only the late and grudging agreement of his lessee to begin additional development. I would argue there must be some point at which the lessee has breached its obligation.

(i) This is by no means an exclusive list of questions which remain open under Article 122 as applied to demands for development. One thing more about this topic should be stated. The relative bargaining power of lessors and lessees in mineral lease negotiation and performance is decidedly one-sided in favor of the lessee. Article 122 is one of very few tools a lessor can use to require development of its minerals. The courts should bear this in mind when considering how open questions under Article 122 should be decided. If the cases allowing leases to be extended by relatively low rates of production under the "paying quantities" test are followed in the future, Article 122 will remain one of the few rights given to lessors to obtain development of their minerals under old leases which are years past primary term. It is difficult to explain to a lessor how a ten or twenty year old well which pays the lessor less than $100 per month in royalties can maintain the lessor's lease in effect indefinitely without additional development of formations which might pay the same lessor royalties of $10,000 a month or more (such as the Haynesville Shale), yet this is the case with many land and mineral owners subject to older leases.

(j) For more on this issue, see the excellent analysis found in: Thomas A. Harrell, A Mineral Lessee's Obligation to Explore Unproductive Portions of the Leased Premises in Louisiana, 52 La. L. Rev. 387 (1991). More recently, see also Reasons for Judgment in Santo Ferrara et ux v. Questar Exploration and Production Company, et al., No. 69590, 42nd JDC, DeSoto Parish, Louisiana (currently on appeal to the 2nd Circuit.) Judge Adams Reasons for Judgment are cited only as a well-written explanation of how Article 122 should be applied, in his view, to the facts at issue in the Ferrara case; time will tell what the final result in the case will be.

12 Unitization and drilling post-petition would likely be circumstantial evidence pertaining to the "geological date" criterion.
3. Other lease cancellation issues:

(a) The oil company did not pay me enough bonus! See Cascio v. Twin Cities Development, LLC, 45,634 (La. App. 2nd Cir. 2010), --- So. 3d ----, 2010 WL 3666323, holding that a claim for error as to the object of a mineral lease, based upon the scope and potential value of the Haynesville Shale, does not rise to the level of substantial quality that would vitiate consent and is synonymous to a claim for lesion, which is not permitted under the Mineral Code.

(b) The lease at issue does not include adequate provisions for material elements of a mineral lease:

(1) Johnson Special Trust v. El Paso E & P Co., L.P., No. 10-0016 (W.D. La. 2010) 2010 WL 3076193. On Rule 12(b) (6) motion to dismiss for failure to state a claim, the court originally rule a complaint which claimed that a standard Bath Form lease executed in 1950 was unclear or ambiguous as to whether it would cover deeper or then-"inaccessible" geological formations, adequately stated a claim. On February 24, 2011, the court reconsidered its opinion and ruled that a lease of "lands" without any depth limitation unambiguously covered all depths.

(2) Adams v. JPD Energy, Inc., 45420 (La. App. 2nd Cir. 2010), 46 So. 3d 751, writ denied, 2010-2052 (La. 2010), 49 So. 3d 892. In a dispute over the validity of an oil and gas lease the trial court applied Civil Code contract analysis concepts to the lease and cancelled it because of a failure of the parties to agree on the royalty fraction, which the court held was a key element of a lease analogous to rent under a predial lease. Defendants argued on appeal the lease should be reformed, not cancelled. The 2nd Circuit affirmed, and the Louisiana Supreme Court denied writs in November, 2010.

(c) Is it possible to prove abandonment of a lease by acts of the lessee which indicate an intent to do so? See, e.g. Martel v. Jennings-Heywood Oil Syndicate, 114 La. 351, 38 So. 253 (La. 1905); Brown v. Ware, 11 La. App. 216, 123 So. 2d 501 (La. App. 2nd Cir. 1929). What about an intention to novate? See Placid Oil Co. v. Taylor, 325 So. 2d 313 (La. App. 3rd Cir. 1976). For a discussion of possible elements for an abandonment claim see, Taussig v. Goldking, 495 So. 1008 (La. App. 3rd Cir. 1986); Powell v. Cox, 92 So. 2d 739 (La. App. 2nd Cir. 1957); Bickham v. Bussa, 152 So. 393 (La. 2nd Cir. 1934).

4. Lease ratification as a defense to lease cancellation:

(a) The argument is often advanced by lessees that signing a Division Order (DO) or acceptance of subsequent royalty payments cures a default under a lease. Ratification is used to support a position asserting the continuing validity of a lease which had an interruption in production and no continuous operations sufficient to result in cancellation of the

- 131 -
lease but the lessor signed a division order or accepted royalty payments after the gap in production.

(b) There is a case holding there is no ratification if the recipient of royalty had no knowledge of a prior default. See Wilcox v. Shell Oil Company, 226 La. 417, 76 So. 2d 416 (1954) which held lessors were not estopped from claiming lease termination after signing a division order and acceptance of royalty checks when there is no showing that lessors knew of the existing facts warranting lease termination. See also Pierce v. Atlantic Refining Co., 140 So. 2d 19, 23 (La. App. 3rd Cir. 1969).

(c) Keep in mind that even unleased owners have a right to be paid from production on their property or attributable to their property by compulsory unitization, in some cases without deduction of costs. See also, La. Civ. Code Art. 1861, “An obligee may refuse to accept a partial performance. Nevertheless, if the amount of an obligation to pay money is disputed in part and the obligor is willing to pay the undisputed part, the obligee may not refuse to accept that part. If the obligee is willing to accept the undisputed part, the obligor must pay it. In either case, the obligee preserves his right to claim the disputed part.”

(d) DOs are agreements used to verify interests in production; oil companies want everyone including royalty owners to sign a DO. They will often refuse to pay until a DO is signed. Many DOs have provisions which warrant that the lessor’s/royalty owner’s mineral lease is still in effect, giving rise to a possible lease ratification argument if the lessor signs a DO to get paid, Wilcox notwithstanding. If there is doubt about the continuing effectiveness of a lease the lessor should not sign a typical DO. See Mineral Code Art. 138.1 C which states execution of DO may not be used as a condition precedent to royalty payments, which gives a possible right to payment without a DO. Additionally, Article 138.1 B provides that a DO may not alter or amend the terms of a lease, and is “invalid to the extent of the variance....”


(f) Additionally, what about the statutory duty imposed on the lessee to notify the lessor of lease termination? See La. Rev. Stat. 30:102.

5. Failure to pay royalties: This can become grounds for lease cancellation (Article 136 of the Mineral Code) but note the necessity for

---

demand, and the lessee's cure rights under Articles 137, 138, 139 and 140 the Mineral Code.\textsuperscript{14}

(a) Your client's royalties are suspended – how do you get payments released? Check with the lessee for title questions, curative rights. Solving this problem requires the careful review of title and production history.

(b) Your client's lessee does not participate in the well generating production revenue; what is the effect on your client's royalty? This appears to be an open question in Louisiana; other states, e.g. Oklahoma, require royalties to be paid to lessors. La. R.S. 30:10 appears to require the operator to pay the non-consenting lessee's royalties, but see Gulf Explorer, L.L.C v. Clayton Williams Energy, Inc., 2006-1949 (La. App. 1st Cir. 2007), 964 So. 2d 1042, which held to the contrary. In this author's opinion, Gulf Explorer is a flawed decision and should be overruled.\textsuperscript{15}

\textsuperscript{14} Mineral Code Art. 137:

\begin{quote}
If a mineral lessor seeks relief for the failure of his lessee to make timely or proper payment of royalties, he must give his lessee written notice of such failure as a prerequisite to a judicial demand for damages or dissolution of the lease.
\end{quote}

Mineral Code Art. 138:

\begin{quote}
The lessee shall have thirty days after receipt of the required notice within which to pay the royalties due or to respond by stating in writing a reasonable cause for nonpayment. The payment or nonpayment of the royalties or stating or failing to state a reasonable cause for nonpayment within this period has the following effect on the remedies of dissolution and damages.
\end{quote}

Mineral Code Art. 139:

\begin{quote}
If the lessee pays the royalties due in response to the required notice, the remedy of dissolution shall be unavailable unless it be found that the original failure to pay was fraudulent. The court may award as damages double the amount of royalties due, interest on that sum from the date due, and a reasonable attorney's fee, provided the original failure to pay royalties was either fraudulent or willful and without reasonable grounds. In all other cases, such as mere oversight or neglect, damages shall be limited to interest on the royalties computed from the date due, and a reasonable attorney's fee if such interest is not paid within thirty days of written demand therefore.
\end{quote}

Mineral Code Art. 140:

\begin{quote}
If the lessee fails to pay royalties due or fails to inform the lessor of a reasonable cause for failure to pay in response to the required notice, the court may award as damages double the amount of royalties due, interest on that sum from the date due, and a reasonable attorney's fee regardless of the cause for the original failure to pay royalties. The court may also dissolve the lease in its discretion.
\end{quote}

\textsuperscript{15} The First Circuit, in this author's opinion, ignored the right of a lessor to be paid, and our conservation law as a whole, and the decision deprivoritizes contract and property rights in favor of the state's police power with regard to conservation.
6. Putting the lessee in default – See Mineral Code Art. 136:

If a mineral lessor seeks relief from his lessee arising from drainage of the property leased or from any other claim that the lessee has failed to develop and operate the property leased as a prudent operator, he must give his lessee written notice of the asserted breach and allow a reasonable time for performance by the lessee as a prerequisite to a judicial demand for damages or dissolution of the lease.

See, recently, Broussard v. Hilcorp Energy Co., 2009-0449 (La. 2009), 24 So. 3d 813 (Article 136 only applies to drainage or failure to develop and operate as a prudent operator and does not apply to other issues, such as other implied obligations. Note there were three dissents.) See also, Lucky v. EnCana Oil & Gas (USA) Inc., 45,413 (La. App. 2nd Cir. 2010), --- So. 3d ----, 2010 WL 3156818 (if lease requires notice to be sent by lessor to lessee, notice sent to sublessee is insufficient, even if actually forwarded by sublessee to lessee).

IV. Representing Clients in Negotiations for New Leases

Things to Think About:

A. Check the Lease:

Printed lease forms used by lease brokers are pretty one-sided in the lessee’s favor. Landowner and mineral owner counsel will need to attach additional terms using an exhibit or addendum. Be sure to expressly state that the addendum controls over the printed lease form.

B. Bonus:

Bonus rates for new leases in the shale plays have declined but can still be high depending upon location. Do your homework when advising a client about a new lease, check the drilling activity and production rates of shale wells in your client’s area. Remember the Bossier Shale and try to determine if your client’s land is within the contour lines of the Bossier on published maps. Check the bonus paid for public leases near your client’s land, the bonus in a public lease is a public record. Ask around.

C. Royalty:

The shale standard in Northwest Louisiana is now twenty five percent (25%), but opportunities for higher royalty exist, or for an increase at payout (well cost recovery) if your client’s tract is in a highly productive, proven area.

D. Unleased interests:

“What happens if I don’t lease?”

1. La. R.S. 30:10 unleased interests: Read La R.S. 30:10(A) carefully; it is a densely worded statute. In general, unleased interests are liable for the drilling, completion and operating costs out of production.
but are not required to pay the extra 200% risk charge – see La. R.S. 30:10.A.2(e). At "payout" i.e. recovery of costs out of production, the operator of the well must pay unleased interests 100% of their tract's share of production revenues less only their share of monthly lease operating expenses.

2. Participation in wells: Unleased interests who are not sophisticated oil and gas investors should never sign a Joint Operating Agreement (JOA) committing to participate in a unit as a working interest owner. If a JOA is signed, the unleased interest owner must pay its share of drilling and completion costs in the initial and all subsequent wells out of pocket and may forfeit its interest or be penalized if it fails to do so.

E. Additions to the printed form lease:

Important lease provisions which the lawyer for the lessor will [usually] need to add:

1. Cost free royalty, market value royalty: See a good clause from a public lands lease form, below:

   Twenty-Five Percent (25%) of the value, as hereinafter provided of all gas, including casinghead gas, produced (produced includes sales, vented, stored and utilized gas), sold and stored saved or utilized by methods considered as ordinary production methods at a time of production. The value of such gas sold to a non-affiliate or affiliate or vented or utilized in the field, shall not be less than the fair market price. “Fair Market Price” may include one or more of the following: a pipeline index in the field or adjacent to the field, Bloomberg Liquefied Petroleum Gas Prices, Platt’s LP Gas Wire, NGCH published in the "Foster Natural Gas Report” a NYMEX closing price, a Henry Hub price, plus/minus premium, and/or transportation outside the field or if at a future date the Fair Market Valuation changes to something other than those listed above, the new method of fair market valuation may be considered and/or utilized.

   Except as expressly permitted herein, Lessee shall not make any deduction whatsoever for the cost of any operation, process, facility, or other item considered to be a producing function at the time such gas is produced. Without limiting the foregoing sentence and without regard to classification as production costs or otherwise, the following costs are not to be deducted from the value of production: (1) costs incurred for gathering or transporting production in the field; or (2) costs incurred for dehydrating, decontaminating, or in any way processing production to make it marketable by methods considered ordinary at the time such gas is produced; (3) marketing fees incurred for gas sales; or line loss. The performance of any producing function or any function mentioned in clause (2) of the

- 135 -
foregoing sentence at a commingled facility in or outside the field in which this lease is situated shall not make the cost of any such function deductible. Without regard to classification as production costs or otherwise, Lessee may deduct costs incurred for compression of gas at a point in or adjacent to the field for insertion into a purchaser’s line or into a line owned by Lessee or a carrier for transportation to a point of delivery outside the field.

Source: Dept. of Natural Resources, Louisiana State Lease Form Revised 2010

2. Shut in wells, shut in royalty clauses:

(a) Check to make sure that only gas wells which are completed as commercial producers of gas should be eligible for shut-in rights under the lease.

(b) Try to limit shut-in period to 18-24 months: Longer periods will tempt the lessee to speculate with gas prices and prevent the lessor from receiving higher production royalties. Try to negotiate higher shut-in royalties.

3. Continuous operations:

(a) Commencement of operations – require the well to be spudded, avoid standard language “operations for the drilling of a well,” which has been interpreted as being satisfied by site preparation and road building.16

(b) Define continuous operations to require actual drilling (a well spudded) or reworking operations, and exclude site preparation.

4. Options to extend the primary term: Try to eliminate such options, if that is not possible, require additional bonus and a clear deadline for payment with option forfeited if payment is not made timely.

5. Pugh clauses, depth limitation provisions:

(a) Purpose – to limit the coverage of a lease after primary term to the acreage under the lease which the lessee actually developed and put in production during primary term. Pugh clauses are customarily horizontal (i.e. apply to geographic area, not subsurface strata) and intended to release non-unitized acreage at expiration of primary term.

(b) However, some good provisions combine vertical (or depth) release provisions in the Pugh clause which are intended to release undrilled depth intervals at the end of primary term. In drafting a depth release clause it is best to base release on the producing formation at the end of primary term as opposed to a drilled formation or total depth

16 Hilliard v. Franzheim, 180 So. 2d 746, 748-749 (La. App. 3rd Cir. 1965); Olinkraft Inc. v. Gerard 364 So. 2d 639 (La. App. 2nd Cir. 1978).
drilled, which is favored by lessees. In the shale developments some lessees have drilled wells to a depth significantly below the interval in which the well was completed to hold lower zones without production, which defeats the purpose of the depth limitation or vertical Pugh clause negotiated by the lessor.

6. **Voluntary unitization provisions:**

   (a) Voluntary units can affect the operation of Pugh clauses. The lessor’s lawyer will need to limit the maximum acreage which can be held by a voluntary unit on large acreage leases to set up application of the horizontal Pugh clause.

   (b) For larger tracts, lessor’s counsel should consider a provision requiring the lessee to declare units or form compulsory units, (most are already using Office of Conservation procedures) because a well on a large lease can hold the entire lease in the absence of a unit if the well is drilled on the lease. In such a case, unless the lease provides otherwise, the lessee would not need to declare or file for a unit.

7. **Surface use – surface damages:**

   (a) Lessor’s counsel should pursue limitation of a standard lease form’s broad granting clause by excluding or restricting surface use, pipeline and road easements. From the lessor’s position requiring separate specific agreements for surface use is better; it allows the lessor some degree of control and a chance to negotiate compensation when the surface use requested is known.

   (b) Lessor’s counsel should always know the client’s use of the leased property i.e., timber, cattle, farming, residential – all of which will affect decisions on surface use provisions.

   (c) Timber and crop damages: These are common items for compensation to the lessor or surface owner but remember to have future lost value estimated and compensated, too. Your client will likely not be able to grow crops or timber on lands used for mineral development for a long time.

   (d) Whenever possible, Lessor’s counsel should try to exclude all surface use, this will allow the client to deny use or separately negotiate agreements for specific surface use.

8. **Water:** Check for or add clauses for surface water and ground water protection – hydraulic fracturing operations use a lot of water, do not let a lessee have your client’s water for free. Remember, the Mineral Code treats underground water as a mineral.

9. **Expanded indemnification clauses:** Lessor’s counsel must carefully review a new lease to be sure broad indemnification of the lessor is included, and if necessary, expand the lease provisions. If your client has an outstanding timber deed, surface lease or crop tenant, the indemnification should include any loss to those interests, also. It should
also include your client’s agents, employees and invitees. The indemnity should outlast termination of the lease for a period of time sufficient to accrue prescription on any potential claims.

10. **No title warranty:** Lessor’s counsel should require a waiver of title warranty by the lessor even to return of bonus or royalty payments. This protects your client from refund obligations if title fails and no title is perfect. Usually a potential lessee approaches a landowner, not the other way around.

11. **Salt water disposal:** Prohibit salt water disposal without additional compensation equal to prevailing commercial rates or a specific price per barrel. This issue is not common but can result in problems. See *eg.* Raymond *v.* Union Texas Petroleum Corp. 697 F. Supp. 270 (E.D. La. 1988) where the court ruled a operator had the right to dispose of salt water by injecting it underneath the lessor’s property without compensation to the lessor because the Office of Conservation authorized it and the landowner could not prove actual damages.

V. Pipelines, Roads, Surface Locations

A. **Separate agreements.**

As noted above a lessor can/should require separate right of way (ROW) agreement or surface use agreement for surface operations. Separate agreements permit the surface owner to be separately compensated and expressly regulate use when actual use is known.

B. **ROW issues:**

1. **Price:** usually stated on a per rod basis or other compensation method. The grantor should carefully consider the location of the line and impact on tract value. Perhaps there are alternative routes with less impact.

2. **Timber value:** damages for standing timber are usually included but be sure to check the lost future value – your client can not grow timber on the ROW.

3. **Construction deadline:** Include a deadline for completion of construction- most land owners do not want to see construction equipment and unreclaimed areas for a long period of time. Provide for a penalty fee if the work is not finished by the deadline.

4. **Limit use:** Define use of ROW, *i.e.* no additional pipelines without additional payments. The bigger the pipeline, the more your client should be paid.

5. **No storage:** Provide that storage of equipment or pipe on a ROW after completion is prohibited.

6. **Be specific on ROW details:** The agreement should be specific as to point of access, route, width, use of additional land during construction and compensation.
7. **Indemnity:** Check for and insist upon broad indemnity provisions.

8. **Protection of non-ROW lands:** Make sure the agreement requires protection of non-ROW lands and improvements.

9. **Protect water sources:** Clauses for the protection of water, surface and ground water should be included.

10. **Fences and other improvements:** Provide for installation of all necessary fences, gates, culverts and cattle guards at the operator's expense. Specify requirements for both construction and maintenance of necessary improvements.

11. **No hunting:** Add a clause prohibiting hunting or discharge of firearms on ROW; and providing that the operator will take steps (gates, locks, etc.) to prevent access by unauthorized persons.

12. **Use of roads:** Find out if your client wants the option to retain a road after the operator no longer uses it or if the client wants it removed; provide accordingly.

C. **Seismic and Geophysical Operations:**

1. **Seismic survey covered by the mineral lease:** Check the existing lease, most forms include the right to conduct “exploration”, does this cover the right to conduct seismic surveys by the lessee’s contractor?

   (a) *Musser Davis Land Co. v. Union Pacific Resources*, 201 F. 3d 561 (5th Cir. 2000) interpreting Louisiana law, found that seismic operations are “exploration” and the right to conduct exploration is included in the granting clause of most mineral leases.

   (b) In 1995, legislature amended Mineral Code Art. 166, to include references to seismic operations in the Article which deals with the “80% requirement” for exercise of rights under a mineral lease.

   (c) Issue: Mineral lessee and surface owner are different – does Musser rule apply? Under Article 11 of the Mineral Code the surface owner may be required to allow seismic activities by a mineral lessee.

2. **Seismic permit agreements:** customarily propose a uniform price per acre in the project area, but it is possible to negotiate a separate “administrative fee” for the landowner, particularly with respect to large tracts which cannot be deleted from a seismic survey.

3. **Timber, crops, etc.:** The permit agreement should also include provisions for reimbursement of damages to timber, crops, livestock, and improvements.

4. **Indemnity clause:** the same issues arise as with leases and ROW agreements. Check indemnification provisions carefully.

5. **Liability insurance:** The permit should provide that the seismic firm will provide you or your client proof of liability insurance prior to conducting operations on the client’s land.
6. **DPS regulation:** Seismic companies are licensed by State Department of Public Safety for use of explosives and a landowner can file a complaint with DPS regarding improper seismic activity.

D. **Subsurface easement agreements:**

1. **Directional drilling:** Such instruments are becoming common in connection with directional drilling in the shale developments. The *Nunez* Doctrine may permit subsurface drilling under unleased lands in a compulsory unit, but that is an open question.

2. **Lease provisions:** Check your client's lease, older leases may not permit subsurface passage if the leased premises are not included in the unit for the well being drilled. In such a case a separate easement would be required which gives an opportunity for additional compensation to the client.

VI. **Things to Ponder for the Future**

A. **Expanding area of Haynesville Shale** – *See Map 1 at Addendum No. 1*

B. **Developing area of Bossier Shale** – *See Map 2 at Addendum No. 2*

C. **Drainage and development wells:**

- Public comments by Haynesville operators indicate that each HA well drains about 80 acres and will likely produce 6 to 10 BCF of gas; thus there could be 6-8 wells per section; and 36 to 80 BCF of gas per section.

- This is a lot of gas per section! You may see it increase on lands prospective for Bossier Shale and Haynesville Shale plays, as many public statements indicate the Bossier Shale may have similar production rates. Landowners and their counsel should view mineral rights in the shale plays as extraordinarily valuable.

- Has the development phase begun? A few operators in the shales have applied for alternate unit well approval to drill new wells in a producing Haynesville Unit and several more have made public statements that they intend to do so this year. *See* e.g. Encana Oil & Gas (USA) Inc., application dated January 21, 2011, in the Woodard Field, Red River Parish, seeking authority to drill seven (7) cross unit horizontal alternate wells for HA RA SU 57 and HA RA SU 64 and fourteen (14) cross unit horizontal alternate unit wells for HA RA SU55. Of additional interest for the royalty owner, this application asks for an order finding that “unit production from each cross unit horizontal alternate unit well shall be allocated to each unit in the same proportion as the perforated length of the lateral in each unit bears to the total length of the perforated lateral...” Is this a new idea to estimate production attributable to each affected unit without actual measurement of gas produced from...
the unit? Do we know if perforations in a lateral produce equally? While it does not matter within a unit, allocating production between two units sharing a lateral (with different unit ownership) is a novel proposal, but one beyond the scope of this discussion. Some might argue that this should require a single unit under existing conservation laws.

D. Environmental impact of horizontal completions and hydraulic fracs:

- Depth of shale plays in Louisiana should protect fresh water aquifers if the surfacing casing rules are followed. The amount of water needed for each frac may be a threat to local fresh water supplies

- Disposal of frac fluid; The escape of fluid has caused problems and should be carefully regulated by the State. An interesting question: Should Louisiana require operators to recycle frac water to protect fresh water resources?

E. “The oil beneath the shale”?

Persistent rumors abound of plans to drill below the shales. Remember to protect your client’s deep rights as much as you can in the event technology allows the development of zones beneath the shales.

VII. More Things to Think About

A. Problems for the legislature:

In the representation of land and mineral owners in connection with shale developments it is difficult not to see an imbalance in relative bargaining power, access to information and legal rights between such owners and oil and gas operators. In other instances of such imbalance in relative bargaining position legislative bodies have considered statutory changes which would “level the playing field.” In the interest of provoking further discussion, I would offer a few topics which I believe many land and mineral owners would argue are items which should be addressed by lawmakers.

1. Statutory Pugh Clause: Provide by statute that the effect of a Pugh clause and depth limitation clause are implied covenants in all leases effective at the expiration of primary term. Many small landowners have never heard of Pugh clauses and depth limitation clauses and would not understand enough to ask for them. More knowledgeable lessors routinely ask for such clauses and routinely get them added to their leases. It seems unfair that the least sophisticated, least informed lessors do not receive the benefits of these important provisions, as the same group is usually least able to hire a lawyer to review a proposed lease. I submit that the law should be changed to provide that (i) a lease holds only the surface acreage in production at the end of the primary term, that is, acreage included in the unit of a
producing or shut-in well and (ii) a lease holds only depths from the surface to the base of the deepest zone or formation in production or shut-in awaiting a pipeline after the expiration of primary term.

2. **Art. 122 expansion:** Amend Article 122 of the Mineral Code to provide that the lessee under an existing lease which is more than five years past primary term will have one (1) year to drill to deeper or shallower depth intervals covered by the lease and provide the lease will terminate as to all depth intervals not in production or shut-in awaiting a pipeline connection at the end of the one year period. Leases signed after the amendment would be covered by the statutory depth limitation clause recommended above. It seems unreasonable to let mineral lessees hold valuable formations undeveloped for an indefinite period of time past primary term. These important mineral rights should revert to the land or mineral owner.

3. **Surface use in leases:** The Mineral Code should require all mineral leases to expressly and conspicuously state that surface operations, pipelines and roads can (or cannot) be undertaken and if those rights are granted by the lease it must include a specific sum of money per acre (per rod for pipeline or road easements) that will be paid to the surface owner (even if the surface owner is not the lessor) as compensation for surface used in such activities, together with a statement that the lessee will pay for all standing timber cut in connection with the lessee’s activities at market value. Article 11 of the Mineral Code should require the surface owner’s consent to the location of surface facilities (even if the surface owner is not the lessor) but provide that such consent cannot be unreasonably withheld. The granting clause in most leases is not clear enough to put lessors on notice that such surface use is possible and many standard form leases do not provide explicit terms for compensation. Further, when the lessor is a mineral owner he has no incentive to negotiate clauses for the protection of the surface owner.

4. **Correlative rights:** The correlative rights doctrine expressed in Article 11 of the Mineral Code should be amended to more clearly state that a mineral lessee must avoid surface locations which adversely affect surface use existing prior to mineral development and must locate mineral development surface use (including roads and pipelines) in locations which minimize adverse impact on the existing surface use.

5. **Water protection:** Prohibit the use of surface and ground water in hydraulic fracing operations, except when water is purchased from recognized commercial sources like a municipality, the Red River Waterway Commission or Sabine River Authority. Local aquifers should not be used directly or indirectly (filling artificial reservoirs) in fracing shale wells. Further, water should be deleted from coverage under the Mineral Code and commercial use and protection of fresh water aquifers
should be covered by separate statutes. The rule of capture is not appropriate as applied to underground water resources. The public interest in fresh water resources should be recognized and protected. In mineral leases there are frequent instances in which a lessor has little interest in fresh water use or protection and a uniform statutory and regulatory scheme is necessary to protect water resources. It is not sufficient to assume this issue can be adequately addressed in individual lease or water use negotiations.

6. Limit Nunez Doctrine: The so-called Nunez Doctrine should be modified by legislation to provide clearly that unleased property owners in a compulsory unit cannot be forced to allow surface operations, roads or pipelines on their property without a mutually agreeable surface use or right-of-way agreement.

7. Notice to surface owners: Surface owners in the governmental section affected by a shale unit application should be made required notice parties for the pre-application conference and for the unitization hearing. Many surface owners do not own minerals under their land and have no notice of prospective mineral development or well locations until the bulldozers arrive on site.

8. Well locations: The distance between well sites and existing residential developments should be fixed by statute at not less than 600 feet, with exceptions for special circumstances not to be granted without notice to affected surface owners and an opportunity for an administrative hearing before the LOC.

9. LOC hearing location: LOC proceedings involving shale units in Northwest Louisiana should be held in Shreveport, Bossier City, Mansfield, Coushatta or Natchitoches. Records available for review by the public for such purposes should be available at a Northwest Louisiana site. Requiring the public to drive 250 miles to attend hearings or review documents is unfair. Proceedings should be made convenient for public participation, not for the LOC staff.

10. Venue for LOC judicial review: Venue for judicial review of administrative orders by the LOC affecting land and mineral owners should be permitted in the parish where the well involved is located, not limited to the 19th JDC in Baton Rouge.

11. Local regulation of locations and public road use: Municipal and parish governing bodies should be given the power to regulate well locations by reasonable zoning restrictions and to regulate the use of municipal and parish roads with regard to access for drilling operations and road repair costs.

B. Argument for Legislation:

This is not an exclusive list of land or mineral owner concerns, but these are issues about which I hear many comments. Some of these
matters will be seen as controversial by the industry and I acknowledge that reasonable minds can disagree about solutions to these problems. However, addressing the foregoing items with reasonable legislative action would alleviate many complaints I hear almost daily from land and mineral owners. Failure to address these concerns in some way may cause increasing public resentment. Eventually, I believe, the public discontent with the failure to fix at least some of these problems will result in the election of state representatives and senators who will pledge to accomplish these things, perhaps in more radical ways. I would submit that entrenched opposition to legislative efforts to address these problems is short-sighted and likely to cost the industry more in the long run than cooperating with other interest groups and lawmakers to implement reasonable solutions to these problems in the near future.

Addendum 1. Source: Petrohawk report to Stockholders

Haynesville SW Extension: How Good Is It?

- Shelby Trough has good rock quality and PhiH
- Quality does not appear to be as good as NW La
- Data set is still fairly limited, but EUR trends do not indicate a core area as good as NW La.
Addendum 2. Source: Petrohawk report to Stockholders

Lower Bossier Shale: Activity Map

- 145 -