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# Mineral Lease Division Revisited—An Old Doctrine with New Applications

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## I. INTRODUCTION

In Louisiana, mineral leases have been considered a form of interest in real property from a very early date.<sup>1</sup> As such, courts consistently held that the mineral lease was indivisible.<sup>2</sup> Additionally, under pre-Mineral Code jurisprudence, courts universally allowed lessees to assign all or part of their interest in a lease to another party.<sup>3</sup> These transactions could, and often did, appear in the form of assignments of the working interest for discrete acreage portions comprising less than all of the originally leased premises.<sup>4</sup>

The notion of indivisibility presented a problem, however, when lessees assigned only a part of their interest in a lease to another party. Since the obligations were not divided, the assignor faced the possibility of damages (or even lease cancellation) based on default under the lease by the partial assignee—and not through any fault of his own. For example, a partial assignee to ten acres of a 100-acre lease might fail to pay the delay rentals due under the lease without

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1. Thomas A. Harrell, *A Mineral Lessee's Obligation to Explore Unproductive Portions of the Leased Premises in Louisiana*, 52 LA. L. REV. 387, 388–89 (1991).

2. *Id.*; see also *Murray v. Barnhart*, 42 So. 489 (La. 1906). Since its effective date in 1975, the Mineral Code has carried forth this principle by providing that leases are, in general, indivisible. See LA. MIN. CODE art. 130 (2000).

3. For an early case which discusses partial lease assignment, see *Smith v. Sun Oil*, 165 La. 907 (1928).

4. At the outset, the authors wish to disclose that they have asserted lease division issues in pending litigation seeking cancellation of pre-Mineral Code leases in behalf of lessors under those leases. Nevertheless, the topic deserves serious discussion. Our “issue bias” is no greater than the views of other lawyers who routinely represent oil and gas companies or others who receive consulting or similar fees to assert the industry position on the lease division issue as expert witnesses.

notice to the original lessee. If the lease obligations were truly indivisible, then the assignor who retained 90 acres could face cancellation as to his portion of the lease as well.

The concept and practice of lease division emerged from this basic problem. It has since evolved into a complex, and sometimes confusing, topic of mineral law in Louisiana. More particularly, the effect of a lease's division on its express and implied obligations is not always clear. This Article's goal is to trace the historical development of lease division, set out issues not entirely settled at present, and suggest possible solutions to these problems.

When a lease, subject to division by assignment under appropriate lease covenants, is assigned in part, we believe the lease becomes divided, in practical effect, into two leases for purposes of lease maintenance. Lease language that protects the lessee of a divided lease from liability for the failures of his assignee should likewise prevent him from benefitting from the maintenance or exploration activities of that assignee. The benefits and burdens of the lease should simply apply separately. Further, because lease division is fundamentally a creature of contract, a lease can be divided in any manner specified by the language of the lease: vertically, horizontally, or even by substance.

## II. HISTORY: PRE-MINERAL CODE JURISPRUDENCE

Arguably, the most important case in the history of lease division is *Swope v. Holmes*, decided by the Louisiana Supreme Court in 1929.<sup>5</sup> In *Swope*, the lessor sought partial cancellation of a 2,500-acre mineral lease as to a 440-acre section.<sup>6</sup> The rights to these 440 acres were transferred from the lessee through a series of assignments to the defendant.<sup>7</sup> The defendant subleased some of this acreage but eventually permitted his sublessees to cease their operations.<sup>8</sup> Though the lease acreage outside the 440-acre tract was productive, no production was obtained from the defendant's 440-acre tract.<sup>9</sup> The lease in question contained 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*

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5. *Swope v. Holmes*, 124 So. 131 (La. 1929).

6. *Id.* at 131.

7. *Id.*

8. *Id.*

9. *Id.*

*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.*<sup>10</sup>

While the court did not expressly say that this language divided the lease upon assignment, the court rejected the defendant's argument that production from other parts of the lease kept the entire lease in force.<sup>11</sup> The court's rationale was simple: the annual rental due under the lease was not paid as to the 440-acre tract in question.<sup>12</sup> The clause quoted above mutually exculpated the assignor, and any partial assignees, from the defaults of the others in non-payment of these rentals.<sup>13</sup> In insulating each partial working interest owner of the lease from the rental defaults of the other, this provision allowed for partial termination of the lease; effectively, portions of the lease were cancelled when the required proportionate rentals were not paid for those parts of the lease.<sup>14</sup>

*Swope* was followed two years later by *Roberson v. Pioneer Gas Co.*<sup>15</sup> The lease in *Roberson* contained an essentially identical clause to the lease provision in *Swope*, which provided that, in the event that one partial holder of the lease defaulted in its rental payments, any other partial holder would not be faced with cancellation of his portion of the lease.<sup>16</sup> The court in *Roberson* first decided that the transaction at issue qualified as an assignment, as opposed to a sublease.<sup>17</sup> Had the transaction been a sublease, it would not have fit the express lease language providing for exculpation in the event that a part of the lease was "assigned."<sup>18</sup> Upon deciding this, the court stated:

The effect of the assignment of the lease on the 40 acres of land . . . was to divide the original lease into *two leases*, by making a lease between the plaintiffs, as lessors . . . and Pipes & Mack, as their lessees, under the terms and conditions stipulated in the original lease. What Pipes & Mack did, or failed to do, to keep their lease in force on the 40 acres of land, could not affect the lease which the Pioneer Gas Company retained on the remaining 85 acres of land.<sup>19</sup>

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10. *Id.* at 132 (emphasis added).

11. *Id.*

12. *Id.*

13. *Id.* at 132.

14. *Id.*

15. *Roberson v. Pioneer Gas Co.*, 137 So. 46 (La. 1931).

16. *Id.* at 47.

17. *Id.* at 48.

18. *Id.*

19. *Id.* (emphasis added).

*Roberson* thus articulated the modern conceptual picture of a divided lease: the divided acreage portions should be thought of as *separate* leases containing the terms and conditions of the original lease. What keeps the lease in force on one divided tract will not maintain the lease for other divided tracts.

The clauses in *Swope* and *Roberson* both dealt specifically with partial assignments of the lease.<sup>20</sup> Louisiana is peculiar among states in its emphasis on the distinction between an assignment and a sublease in the mineral law context. Thorough explanations of the evolution of this dichotomy are available from many sources.<sup>21</sup> In brief, the difference is that, in a sublease, the transferor retains something in the transferred interest; whereas, in an assignment, the transferor hands over the entirety of his interest.<sup>22</sup> For example, in *Smith v. Sun Oil Co.*,<sup>23</sup> a transfer of a lease interest was classified as a sublease, as the assignor retained an overriding royalty and right of reversion in the transaction.<sup>24</sup> These particular retained interests are not the only ones that will render a particular transfer a “mere” sublease; rather, the lessee need only to retain some interest that runs for the life of the lease.<sup>25</sup> Conversely, not all retained interests are significant enough to constitute a sublease when, on the facts, the court concludes an assignment was intended.<sup>26</sup>

A consequence of this dichotomy in the lease division context was that leases that allowed for division in the event of an assignment were not adjudged to be divided when the transfer at issue was determined to be a sublease.<sup>27</sup> Though this approach has been criticized as overly formalistic,<sup>28</sup> it is clearly a part of the jurisprudence.

However, a 1929 Louisiana Supreme Court case, *Johnson v. Moody*, raised the possibility of lease division by sublease, rather than assignment.<sup>29</sup> In *Johnson*, that is exactly what happened: a transfer of a particular lease interest was classified as a sublease

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20. *Id.* at 47; *Swope v. Holmes*, 124 So. 131, 132 (La. 1929).

21. *See e.g.*, Stevia M. Walther, *Overrides, Assignments, and Subleases*, in 8 LOUISIANA MINERAL LAW TREATISE, (Patrick H. Martin ed. 2012).

22. LA. MIN. CODE art. 127 cmt. (2000).

23. *Smith v. Sun Oil Co.*, 116 So. 379 (La. 1928).

24. *Id.* at 384.

25. LA. MIN. CODE art. 127 cmt. (2000).

26. *See, e.g.*, *Dore Energy Corp. v. Carter-Langham, Inc.*, 997 So. 2d 826, 829 (La. App. Ct. 2008).

27. *Sun Oil Co.*, 116 So. at 380.

28. *See* PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS AND MEYERS, OIL AND GAS LAW § 414 (LexisNexis, Matthew Bender & Co. rev. ed. 2012) (1959).

29. *Johnson v. Moody*, 123 So. 330 (La. 1929).

rather than an assignment.<sup>30</sup> Despite this, the court pointed out that the contract contained provisions “showing that the lease was not indivisible, and might be forfeited as to a part only of the land.”<sup>31</sup> The court held that the unproductive, undeveloped portions of the leased land could not be held by production from the subleased tract.<sup>32</sup> The undeveloped property was held to be abandoned.<sup>33</sup> Though this decision did not explicitly declare that a sublease *did* divide the lease in question, it suggests that such a result is possible.

Subsequent pre-Mineral Code cases tended to follow the basic theoretical guidelines set by *Swope* and *Roberson*, and some took on the more expansive view of *Johnson*. For instance, one 1952 case referred to the availability of many clauses which could operate to divide a lease:

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.<sup>34</sup>

This body of case law established the basic proposition that a mineral lease could be rendered divisible by appropriate contractual language. The typical triggering language was a clause that provided for “mutual exculpation” for holders of the lessee’s interest in the event of a partial assignment, but other types of lease provisions were also held to allow for lease division. If the mineral in question was divided by lease provisions or assignment covenants—or both—that lease would then be considered as two (or more) separate leases to be maintained separately, even though each contained all of the terms and conditions of the original lease. This included extension of the term of the divided segments by operations or production.

### III. MINERAL CODE

In 1974, the legislature enacted the Louisiana Mineral Code in Title 31 of the Revised Statutes, effective January 1, 1975. The

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30. *Id.* at 330.

31. *Id.*

32. *Id.*

33. *Id.*

34. *Smith v. Carter Oil Co.*, 104 F. Supp. 463 (W.D. La. 1952) (emphasis added).

Mineral Code carried forward the prior law allowing the lessee to subdivide or assign the lease in whole or in part, codifying this rule in Mineral Code article 127. The Code then expressly addresses the issue of lease division in article 130, which states plainly: “[a] partial assignment or partial sublease does not divide a mineral lease.”<sup>35</sup> Unlike the prior case law, the article makes clear that a partial assignment does not, by itself, divide a mineral lease.<sup>36</sup> However, the Comment to article 130 recognizes the pre-Mineral Code jurisprudence allowing division when there is a lease clause providing for such, 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 proportionate 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. Not only will this be true as to the rental obligation, it is true also of the effect of drilling or production on maintenance of the lease. The unarticulated premise of these cases is that in the absence of such provisions the lease would be indivisible in the sense that a partial assignment would not have the effect of creating two leases where but one existed before. It is therefore correct to say that [a]rticle 130 reflects established law insofar as assignments are concerned.<sup>37</sup>

Thus, the default rule of article 130—that a mineral lease is not divided by assignment—is open to alteration by the parties to a lease.<sup>38</sup> Such modification is permissible under Mineral Code article 3, which states, “[u]nless expressly or impliedly prohibited from doing so, individuals may renounce or modify what is established in their favor by the provisions of this Code if the renunciation or modification does not affect the rights of others and is not contrary to the public good.”<sup>39</sup> The explicit recognition in the Comment to article 130 of pre-Mineral Code jurisprudence (specifically, those cases concerning leases containing language of divisibility) makes it clear that such language is not contrary to the public good, and

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35. LA. MIN. CODE art. 130 (2000).

36. *Id.*

37. LA. MIN. CODE art. 130 cmt. (2000).

38. *Id.*

39. LA. MIN. CODE art. 3 (2000).

leasing parties are not, therefore, expressly or impliedly prohibited from using language modifying the rule of article 130.<sup>40</sup>

The Comment to Mineral Code article 130 also asserted that article 130 sustained pre-Code jurisprudence limiting lease division under the standard divisibility language to assignments, rather than subleases. The Comment to article 130 states: “[a]s to the effect of a partial sublease, it is, again, consonant with the theory concerning the nature of the sublease to conclude that a partial sublease has no divisive effect.”<sup>41</sup> However (with due respect to authors of the Comment), that statement is not categorically true. Consistent with the principle of Mineral Code article 3, parties are free to add language to their lease allowing for a sublease that divides the rights and obligations of the lessor and lessee.<sup>42</sup> Such a division was at least impliedly deemed possible in *Johnson v. Moody*,<sup>43</sup> and nothing in the language of article 130 evidences a desire to overrule this result.

The present Civil Code articles regarding the divisibility of obligations support the important pre-Mineral Code lease division decisions.<sup>44</sup> By stipulating that the lessee and his transferee are not liable for each other’s defaults, the assignability clauses in these cases contracted out of the Civil Code’s suppletive rules on solidarity.<sup>45</sup> Civil Code article 1818 states that “[a]n indivisible obligation with more than one obligor or obligee is subject to the rules governing solidary obligations.”<sup>46</sup> Expanding on this notion, Civil Code article 1819 declares: “[a]n 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.”<sup>47</sup>

The assignability provisions, which relieve the transferor or transferee of a lease interest for the fault of the other on the assigned portion, clearly cut off solidarity.<sup>48</sup> As such, the obligations of the lease are rendered divisible. Allowing for the insulation of the transferor and transferee for the default of the other by way of the

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40. See LA. MIN. CODE art. 130 cmt.

41. LA. MIN. CODE art. 130.

42. LA. MIN. CODE art. 3.

43. *Johnson v. Moody*, 123 So. 330 (La. 1929).

44. See LA. CIV. CODE ANN. arts. 1818, 1819 (2013).

45. See, e.g., *Swope v. Holmes*, 124 So. 131 (La. 1929); *Roberson v. Pioneer Gas Co.* 137 So. 46 (La. 1931).

46. LA. CIV. CODE ANN. art. 1818.

47. LA. CIV. CODE ANN. art. 1819 (emphasis added).

48. See *id.*; LA. CIV. CODE ANN. art. 1818. If the lease obligations remained solidary, then there obviously would be no division; that is, each party would remain liable for the defaults of the others.

assignability clause, but permitting the performance of the lease covenants by one to count for the other, would result in a curious asymmetrical result clearly not contemplated by the Mineral Code or Civil Code.

In sum, the Mineral Code settled many of the existing questions regarding what was required to divide a lease. The law in effect for leases executed after 1975 is that a mineral lease is—in the absence of special contractual covenants regarding divisibility—indivisible.<sup>49</sup> However, as mentioned above in the discussion concerning Mineral Code article 130, the parties to the lease can alter this rule by including specific language authorizing division. Whether (and to what extent) a lease is divided is dependent on the language of the lease.<sup>50</sup> When a lease is divided, the lessee's obligations applicable to the lease should inure to each tract separately; a partial assignor or assignee's failure to meet these obligations will not endanger the lease rights of the other parties. However, the assignor and assignee should not be allowed to rely on performance by one to hold the lease interest of the other.

Though the conclusions we draw above rest upon established principles of Louisiana law, a contrary view construes lease division in a much narrower sense.<sup>51</sup> This position emphasizes that every lease clause should be read against the background of the default rule of indivisibility in Mineral Code article 130; to get around this rule, the argument goes, contracting parties must expressly provide the extent to which a particular lease is divisible.<sup>52</sup> This position argues courts should not infer a total division of lease rights and obligations from lease clauses that only speak to limited circumstances.

That *Swope*, *Roberson*, and their progeny are pre-Mineral Code decisions is all the more reason, under this view, to resist broad interpretations of exculpation clauses that arguably go well beyond the intent of the contracting parties. Proponents of this position would argue that, with article 130, the legislature provided a firm rule for indivisibility that can only be deviated from when parties explicitly repudiate it.

We agree that lease division is a function of the lease itself. In the absence of a lease clause providing for a division of lease rights and obligations upon assignment or sublease, article 130's rule of indivisibility holds. However, the jurisprudence clearly indicates

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49. LA. MIN. CODE art. 130 cmt. (2000).

50. *See id.*

51. *See id.* (noting that Mineral Code art. 130 is “based on the concept that the lease is indivisible unless otherwise provided by contract.”).

52. *Id.*

that certain common lease clauses do imply a total division upon assignment, such as the *Swope* and *Roberson* lease provisions, quoted above.<sup>53</sup> The courts in those cases wisely recognized that limiting lease division to merely one area yields an array of inconsistent consequences and uncertain relations between the relevant parties.<sup>54</sup> Again, one must consider that allowing the lessees to be exculpated from defaults with respect to the interests owned by the assignee (or retained by the assignor) should also result in separate lease maintenance obligations to the lessor. The premise is simple but rests on sound principles of equity. A recent Second Circuit opinion supports this understanding.<sup>55</sup> In *Hoover Tree Farm, L.L.C. v. Goodrich Petroleum Co.*, the Second Circuit noted that the *Roberson* court, in its interpretation of the rental payments clause:

[R]uled that a lease containing such provision would be divided *for all purposes* into two leases upon the transfer of the entirety of the leasehold rights to a specific geographical portion. Such broad interpretation therefore moved the clause beyond merely the subject of rental payment default to effect a stringent modification of the typical habendum clause principle for maintenance of the entire lease beyond the primary term by the operations and production of one well.<sup>56</sup>

Similar clauses providing for such divisibility are widely employed in mineral leases today, and their basic effect is almost unquestioned by modern courts. There are a variety of open questions, however, relating to lease division that still demand judicial resolution.

#### IV. UNANSWERED LEASE DIVISION ISSUES

##### *A. Horizontal Lease Division*

One question still undecided is that of horizontal lease division. In all the cases mentioned above, the leases were divided along a vertical plane; to state it differently, assignor and assignee were in each case responsible for the lease obligations under discrete surface acreage. In contrast, the assignor and partial assignee of a lease

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53. Other decisions which recognize total division include: *Noel Estate, Inc. v. Murray*, 65 So. 2d 886 (La. 1953); *Bond v. Midstates Oil Corp.*, 53 So. 2d 149 (La. 1951); *Tyson v. Surf Oil Co.*, 196 So. 336 (La. 1940); *Odom v. Union Producing Co.*, 129 So. 2d 530 (La. Ct. App. 1961), *aff'd*, 141 So. 2d 649 (1961).

54. *Id.*

55. *Hoover Tree Farm, L.L.C. v. Goodrich Petroleum Co.*, 63 So. 3d 159 (La. Ct. App. 2011).

56. *Id.* at 174 (emphasis added).

divided along a horizontal axis would own lease interests as to discrete *subsurface* acreage. Such division ostensibly occurs when a lessee makes an assignment of only certain depths covered by the lease; for example, “all those depths below 5,000 feet”; or, “down to the base of Formation X.”

These sorts of depth-limited partial assignments are quite common and are motivated by similar considerations as instances of vertical division. A particular lessee-assignor may be faced with certain limitations, either technological or financial, which make it unable to exploit the deeper intervals of the lease. In such a situation, a partial assignment of the lease (which would yield the deeper zones to a more sophisticated, well-financed operator) might make sense. Similarly, the lessee-assignor may believe the shallower depths of the lease are “played-out” and may consider receiving some money from an ambitious operator, who is willing to further develop the shallow zones, preferable to simply abandoning these intervals and getting nothing for them. Finally, a lessee-assignor may make an assignment of only a subsurface interval covering specific target formations; for example, an assignment of the Haynesville Shale Formation. Again, different opinions regarding the continued feasibility of a particular zone or horizon, including the economic and technological limitations of exploiting certain plays already mentioned, might motivate an assignment covering only a defined subsurface interval.

A threshold question is whether an assignment of only certain depths underlying a lease even represents an “assignment” which could result in division at all, or is merely a sublease. Though we argue a sublease can divide a lease in situations where specific lease language allows such a division,<sup>57</sup> the more common assignability clause only contemplates division for an actual assignment. If an “assignment” of only specific subsurface depths is always found to be a sublease, then, as a practical matter, the vast majority of leases are not divisible horizontally, which does not reflect the intent of many of these assignments and thus does not follow logically from the basic principles of lease division. The inquiry should focus on the division of obligations of the lessee and what rights the assignor retains; the issue should not be resolved simply by the assignor’s reservation of an overriding royalty or the retention of other depth intervals.<sup>58</sup> However, the Second Circuit in

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57. See *supra* Part II.

58. See *id.*; *Dore Energy Corp. v. Carter-Langham, Inc.*, 997 So. 2d 826, 829 (La. Ct. App. 2008); *Hoover Tree Farm*, 63 So. 3d at 174.

*Hoover Tree Farm* seemed to assume (perhaps in *dictum*) that assignment of a specific depth interval would not divide a lease.<sup>59</sup>

The argument that an “assignment” of certain depth intervals is more properly classified as a sublease that, in general, does not divide a lease is well articulated in *Scurlock v. Getty Oil*,<sup>60</sup> a Third Circuit case from 1973. In that case, the court found that a particular partial transfer of interests in two mineral leases—a transfer that covered only the lease rights in a particular unit and only as to a particular formation—was a sublease, rather than an assignment.<sup>61</sup> The court made this determination partly on account of the fact that the assignor retained some rights as to the assigned property; namely, the rights to use the surface of the property, the right to drill *through* the assigned stratum, and the right to benefit from the payment of delay rentals by the assignee.<sup>62</sup> The majority opinion went on to state that the leasing parties did not contemplate horizontal segregation of the lease by the lessee.<sup>63</sup>

The opinion in *Scurlock* did not rule out the possibility of a horizontal division of the lease under different facts, stating that such a result was conceivable under some circumstances.<sup>64</sup> The court did not specify, however, what would be required for horizontal division in this counterfactual. On appeal, the Louisiana Supreme Court reversed the outcome of the case, but it did not reach the question of horizontal division in doing so.<sup>65</sup> Justice Barham’s concurrence, though, maintained that the majority opinion necessarily presupposed that the leases were divided: “[t]hus it is necessary to determine that there can be a horizontal segregation of a mineral lease. In my opinion it has been so determined. In my opinion it has been correctly determined.”<sup>66</sup>

The dissent in the appellate panel’s *Scurlock* decision observed that the assignor in that case did not retain any rights under the lease

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59. *Hoover Tree Farm*, 63 So. 3d at 175 n.18 (“The Transfer in this case, creating ownership in indivision to the Deep Rights, is not such a transfer of leasehold rights in a specific geographic portion of the Lease, like the two transfers at issue in *Sun Oil* and *Roberson*. As such, the Transfer did not implicate the provision of paragraph 10 of the Lease . . . concerning partial lease default and a possible lease division.”). It is crucial to note, however, that the transfer in this case was to 50% of the deep rights in the leased property, rather than all of the interest as to those depths.

60. *Scurlock Oil Co. v. Getty Oil Co.*, 278 So. 2d 851 (La. Ct. App. 1973), *rev’d in part*, 294 So. 2d 810 (La. 1974).

61. *Id.* at 854.

62. *Id.* at 857.

63. *Id.* at 858.

64. *Id.* at 856.

65. *Scurlock Oil Co. v. Getty Oil Co.*, 294 So. 2d 810, 819 (La. 1974).

66. *Id.* at 821 (Barham, J., concurring).

as to the land conveyed.<sup>67</sup> Just as a partial assignment of the lease as to discrete surface acreage does not entail that the assignor retains a right in the property assigned (in that case, the assignor necessarily retains only what was *not* included in the assignment), an assignment of certain depths under a lease assignment clause does not involve a retention of any rights as to those *depths*.<sup>68</sup>

The majority's argument, that both assignor and assignee would have rights to use the surface, is susceptible to this critique as well. The assignor, in that case, did not retain rights to the assigned depths—the rights to the surface were not kept out of the transfer, away from the assignee's control, in the sense that an overriding royalty interest might be.<sup>69</sup> Similarly unpersuasive is the argument that the ability to drill through the assigned stratum represents some retention of rights; rather, the right to drill through those depths springs not only out of the original lease, but also from the doctrine of correlative rights.<sup>70</sup>

The claim that the initial parties to the lease did not intend it to be divisible by a horizontal segregation is more interesting but ultimately no more tenable. By the plain language of the typical assignability clauses, like those quoted above in previous sections of this Article, it appears that most leases simply *are* divisible by the partial assignment of certain depths. When the words of a contract are clear and explicit and lead to no absurd consequences, no further interpretation may be made in search of the parties' intent.<sup>71</sup> An assignment of the lease rights below 5,000 feet, for example, is an assignment of a "part or parts" of the lease. On the other hand, if the lease clause providing for division mentions only segregated surface portions of the property, then the lease may not be divided by depth.

The effect of the non-payment of delay rentals by one of the parties is potentially problematic. If a party with rights as to the shallow depths fails to pay delay rentals, could the party with rights to the lower depths face forfeiture? Is the "burden on the lessee" increased if the holders of the shallow and the deep rights are each required to pay the full amount of delay rentals?<sup>72</sup> In the most commonly encountered lease forms assignment clause, once the assignor signs away his lease interest as to a particular depth, he is not liable for the obligations allocable to that interval, nor is he

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67. *Scurlock*, 278 So. 2d at 863.

68. *Id.*

69. *See id.* at 857–58.

70. *See* LA. MIN. CODE art. 11 (2000).

71. LA. CIV. CODE ANN. art. 2046 (2013).

72. *See infra* Part V.B.

required to pay any more than he would have before the assignment.<sup>73</sup>

In sum, the rationale allowing for lease division by an assignment of segregated surface portions of the lease would logically apply equally to assignments of discrete subsurface depths. A typical partial transfer of the lease rights to certain depths or a certain formation—where the assignor retains nothing substantial in those depths—should be properly categorized as an “assignment” as that term is understood in Louisiana. Decisions from other jurisdictions endorse the concept of horizontal lease division.<sup>74</sup> If and when the Louisiana Supreme Court considers the issue, it should be decided similarly.

### *B. Division by Substance*

An even more uncertain area of lease divisibility is the possibility of a lease that is divided by substance type. Mineral lessees rarely assign out their lease rights to either oil or gas under the leased property. If such an assignment operated to divide the lease rights and obligations, the assignor and partial-assignees would be confronted with many of the lease division issues discussed in sections of this Article above. For instance, if an assignment of “all gas rights” under a given lease resulted in a division between those gas rights and the oil and other mineral rights under the lease, production of oil alone from the leased premises might not maintain the lease as to the gas rights, and *vice versa*. The lease might then terminate as to these rights, and the lessor would be free to re-lease the property for gas exploration.<sup>75</sup>

This issue is purely speculative at the moment. We know of no reported Louisiana case where the divisibility by mineral substance was at issue. The division by substance in an assignment is rare and will likely continue to be rare. As has been stated several times in this Article, lease divisibility in Louisiana is dependent on language

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73. The M.L. Bath LA. Special 540-R1 form states: “[t]he rights of either party hereunder may be assigned in whole or in part, and the provisions hereof shall extend to the heirs, successors, assigns and sublessees of the parties hereto, but no change or division in ownership of the land, rentals or royalties however accomplished shall operate to enlarge the obligations or diminish the rights of Lessee.”

74. See also John H. Tucker, Jr., *Sub-lease and Assignment, Some of the Problems Resulting from the Distinction*, LA. STATE UNIV. THIRD ANNUAL INST. ON MINERAL LAW 196 (1955); W.R. Niblack, *Some Consequences of Horizontal Division of Oil and Gas Leaseholds*, 8 ANNUAL ROCKY MT. MIN. L. INST. 1 (1963).

75. See LA. MIN. CODE arts. 115, 133 (2000).

in the lease authorizing division. Thus, the lease is only divisible to the extent provided for by lease; that is, a lease is divisible only where the lease's language allows, and by no more. If the lease providing for division references the assignment of a "segregated portion," (or words of similar meaning of the leased premises) as many lease forms do, the possibility of a division of the lease by mineral type would arguably be foreclosed. Though oil and gas are, in reality, sometimes found in different horizons, the "segregation" in an assignment of gas rights does not necessarily happen along a physical plane. A clause allowing for division by substance would have to be sufficiently clear that the lease is to be divided by assignment of specific minerals.

Another issue that might present further practical limitation on the possibility of a division by substance type is the assignment-sublease dichotomy discussed above. A partial assignee of a lease limited to a particular substance might argue that an "assignment" of a type of mineral represents a sublease, as the assignor is retaining the remaining minerals in the transaction. Though an obvious response would be that the assignor is giving over all rights he holds in that mineral, the point remains that the assignor is retaining rights in the same lease acreage.

Though there do not appear to be any mineral lease cases on point, an analogue to the pre-Mineral Code lease division framework may exist in the context of a mineral servitude. In *Continental Group v. Allison*,<sup>76</sup> the Louisiana Supreme Court decided that, under pre-Mineral Code law, a mineral servitude could prescribe as to only one of the minerals it covered, in the absence of production of that mineral.<sup>77</sup> Under the facts of *Allison*, the servitude holders never mined the servitude for lignite, and the Louisiana Supreme Court ultimately held that their right to explore for that mineral had prescribed for ten years non-use.<sup>78</sup> This result would not occur today for servitudes created after adoption of the Mineral Code; article 40 provides that an interruption of prescription applies to all types of minerals covered by "the act creating the servitude."<sup>79</sup> No comparable provision in the Mineral Code covers mineral leases.

Additionally, the case law is extensive in holding a lease is fundamentally a creature of contract between the lessor and lessee and thus is subject to a different set of rules than those governing

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76. *Continental Grp., Inc. v. Allison*, 404 So. 2d 428 (La. 1981).

77. *Id.* at 436.

78. *Id.* at 438.

79. LA. MIN. CODE art. 40 (2000).

servitudes.<sup>80</sup> However, one may logically envision a similar result in a suit for a breach of lease obligations under a divided-by-substance lease, such as the result given in *Allison*: a cancellation of the lease limited to the assigned and undeveloped mineral substance.<sup>81</sup> This outcome would allow a party that holds the producing oil rights to a certain lease to be shielded from any breach by the holder of the rights to produce gas. It would also permit a lessor to free up a portion of his mineral rights if one of the substances was not being adequately exploited after an assignment of that mineral.

In any case, discussion of the effects of a breach of a lease covenant in a divided-by-substance lease necessarily remains merely academic until an intrepid lawyer advances a case involving a lease with divided substances. Such a case would need sufficiently broad language in the lease assignability clause to reasonably implicate a specific mineral substance.<sup>82</sup> Even then, it might be argued that such a division by substance was a sublease, and thus, the drafting parties did not contemplate separate lease maintenance by mineral. Despite this, there appear to be some compelling reasons for recognizing such a division. For example, a lessor should be able to avoid having his lease rights to a certain substance maintained by production of other substances by other parties, effectively removing some minerals from commerce indefinitely. If a lessee holding rights to only one mineral or minerals could avoid negative consequences flowing from a failure of the other lessee party to develop the assigned minerals, then it follows that the lease should be considered legally divided by substance.

## V. LEASE DIVISION AND EXPRESS LEASE COVENANTS

### A. *Habendum Clause*

No great controversy exists as to the effect of lease division on the most important of the express lease covenants: the habendum clause. An assignor and a partial assignee of a divided lease must *separately* secure production from the leased tract for which they are

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80. See *Caskey v. Kelly Oil Co.*, 737 So. 2d 1257, 1262 (La. 1999) (stating that mineral leases are construed as leases generally and that the provisions of the Civil Code applicable to ordinary leases, when pertinent, are applied to mineral leases). On the other hand, mineral servitudes are more tightly regulated. See LA. MIN. CODE art. 21–79 (2000).

81. *Allison*, 404 So. 2d at 438.

82. For instance, language stating: “in the event of an assignment of the lease as to *any interest* therein, the lease rights and obligations shall be apportioned among the several leasehold owners and default by one shall not affect the rights of the others,” might be sufficiently broad enough.

responsible or pay the appropriate rentals directly to the lessor if delay rentals are due.<sup>83</sup> The failure of the one does not result in forfeiture of the lease by the other, and production from one does not maintain the lease as to the other.<sup>84</sup> This is the most common situation in which lease division is considered today.

Lease division thus operates to contravene the general rule that production from one part of the lease, even a non-contiguous tract, will maintain the entirety of the lease. This principle is codified in Mineral Code article 114.<sup>85</sup> By dividing the obligation to maintain a lease after its primary term by production, lease division actually goes a step further than the similar effect provided by a Pugh clause.<sup>86</sup> In a divided lease, even production from a *contiguous* divided tract will not maintain another segregated tract if the tracts have been assigned to separate lessees.<sup>87</sup>

The effect is that a lessor has a relatively straightforward means of proving a failure of one lessee to live up to the lease conditions; rather than asserting a failure to develop as to a given portion of the lease under implied lease covenants—a more significant burden, as discussed below—the lessor is able to simply provide the production reports for each assigned tract. If no production is attributable to a specific assigned and divided tract, the lessor will be able to prove automatic termination of the lease under the habendum clause, rather than engaging in a lengthy battle under the implied covenant to develop.<sup>88</sup> Again, if assignors or partial assignees of the lessee's interest benefit (in that they are shielded from the failure to develop

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83. See, e.g., *Noel Estate, Inc. v. Murray*, 65 So. 2d 886 (La. 1953); *Bond v. Midstates Oil Corp.*, 53 So. 2d 149 (La. 1951); *Tyson v. Surf Oil Co.*, 196 So. 336 (La. 1940); *Johnson v. Moody*, 123 So. 330 (La. 1929); *Swope v. Holmes*, 124 So. 131 (La. 1929); *Odom v. Union Producing Co.*, 129 So. 2d 530 (La. App. Ct. 2d 1961), *aff'd*, 141 So. 2d 649 (La. 1961).

84. *Id.*

85. LA. MIN. CODE art. 114 (2000), which states in part: “[a] single lease may be created on two or more noncontiguous tracts of land, and operations on the land burdened by the lease or land unitized therewith sufficient to maintain the lease according to its terms will continue it in force as to the entirety of the land burdened.”

86. A Pugh clause is a lease provision that operates to divide the lease based upon the lessee's development activity on the lease. Under the typical Pugh clause, off-tract unit production will only maintain that portion of the leased acreage included within the unit boundaries. A vertical Pugh clause applies the same principle to the development of the lease by depth intervals and would operate to release depths below those intervals in production at the expiration of the primary term of the lease or any extension of the term. See 4 SUMMERS OIL AND GAS § 54:9 (Nancy Saint-Paul ed., 3d ed.) (Westlaw 2012).

87. See, e.g., *Roberson v. Pioneer Gas Co.*, 137 So. 46 (La. 1931); *Swope v. Holmes*, 124 So. 131 (La. 1929).

88. See LA. MIN. CODE art. 133 (2000).

other tracts), then separate lease maintenance obligations should follow. There have not, as yet, been any Louisiana cases holding that this automatic termination applies in the horizontal division context. However, if one assumes that such division is possible, it follows that production from one divided formation or depth interval will not operate to maintain another formation or interval owned by another lessee. Any other result would yield a significant logical inconsistency in the existing theoretical framework of lease division in the case law.<sup>89</sup>

### *B. Delay Rentals*

The “mutual exculpation” clauses that gave rise to the concept of lease division in the first place specifically related to delay rentals. These clauses were concerned with the effect on the entire lease of a failure to pay such rentals by a party who was a mere partial assignee. As a result of *Swope* and its progeny, the issue is firmly settled for the classic example of the divided lease: if a lease containing a mutual exculpation clause is assigned as to discrete surface acreage, the failure of the assignee to pay the delay rentals will not result in any forfeiture of the lease for the assignor and *vice versa*.<sup>90</sup> These rentals are payable in an amount proportional to the acreage held by each party.<sup>91</sup>

As highlighted above, the question with regard to a horizontally-divided lease is potentially more difficult. If a lease holds that delay rentals are \$10 an acre and the lease is divided by depth—so that the assignor and assignee are still under the exact same surface acreage—how are the rentals to be split up, if at all? If we assume that both assignor and assignee owe \$10 per acre, are we not increasing the burden under the lease? Such a result would be in contravention of the typical assignment clause, which states that an assignment will not enlarge the obligations on the lessee or assignee.<sup>92</sup>

The problem may be an illusory one. The burden on the “lessee” is increased only if we view all partial assignors and partial assignees *collectively* as the lessee under the original lease. The partial assignor has no greater duty, after assignment, in our hypothetical—he still owes only \$10 an acre, just as he would if he simply released those depths. The partial assignee has the same

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89. See *supra* Part I.

90. See the discussion on *Roberson*, *supra* Part II.

91. *Id.*

92. See Scurlock, *supra* note 60, at 819 (quoting an example of a typical assignment clause).

duty; his obligation has not been increased and is equal to what he would likely owe if he had independently leased only those depths. The delay rental obligation is typically tied only to the amount of surface acreage and is not dependent on the extent of the lessee's subsurface rights. Though the lessor's benefits are now greater, they are not so because of the increase of any particular burden on the party with whom he signed the lease. Rather, the partial assignee is essentially the lessee of a new lease though he is bound under the same terms and conditions as those contained in the original lease. It is no more burdensome for either party than if the lessor originally leased both the shallow and deep rights separately and demanded the same delay rentals from both lessees.

Three practical considerations should operate to allay concerns about this issue in a horizontally divided lease. First, the amount due under most delay rental clauses is very small; a potential partial assignee will likely not be dissuaded from taking an assignment in the lease rights as to certain depths because of the possibility of paying the same amount of delay rentals as was due under the original lease. Second, most leases are now paid-up leases that do not contain any provision relating to ongoing delay rentals.<sup>93</sup> In these leases, there is no rental obligation at all, so the problem does not even arise. Third, lease division issues most often arise after the expiration of the primary term of the lease at issue, and delay rentals are not being paid at that point.<sup>94</sup>

## VI. LEASE DIVISION AND THE IMPLIED COVENANTS

Today, an important part of the lessee's obligations arises under article 122 of the Mineral Code. This article codified prior jurisprudence and states, in part: "[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."<sup>95</sup> Thus, the central issue in implied obligations cases remains whether the lessee has developed and operated the lease property as a reasonably prudent operator. The breadth of this standard has allowed courts to tailor remedies to the individual facts

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93. See PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS AND MEYERS, *MANUAL OF OIL AND GAS TERMS* at 685 (14th ed. 2009) ("A lease effective during the primary term without further payment of delay rentals, the aggregate of rentals for the entire primary term having been paid in advance.").

94. See *id.* at 231 ("A sum of money payable to the lessor by the lessee for the privilege of deferring the commencement of drilling operations or the commencement of production during the primary term of the lease.").

95. LA. MIN. CODE art. 122 (2000).

in a range of cases. Courts have, for the most part, wisely rejected the application of mechanical tests in determining whether a particular lessee has lived up to the prudent operator standard.<sup>96</sup>

Despite the statutory openness to individual details afforded by an expansive standard, the Comment to article 122 asserts a narrower scope of the duty of lessees to a group of four (possibly five) implied obligations found in the pre-Code jurisprudence:

In Louisiana, the general obligation to act as a “good administrator” or “prudent operator” has been clearly specified in four situations: (1) the obligation to develop known mineral producing formations in the manner of a reasonable, prudent operator; (2) 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; (3) the obligation to protect the leased property against drainage by wells located on neighboring property in the manner of a reasonable, prudent operator; and (4) the obligation to produce and market minerals discovered and capable of production in paying quantities in the manner of a reasonable, prudent operator.<sup>97</sup>

Additionally, the Comment mentions the possibility of including a fifth covenant duty to restore the surface of the leased premises after the cessation of operations as an implied obligation under article 122.<sup>98</sup> However, as will be explained below, this obligation should no longer be treated as an implied covenant in Louisiana; it is an express obligation under most lease forms, and the issue is governed by other statutes.<sup>99</sup>

With due respect to these Comments, nothing in article 122 purports to limit its scope to the four items mentioned in the Comments, and we would argue that the legislature, by its broader language, intended to provide for future developments in our mineral law to meet new challenges in the industry’s development and the interface between the lessor and lessee.

#### *A. Exploration and Development*

The covenants of exploration and development are closely related. The Comment to Mineral Code article 122, while itself listing the obligations separately and noting that Williams and

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96. Harrell, *supra* note 1, at 406.

97. LA. MIN. CODE art. 122 cmt. (2000).

98. *Id.*

99. *E.g.*, LA. REV. STAT. ANN. § 30:29 (2007).

Meyers makes the same distinction, states that the covenant of exploration is an “evolutionary offshoot” of the obligation to develop.<sup>100</sup> The connection comes from the fact that both obligations are essentially about the use of the leased property; the lease encumbers the minerals under the entire premises, and therefore, the lessee must explore and then develop the minerals to the greatest extent practical under the circumstances. If he fails to do so, the lessor never obtains his main consideration for the contract—the development and production of any minerals underneath the leased premises.<sup>101</sup>

The connection between these obligations and lease division is perhaps obvious in light of the history of the lease division issue. Some of the earliest cases regarding lease division dealt with the failures of assignors or assignees of the lessee’s interest to develop their respective portions of the lease.<sup>102</sup> The courts in those cases recognized the inequity of cancelling an entire lease because of the failure of one partial assignee to develop.<sup>103</sup> The remedy of partial cancellation evolved as a response to the problem of a lease that was only partially developed.<sup>104</sup> A court could target those portions of a lease that had not been adequately explored or developed and leave the lease untouched as to the remaining acreage. Article 142 of the Mineral Code explicitly carried this solution forward to the modern day.<sup>105</sup> The practical effect seems to be that whether a lease has been divided among multiple parties (by assignment, sublease, or anything else) is irrelevant to a determination of whether a given portion is subject to a penalty, or perhaps cancellation, for a breach of the exploration or development covenant. According to Williams and Meyers:

The availability of decrees of partial cancellation renders almost academic the problem of the effect on lease covenants of partial assignments. If a portion of the leasehold has been adequately explored or developed and another portion has not, most courts will cancel (at least

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100. LA. MIN. CODE art. 122 cmt. (citing 5 WILLIAMS AND MEYERS, *Oil and Gas Law*, ch. 8 (1969)).

101. *Carter v. Ark. La. Gas Co.*, 36 So. 2d 26, 28 (La. 1948).

102. See the discussion of *Roberson* and *Swope*, *supra* Part II.

103. *Id.*

104. See *Eota Realty Co. v. Carter Oil Co.*, 74 So. 2d 30, 36 (La. 1954); *Carter*, 36 So. 2d at 30; *Harrell*, *supra* note 1, at 393.

105. LA. MIN. CODE art. 142 (2000) (“A mineral lease may be dissolved partially or in its entirety. A decree of partial dissolution may be made applicable to a specified portion of land, to a particular stratum or strata, or to a particular mineral or minerals.”).

conditionally) the lease as to the neglected portion of the leasehold and preserve it as to the other.<sup>106</sup>

However, the assignments or subleases that divided a mineral lease may have a great practical effect when it comes to resolving the following issues: (1) the relief a lessor can obtain; (2) the determination of the lessor's most effective legal theory to clear title to his minerals; and (3) the standards by which a court will determine whether exploration or development has been adequate.

For one, the boundaries created by assignments that have divided the lease provide obvious and convenient lines of demarcation for partial cancellation of such leases for failure to develop.<sup>107</sup> In practice, these demarcations will be obvious because the different owners of lease interests behave in different ways. The aggressiveness of one operator on his divided tract or depth interval may influence a lessor's decision to bring suit against another operator on a divided tract or depth interval who is not conducting operations. In this sense, the internal boundaries within a lease created by assignment can have significant practical importance.

As mentioned above, a divided lease provides the frustrated lessor with an additional avenue for relief: automatic termination under the habendum clause.<sup>108</sup> A determination that a lease was divided, therefore, has great import for the lessor in determining whether he can proceed under the rather settled issue of whether there was production from any acreage attributable to the divided portion of the lease.<sup>109</sup> But what of the scenario where old, marginally productive wells are arguably satisfying held-by-production status for habendum clause purposes for each divided section of the lease, but a lessor does not believe the total mineral resources of the lease are being adequately developed? The covenants of development and exploration appear straightforward enough on paper, but in practice, disputes over additional development covenants will require putting the lessee in default.<sup>110</sup> This may be deemed an admission by the lessor that the lease continues in effect, and an extensive and expensive evidentiary battle will likely ensue. A single lessor may not have sufficient resources to engage in such a battle, which may demand expert testimony on geophysical data, evidence of operations on neighboring property, and an analysis of expected costs and profits.

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106. PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS AND MEYERS, OIL AND GAS LAW § 409.4 (LexisNexis, Matthew Bender & Co. rev. ed. 2012) (1959).

107. *Id.*

108. See discussion *supra* Part V.A.

109. See *Noel Estate, Inc. v. Murray*, 65 So. 2d 886 (La. 1953).

110. See LA. MIN. CODE art.136 (2000).

Additionally, Louisiana places the burden on the lessor to prove a failure to develop.<sup>111</sup>

Adding to the lessor's burden is the fact that the resolution to the following issue is not entirely clear: What must he, the lessor, prove has been inadequately developed—the lease as a whole or only a discrete portion of it? Though the difference may appear to be semantic, a court adopting the “lease as a whole” approach will likely view a demand for partial cancellation based on failure to develop less favorably if all other portions of the leased premises are adequately developed. The Williams and Meyers treatise discusses the issue in the following manner:

[W]here there is a question of the degree of diligence exercised by the partial assignee, partial assignments may influence the finding or not of breach of covenant. Should the defendant-partial assignee's diligence be considered only in light of what he has done on his premises, or should reasonable development and exploration be judged on a lease-wide basis? . . . We are inclined to think . . . the latter position is sounder. The original lease contemplated development and exploration on a lease-wide basis. Nothing in the ordinary lease suggests a different standard after partial assignments.”<sup>112</sup>

This view is attractive to the lessee's position in these disputes, as it offers a clean, simple, holistic approach to examining lease exploration and development. However, the view appears to be at odds not only with the rationale allowing for lease division in the first place, but also with further development covenants under Mineral Code article 122. That is, if a clause allowing for divisibility cuts off solidarity as to the lease obligations—so that the failure or fulfillment of an obligation on one divided tract is cut off from any other divided tract—it would seem to follow that the covenants to explore and develop should likewise be divided and applied separately. Here, the concept from *Roberson* is helpful: two new, different leases are created after division (these leases would cover two different leasehold interests but maintain the original lease terms).<sup>113</sup> Though the terms of a hypothetical original mineral lease do contemplate development and exploration on a lease-wide basis, the division of the lease by assignment should result in these lease terms being separately applicable to the acreage of each divided

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111. *Frazier v. Justiss Mears Oil Co.*, 391 So. 2d 485, 486 (La. Ct. App. 1980); Harrell, *supra* note 1, at 397.

112. MARTIN & KRAMER, *supra* note 106, at § 409.4.

113. *See supra* note 15.

tract. As such, it is more consistent to understand the lease conditions—express and implied—as imposed upon each partial owner of a lease interest as to, and only as to, the acreage in which he has rights. The legal result should be two independent leases.<sup>114</sup> Just as a partial owner of a lease interest should not be punished for the failure of another partial owner to explore for or produce minerals on that other tract, he should not receive the legal benefit from the overall development of the leased premises if he does not adequately develop his own tract.

This issue has not been directly addressed in Louisiana. However, a 1932 case decided by the U.S. Fifth Circuit, *Cosden Oil Co. v. Scarborough*,<sup>115</sup> provides a good analysis of the problem and recommends an approach that accords with the one offered in this Article:

In short, while the lease is entire as to the vesting not only in the original lessee, but in all of his assigns, of a determinable fee in each as to the part of the land he owns, that determinable fee as to each owner stands or falls, is abandoned or ceases, according to his own acts, subjecting him to the obligation for damages not at all for what is being done or not done upon the tract in general, but only for what he does. Any other construction would lead to interminable confusion.<sup>116</sup>

Though *Cosden's* rationale has been employed in many other decisions,<sup>117</sup> the approach suggested by Williams and Meyers is perhaps equally relied upon in case law.<sup>118</sup>

Framing the scope of the development and exploration covenants after lease division is similarly problematic when the division in question occurred along a horizontal plane. Assuming that such division is possible, a question arises: do we judge the adequacy of development on the basis of what has been done on all depths, or do we examine each divided depth interval separately? Imagine a situation wherein a lessee, A, assigns the lease rights below 5,000 feet to lessee B. Both tracts are separately maintained

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114. *Tyson v. Surf Oil Co.*, 196 So. 336 (La. 1940).

115. *Cosden Oil Co. v. Scarborough*, 55 F.2d 634 (5th Cir. 1932).

116. *Id.* at 638.

117. *E.g.*, *Hull v. Magnolia Petroleum Co.*, 119 F.2d 123 (5th Cir. 1941), *rev'd on other grounds*, *Magnolia Petroleum Co. v. Hull*, 314 U.S. 575 (1941); *Standard Oil Co. v. Giller*, 38 S.W.2d 766 (Ark. 1931); *W.T. Waggoner Estate v. Sigler Oil Co.*, 19 S.W.2d 27 (Tex. 1929).

118. *E.g.*, *Heman v. Jefferson*, 483 N.E.2d 537 (Ill. App. Ct. 1985); *Kothe v. Jefferson*, 440 N.E.2d 415 (Ill. App. Ct. 1982), *aff'd and remanded*, 455 N.E.2d 73 (Ill. 1983).

by production, but A's exploration and development activity as to the shallow depths are far more extensive than B's are as to the deeper zones. Under the approach urged by Williams and Meyers, a judge faced with determining the adequacy of lease exploration and development would properly examine the development of the original leased premises as a whole, rather than treating the upper depths and lower depths as separate leasehold interests with individual obligations inuring to each.<sup>119</sup> Such an approach mirrors the asymmetry noted in Section III above, where a party is shielded from the failures of another holder of part of the lease but shares, to some extent, in the successes.

This problem is not merely theoretical, as the covenants of exploration and development extend to each part of the lease, and partial cancellation of a lease is a recognized remedy for failure to develop a lease even when leases have not been divided.<sup>120</sup> A lessor *should* be able to point out the unexplored or undeveloped portions of a lease and pray for partial cancellation, regardless of who has the lease rights to that portion. However, under the contrary position, a judge looking at the development or exploration of a leased premise as a whole may frame the issue differently than in the case of a lease divided by assignment. Adopting the "no division of the lease obligation" position would seem to stack the deck against lessors.

### *B. Protection Against Drainage*

The duty to protect the leased property against drainage from adjoining lands is well-established in Louisiana. Early on, courts determined that lessors could obtain cancellation if their lessees allowed wells on neighboring tracts to drain the minerals underneath the leased properties. In *Breaux v. Pan American Petroleum Corp.*,<sup>121</sup> the Louisiana Third Circuit Court of Appeal decided that lessors could also recover damages for the failure to protect against drainage.<sup>122</sup>

There is no real change in the application of this duty in the most common divided lease scenario, where a lease is partially assigned into discrete surface tracts. If one or both of those tracts is being drained, the lessor can and should treat each tract as a separate leasehold and make demand on the lessee who has rights to the tract actually being drained. If both are being drained, either should be subject to cancellation or damages for his or her own failure to

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119. See MARTIN & KRAMER, *supra* note 106 at § 409.4.

120. See *Sohio Petroleum Co. v. Miller*, 112 So. 2d 695 (La. 1959).

121. *Breaux v. Pan Am. Petroleum Corp.*, 163 So. 2d 406 (La. Ct. App. 1964).

122. *Id.* at 415.

perform, though not for the failure of the other.<sup>123</sup> If only one party can prevent the drainage, the other should not be held liable for a failure to do so. A partial assignee of a horizontally-divided lease should not be held liable for drainage occurring at a depth he could not protect—for instance, drainage of gas at 12,000 feet if he only has the lease rights down to 4,000 feet.

A thornier matter is the issue of drainage from the other divided tracts. In this instance, a conceptual problem arises if the lessor has also assigned his interest, so that the lessor's rights to Tract 1 belong to one party and Tract 2's to another. Can the former demand the drilling of an offset well to prevent drainage by Tract 2? The Williams and Meyers treatise suggests the answer is no.<sup>124</sup> The original lease did not contemplate protection against this "internal" drainage, and an assignment by the lessor could increase the duty on the lessee.<sup>125</sup> However, Williams and Meyers notes that at least one author has felt this position to be entailed by the very concept of the divisibility of lease obligations.<sup>126</sup>

The reality may be that the concept of lease division is not and cannot be a completely consistent doctrine. There are inevitable contradictions that prevent a totally consistent result across each issue. Such appears to be the case here. If all the obligations are divided and the divided tracts represent separate leaseholds, the covenant to protect against drainage should inure to each separate tract or depth interval. That is, there can be claims for internal drainage in a horizontally divided lease.

Rather than ask what the "correct" answer is, perhaps courts should instead simply look for the most pragmatic solution. The fact that the original lease language did not contemplate "internal" drainage should not be determinative. Instead, the potential for a multiplication of the lessee's duty with each assignment by the original lessee should be the focus. From a practical standpoint, the lessee has an alternative means of satisfying or avoiding a demand to prevent drainage other than drilling a set-off well: the lessee can request unitization.<sup>127</sup> A unitization order will ordinarily require a finding that the well is draining the unit acreage, but not acreage outside the unit.<sup>128</sup> In practice, the order will usually satisfy the

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123. *Contra* MARTIN & KRAMER, *supra* note 106, at § 409.3, which suggest that these parties are jointly and severally liable for the full amount of drainage.

124. *Id.*

125. *Id.*

126. *Id.* (citing Hiram H. Lesar, *Divisibility of Covenants in Oil and Gas Leases*, 25 KY. L.J. 142, 162 (1937)).

127. LA. MIN. CODE art. 122 cmt. (2000); *Breaux v. Pan Am. Petroleum Corp.*, 163 So. 2d 406 (La. Ct. App. 1964).

128. LA. REV. STAT. ANN. § 30:9 (2007).

drainage covenant, regardless of whether the unit order is accurate. In a scenario where the divided tracts are actually near enough that spacing regulations are at issue, unitization would almost certainly be granted. Thus, arguably, there is a duty to prevent so-called internal drainage in a divided lease. From a practical standpoint, however, such a duty will be confined to a very narrow set of circumstances, and such cases can be dealt with on their facts.

### *C. Marketing*

The duty to exercise diligence in securing a market is made up of two components: (1) the duty to make diligent efforts to market any production; and (2) the duty to obtain the best price for that production.<sup>129</sup> This covenant is generally applicable to gas rather than oil because of the relative ease of securing such a market for oil.<sup>130</sup>

Based on the basic principles set forth already, the application of this duty to a divided lease is fairly straightforward: the obligation should be separately imposed on each segregated tract, so that each partial assignor or assignee is responsible for marketing only to the extent of his control of the leased premises. If *A* can only produce and market from Tract 1, he is not responsible for the failure of *B* to market from Tract 2. The rationale would hold with equal force for a lease divided by depth, strata, or substance. In the hypothetical scenario of a lease divided by depth, it seems obvious that a party with rights vested in only a certain depth interval should not face forfeiture of his lease interest simply because the holder of the another depth interval failed to properly market its production. The same rationale, of course, would apply to a lease divided by substance.

### *D. Surface Restoration*

Louisiana law on surface restoration is in a period of rapid change, evolving in response to a number of statutory and public policy considerations.<sup>131</sup> To state it briefly, only the following can be said safely: an implied covenant to restore the surface of the leased property to pre-lease conditions after the cessation of operations exists under Mineral Code article 122 (which sets forth the lessee's duty to act as a reasonably prudent operator); however,

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129. *Frey v. Amoco Prod. Co.*, 603 So. 2d 166, 175 (La. 1992).

130. John M. McCollam, *A Primer for the Practice of Mineral Law Under the New Louisiana Mineral Code*, 50 TUL. L. REV. 732, 809–10 (1976).

131. A full account of this transformation is beyond the scope of this Article.

the exact scope of that obligation is unknown.<sup>132</sup> Some restoration obligations seem obvious. For example, filling in pits and removing surface tanks and equipment are to be expected from a prudent operator—but the resolution of other issues is less clear.

After the extensive damages award in the famous legacy case of *Corbello v. Iowa Production*,<sup>133</sup> the legislature enacted Louisiana Revised Statutes section 30:2015.1 in 2003, establishing procedures for the remediation of usable groundwater.<sup>134</sup> The legislature expanded the remediation procedures in 2006 with Act 312, which set forth processes to regulate the remediation of well sites; Act 312 was later brought into the Revised Statutes as Louisiana Revised Statutes section 30:29.<sup>135</sup> In 2005, the Louisiana Supreme Court held that, in *Terrebonne v. Castex Energy, Inc.*,<sup>136</sup> Mineral Code article 122 did not impose an implied duty to restore or remediate the leased property to the pre-lease condition, absent proof that the lessee had exercised his rights unreasonably or excessively.<sup>137</sup> Thus, it was thought the obligation to restore the surface was only due under an *express* lease provision. However, subsequently, in *Marin v. Exxon Mobil Corp.*,<sup>138</sup> the Court stated:

In our view, the duty to remediate oilfield containment exists under the prudent operator standard of the Mineral Code by virtue of our holding in *Castex*, and it certainly exists under the Civil Code. The holding in *Castex* merely recognized that in the absence of unreasonableness or excessiveness, the lessee has a duty to restore the surface minus normal wear and tear. Where the lessee has operated unreasonably or excessively . . . the lessee has additional obligations. . . .<sup>139</sup>

In 2013, the court went further in *State v. Louisiana Land and Exploration*<sup>140</sup> and decided that a court could make a damage award for a remediation claim in excess of the amount required under Louisiana Revised Statutes section 30:29, even in the absence of an express lease provision providing for such excess damages.<sup>141</sup>

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132. LA. MIN. CODE art. 122.

133. *Corbello v. Iowa Prod.*, 850 So. 2d 686 (La. 2003).

134. LA. REV. STAT. ANN. § 30:2015.1 (2013).

135. LA. REV. STAT. ANN. § 30:29 (2013).

136. *Terrebonne Parish Sch. Bd. v. Castex Energy, Inc.*, 893 So. 2d 789 (La. 2005).

137. *Id.* at 797.

138. *Marin v. Exxon Mobil Corp.*, 48 So. 3d 234 (La. 2010).

139. *Id.* at 259–60.

140. *State v. La. Land & Exploration Co.*, 110 So. 3d 1038 (La. 2013).

141. *Id.* at 1054.

The relevance of these recent decisions to lease division is not entirely clear. There have not yet been enough cases decided to determine the respective restoration obligations of partial assignors and assignees after a lease has been divided. A partial assignee of one tract should not be held liable for a remediation claim relating to a tract in which he never held rights. On the other hand, an assignor who divested himself of rights to a certain tract on which operations had been conducted prior to assignment probably will bear some responsibility for a later remediation claim relating to pre-assignment operations on that tract, absent an express assumption of liability for remediation by the assignee. Such a result would be consistent with articles 128 and 129 of the Mineral Code and with prior decisions that have held that all parties in the chain of title for a particular piece of leased property can be joined as defendants.<sup>142</sup>

## VII. CONCLUSION

The concept of lease division initially benefitted lessees who were assigned discrete acreage of leased property. With a divided lease, the failure of the partial assignee to make payments of delay rentals (or the commission of some other default under the lease) did not affect the rights of the lessee-assignor. More recently, the notion has been used by lessors frustrated by inactivity on an assigned portion of their leased premises—usually through the lessor's assertion that the assigned portion of the lease had to be separately maintained. Obtaining a judgment that an assignment divided the lease may result in a determination that there was an automatic termination for failure to maintain the separate areas of a divided lease. This remedy is attractive because of its relative simplicity. If all divided tracts are, in fact, separately maintained, a lessor may move to a cause of action based on a "failure to develop": an implied lease covenant under article 122 and a more onerous action to bring. In article 122 cases, not only is a great deal more evidence required to bring the action (and, therefore, more expense), but there also remain a great many unanswered questions about how exactly implied covenants are enforced and about what exactly the remedy is for a breach of an implied covenant.

If the assignor and assignee of the lessee's interest under a mineral lease receive the benefit of *limiting* their liability to the lessor to the portion of the lease they own, it logically and equitably follows that each post-assignment segment of the lease must be

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142. *But see* Wagoner v. Chevron USA Inc., 55 So. 3d 12 (La. Ct. App. 2010) (holding that a landowner has no right of action over damage to his property sustained prior to his acquisition of the property).

treated as a separate lease for purpose of lease maintenance. Further, our law should treat an assignment of discrete depth intervals as a division of the lease with the same effect as a division by surface acreage. Division by substance, though rare, should be subject to the same rule. The basis for such a doctrine exists in our case law, and the courts should recognize and apply the doctrine liberally in cases where lease covenants and assignment provisions require the lessee's interest to be treated as divided for purposes of performance of lease covenants post-assignment. The vast majority of lessors have no control over the partial assignment of their lease; the division of the lease is initiated by the lessee for the benefit of lessees. Some protection of the lessor's interest therefore seems warranted and desirable for the public interest.