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Hoover Tree Farm v. Goodrich Petroleum

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AN OVERVIEW OF ASSIGNMENTS AND SUBLEASES OF MINERAL LEASES AND THE MOST-FAVORED NATION CLAUSE: *HOOVER TREE FARM, L.L.C. V. GOODRICH PETROLEUM COMPANY, L.L.C.*

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Oil and Gas lessees have long assigned and subleased all or part of their interests in those leases to third parties. While much early Louisiana jurisprudence in the area centered merely on identifying the language that distinguishes assignments from subleases, and on analyzing the legal effects of that difference, the importance of correctly assessing the relationship either between lessee and assignee or between lessee and sublessee takes on an even *more* significant meaning when examining the issue through the lens of an existing so-called "most-favored nation clause" (hereinafter "MFN clause") in the original oil and gas lease. In the fervent rush to secure leasehold acreage in a profitable shale "play" (such as the Haynesville shale of North Louisiana, the area at issue in this case), many exploration and production (hereinafter E&P) companies eventually pay exponentially more both in per-acre bonus amounts and royalty percentage amounts in lease conveyances than did the original E&P company party to the lease as a lessee. Usually, this common form of speculation creates no additional payments owed to the lessor. However, as it will be seen in the coming discussion of *Hoover Tree Farm v. Goodrich Petroleum*,[1] a lease containing an MFN clause serves to place liability *in solido* both on the original lessee and the transferee, obliging them together to compensate the lessor the amount in

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1. Hoover Tree Farm, L.L.C. v. Goodrich Petroleum Co., L.L.C., 46,153 (La. App. 2 Cir. 3/23/11), 63 So. 3d 159.

difference between the price of the original lease and that of the partial assignment, both in per-acre bonus and royalty percentage payments, if in fact the transfer at issue is deemed to be an assignment rather than a sublease, or if the two lessees may be deemed to be "co-owners" of the lease.

I. BACKGROUND

Hoover Tree Farm, L.L.C. ("Hoover") leased 317 acres of land in Caddo Parish to Goodrich Petroleum Company, L.L.C. ("Goodrich") in 2008, for whom Petroleo Properties, L.L.C. ("Petroleo") acted as a broker in negotiating the lease. The final negotiated terms of the Oil, Gas and Mineral Lease[2] granted Hoover a 25% royalty and a $1,000 per acre lease bonus.[3] After early revisions of the MFN clause by Hoover's attorney, its final version, and the source of this case's litigation, provides as follows:

> Lessee and Goodrich Petroleum Company, L.L.C., which joins herein, each guarantee that no lessor of either Lessee or Goodrich Petroleum or their successors and assigns shall receive a higher royalty and/or bonus than the Lessor under this Lease. Should any lessor receive such higher bonus and/or royalty, the Lessor under this Lease shall receive from Goodrich Petroleum Company, L.L.C. the difference between the higher bonus and the bonus paid to Lessor at the inception of this Lease, and the difference between the higher royalty and the royalty paid to Lessor under this Lease. This clause will remain in effect separately with respect to each Section covered by this Lease, and with respect to each such Section, this clause will remain in full force and effect until the end of the Primary Term of this Lease. This clause covers every lease which may be made by Lessee, Goodrich Petroleum Company, L.L.C., Sendero

2. *Id.* at 161-62.

3. While the lease initially listed Petroleo, L.L.C. as the Lessee, paragraph 27 of the Lease clearly provides that Goodrich is to be deemed the original Lessee since it was always Petroleo's intent as broker to assign the lease to Goodrich. On May 7, 2008, Petroleo assigned to Goodrich "all of the Assignor's right, title and interest" in and to the lease. *See* Hoover, 63 So. 3d at 162, n.4.

> Resources Incorporated and/or Caddo Resources LP, as Lessee, and their respective successors and assigns, in any section in any of the following townships and ranges in Caddo Parish, Louisiana: (19N–16W), (19N–15W), (18N–16W), and (18N–15W).[4]

On June 6, 2008, Goodrich and Chesapeake Louisiana, LP ("Chesapeake") executed an "Assignment, Conveyance, and Bill of Sale," in which Goodrich "Granted, Sold, Assigned, Conveyed, and Delivered" to Chesapeake an undivided 50% interest in the Hoover lease and other leases to all depths below the "Cotton Valley Formation." The transfer did not contain any forms of payment that resembled an overriding royalty for Goodrich.[5] Soon after this agreement, Chesapeake acquired other oil and gas leases ("third party leases") in the area within the established bounds of the Hoover lease's MFN clause for a counter-performance of $25,000 per acre bonus payments and a 30% lease royalty. Hoover then filed suit against Petroleo, Goodrich, and Chesapeake, asserting these third party leases triggered application of the MFN clause in its own lease. Hoover contended that, because Chesapeake was an "assign" of Goodrich and entered into other mineral leases in the range covered by the lease's MFN clause, it (Hoover) is owed the difference between the bonus and royalty it received initially and the amount of bonus and royalty Chesapeake paid for the third party leases. Hoover's September 28, 2009 Motion for Summary Judgment sought $7,608,000 (317 acres x $24,000) and a 30% royalty. In response, Chesapeake's and Goodrich's opposing summary judgments asserted the transfer between them was a sublease rather than an assignment, thereby not triggering the MFN clause. In the alternative, Chesapeake also contended that even if the clause would be deemed to come into effect, that Goodrich alone would be liable for breach of the clause.[6]

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4. Hoover, 63 So. 3d at 162.
5. *Id.* at 162.
6. *Id.* at 163-64.

The trial court, after receiving the arguments from all parties, granted Hoover's Motion for Summary Judgment, holding that the transfer between Goodrich and Chesapeake was an assignment and that the MFN clause's application would be allowed because of Chesapeake's third party lease acquisitions. The court thus increased the Hoover royalty to 30%, denied Goodrich's cross-motion for summary judgment, and granted Chesapeake's summary judgment, holding that Goodrich was the only party accountable for the higher bonus under the Hoover lease's MFN clause. Hoover and Goodrich both appealed following the judgment; Hoover also sought to hold Chesapeake liable along with Goodrich for the $7.6 million judgment in its favor.[7]

II. DECISION OF THE COURT OF APPEAL

The Court of Appeal of Louisiana, Second Circuit, amended the lower court's judgment, affirming in part and reversing in part, holding that Chesapeake was obligated *in solido* with Goodrich to satisfy the higher bonus payment under the most-favored nation clause,[8] and that the transfer executed between Chesapeake and Goodrich was an assignment rather than a sublease.[9] Despite the court's recognition of the fact that the case's primary issue is the interpretation of the MFN clause, it nevertheless first addresses the issue of the *in solido* obligation of both Goodrich and Chesapeake

7. *Id.* at 164.

8. *See* the block quotation *supra* for the exact terms of the most-favored nation clause at issue in this case. While there are many available published attempts to precisely define MFN clauses as they are modernly used, the exact definition depends upon the circumstances in which they are employed and the type of obligations they modify. A basic MFN clause definition is as follows: "a contractual agreement between a buyer and a seller that the price paid by the buyer will be at least as low as the price paid by other buyers who purchase the same commodities from the seller." Arnold Celnicker, *A Competitive Analysis of Most Favored Nations Clauses in Contracts between Health Care Providers and Insurers*, 69 N.C. L. REV. 863, 864 (1991). In the instant case, the MFN clause provides that the lessor will receive the *highest* prices paid by other lessees within a strictly defined geographic area of mineral exploration.

9. Hoover, 63 So. 3d at 181.

(with regards to their having to pay the $7.6 million). After briefly but clearly noting that mineral leases are real rights governed by Louisiana's Mineral Code,[10] the court states that Article 128[11] provides that the assignees or sublessees acquire the rights and powers of the original lessee to the extent conveyed by the partial assignment or sublease. Noting the lower court's inconsistency in holding that Goodrich alone was liable under the judgment, but also somehow holding that both Goodrich and Chesapeake would be jointly affected by the lease's royalty obligation increasing for 30%, the appellate court rejected the notion that Goodrich is solely liable for the payment of the $7.6 million judgment to Hoover. The court thus held that since Article 128 makes clear that both Goodrich and Chesapeake are co-owners of the lease's operational rights, that both companies are therefore liable for payment to Hoover.[12]

Regarding the appeal's principal issue (whether the transfer between Goodrich and Chesapeake was an assignment or sublease), the court provides a thorough jurisprudential history of the long-litigated difference between the two forms of lease conveyances, starting with a basic examination of the importance of a contract's interpretation being clear and unambiguous, if possible.[13] Eventually, the court outlines the Civil Code's definitions for successors and assigns, concluding that within the meaning of Civil Code article 3506,[14] Chesapeake was an assign of Goodrich; however, since the transaction involved a mineral lease, the court further examines the unique law and Louisiana jurisprudence surrounding subleases and assignments as they pertain to mineral leases. Although the Louisiana Supreme Court has decided many cases on the issue, the most important cases, and

10. *See, generally*, LA. REV. STAT. ANN. § 31 (2012).
11. Hoover, 63 So. 3d at 163. *See also* LA. REV. STAT. ANN. § 31:128 (2012).
12. Hoover, 63 So .3d at 167.
13. *Id.* at 168.
14. *Id.* at 170. *See also* LA. CIV. CODE art. 3506.

the two which this court considers the most,[15] are *Roberson v. Pioneer Gas Co*[16] and *Smith v. Sun Oil.*[17] Noting the inconsistencies in jurisprudence because of a lack of the code's guidance on the issue, the court holds that the "lease upon a lease" concept as first presented in *Sun Oil* became relaxed and broadened to mean that the sublease test became "any retained measure"—that is, for a sublease to exist, the transferor has to retain a "measure," now commonly called an "override," of the original lease. Importantly, the court states in *dicta* in footnote 20 that "we have not uncovered a Louisiana decision where a tenant conveyed an undivided interest in his lease and became faced with the claim that a sublease had occurred."[18] The court again reiterates that in all prior cases involving the transfer of an undivided interest in a mineral lease, such as what happened between Goodrich and Chesapeake, courts have not found the transfers to be subleases.[19] Thus, despite both Chesapeake's and Goodrich's claims that their transfer was a sublease, the court holds that "we cannot find that the Transfer from Goodrich to Chesapeake was a sublease, causing them to be in a sublessor/sublessee relationship."[20]

However, after this thorough legal and jurisprudential framework of the assignment vs. sublease realm, the court seems to shift entirely to a separate (if related) legal topic—co-ownership. Ultimately, despite definitively declaring the transfer as an assignment, the court declares "the relationship between Goodrich and Chesapeake after the transfer falls squarely within the Louisiana Law of co-ownership."[21] Therefore, the assignment of the leasehold rights to Chesapeake made it responsible directly to

15. *Id.* at 175-76.
16. Roberson v. Pioneer Gas Co., 137 So. 46 (La. 1931).
17. Smith v. Sun Oil Co., 116 So. 379 (La. 1928).
18. Hoover, 65 So. 3d at 176.
19. *Id.* at 177.
20. *Id.* at 179.
21. *Id.*

the original lessor, Hoover.[22] In the final analysis, the court's holding seems to hinge more on the finding that Chesapeake and Goodrich were co-owners of the lease, rather than on the finding that Chesapeake was an assignee instead of a sublessee after the transfer. Both findings, however, are clearly stated in the reasons given by the court.[23]

III. COMMENTARY

This brief commentary will argue that the Second Circuit Court of Appeals made the correct holding regarding both the MFN clause issue and the assignment/sublease issue present in *Hoover Tree Farm* v. *Goodrich Petroleum Company*, but that it was unnecessary, superfluous, and confusing for the court to cite the law of co-ownership at the end of its discussion in support of its holding. Put simply, the court arrived at the correct holding after it accurately concluded that, since Chesapeake was a partial assignee in the lease transfer, Chesapeake along with Goodrich were liable to Hoover—the court should have concluded the opinion following assignment/sublease analysis instead of proceeding to discuss co-ownership as well. While some of the points of this commentary's straightforward argument are perhaps touched upon in the court's discussion, the argument *infra* attempts to lay out a simpler, more direct means of getting to the same, correct holding(s) as did the court in its opinion.

Article 114 of the Mineral Code provides that "a mineral lease is a *contract* by which the lessee is granted the right to explore for and produce minerals."[24] While the Mineral Code makes abundantly clear that the mineral lease is notably different than most other contracts in that it creates a real right (rather than a

22. *Id.* at 180.
23. *Id.*
24. LA. REV. STAT. ANN. § 31:114 (2012) (emphasis added).

personal obligation),[25] a mineral lease is nevertheless a legally effective agreement between parties, regulating rights and obligations like any other personal contract.[26] Accordingly, the interpretation of mineral leases operates exactly like that of any other contract: the words used in the lease are to be given their prevailing meaning (unless they are words of art or technical),[27] and no further interpretation should be made in search of the parties' intent if the lease's words are "clear, explicit, and lead to no absurd consequences."[28] In this case, the disputed clause in the original lease between Hoover and Goodrich, and the initial reason for the litigation, is its most-favored nation clause. The first sentence of the MFN clause clearly and unambiguously states that Goodrich "guarantee[s] that no lessor or lessee of either entity *or their successors and assigns* shall receive a higher royalty and/or bonus than the Lessor under this Lease."[29] The concluding sentence provides clearly and unambiguously that the clause covers every lease within a specified geographic range made by Goodrich and their respective successors and assigns.[30] If, therefore, in conjunction with the language from the above-mentioned civil code articles discussing contract language interpretation, the terms in this MFN clause can be given their prevailing meaning, no further interpretation of the clause is necessary if that interpretation does not lead to absurd consequences. Here, then, if Chesapeake can be deemed an "assign" of Goodrich, the MFN is therefore triggered, and Chesapeake as an assign would be liable for payment along with Goodrich for that guarantee of the difference of bonus and royalty amounts to the lessor, Hoover.

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25. LA. REV. STAT. ANN. § 31:16 (2012). *See also* LA. REV. STAT. ANN. § 31:18 (2012).
26. *See, generally*, Stephenson v Petrohawk Properties, L.P., 37 So. 3d 1145 (La. App. Ct. 2d 2010); Winnon v Davis 759 So. 2d 321 (La. App. Ct. 2d 2000).
27. LA. CIV. CODE art. 2047 (2012).
28. LA. CIV. CODE art. 2046 (2012).
29. Hoover, 65 So. 3d at 162 (emphasis added).
30. *Id*.

Determining whether Chesapeake is a partial assignee, and therefore liable *in solido* with Goodrich, or a sublessee, and therefore not liable, involves a slightly more complex and involved analysis than that of the interpretation of the language of the MFN clause. However, it quickly becomes clear after reading the Mineral Code, relevant jurisprudence,[31] and secondary sources[32] that it is highly unlikely that this transfer between Goodrich and Chesapeake would make the latter a sublessee rather than an assignee. In the law of mineral leases in Louisiana, a unifying trait present in subleases, and not in assignments, is the presence of a reservation of an interest of some kind by the original lessee; an assignment of a lease, however, is generally viewed merely as a kind of sale of all or part of the lease.[33] The distinction is well-established through several decades of the development of Louisiana oil and gas law[34] and is clearly laid out in this excerpt from Leslie Moses' 1940 law review article on the matter:

> There is a difference under the Louisiana law between an assignment and a sublease of an oil and gas lease. An assignment is the conveying of all or a part of the entire lease for the whole of the unexpired term. The assignee secures the same interest that his assignor had at the time of

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31. Mire v. Sunray DX Oil Co., 285 F. Supp. 885, 890 (W.D. La. 1968): There is a sharp distinction between an assignment of a lease and a sublease, recognized in the jurisprudence. In the case of a sublease a new and, in a sense, separate contractual relationship of lease exists between the original lessee and the sublessee. There can be no actions on the contract between the original lessor and the sublessee because there is no privity between them; there are two contracts, the original lease and the sublease, only the original lessee is a party to both… *Where there is an assignment of the lease…the assignee is liable to the original lessor for the obligations of the original lessee which he has assumed completely. To sublease is to lease in whole or in part the thing of which one is the lessee, with reservation of an interest in it by the original lessee, or sublessor; while to assign a lease is to sell it* (emphasis added).

32. *See generally* Leslie Moses, *The Distinction between a Sublease and an Assignment of a Mineral Lease in Louisiana,* 18 TEX. L. REV. 159 (1940).

33. *See* the emphasized portion of the quotation, *supra* note 31.

34. *See* Broussard v. Hassie Hunt Trust, 91 So. 2d 762 (La. 1956); *see also* Roberson v. Pioneer Gas Co., 137 So. 46 (La. 1931); Smith v. Sun Oil Company, 116 So. 379 (La. 1928).

> the assignment. Any instrument transferring less than this, or a part of lessee's rights or obligations under the original lease, is a sublease.
> In Bouvier's *Law Dictionary* a sublease, or an underlease, is defined as: "An alienation by a tenant of a part of his lease, reserving to himself a reversion; it differs from an assignment which is a transfer of all the tenant's interest in the lease. And even a conveyance of the *whole* estate by the lessee, reserving to himself the rent, with a power of reentry for nonpayment, was held to be not an assignment but an underlease."[35]

In the instant case, the transfer between Goodrich and Chesapeake was an assignment, rather than a sublease, because the terms of the transfer were such that Chesapeake received "an undivided 50% interest in the Lease . . . as to all depths below the Cotton Valley formation. The Transfer contained no provisions for payment to Goodrich in the nature of an overriding royalty."[36] Nothing about this transfer mirrors the mechanisms of a sublease, or an "underlease" (to use the original civilian term), since Goodrich reserved no interest or overriding royalty, as made clear in the court's observation quoted immediately above. Rather, this is an assignment in which the conveyance is of "all or a part of the entire lease for the whole of the unexpired term"[37]—in this partial assignment, the lessee transferred all the rights associated with half of the lease's interest. Indeed, the assignee (Chesapeake) has secured "the same interest that his assignor had at the time of the assignment."[38]

Thus, Chesapeake, as an assignee rather than sublessee, should be held liable *in solido* with Goodrich for both the $7.6 million judgment and the higher royalty amount. The MFN clause, read clearly and unambiguously as the language in any mineral lease should be, was triggered when Goodrich executed the 50% partial assignment to Chesapeake. According to Mineral Code

35. Moses, *supra* note 32, at 159-60 (citations omitted).
36. Hoover, 63 So. 3d at 162.
37. Moses, *supra* note 32, at 159.
38. *Id.*

Article 128, the partial assignee (Chesapeake) is directly responsible to the lessor (Hoover). The Second Circuit thus correctly held that Hoover shall recover from both Goodrich and Chesapeake. The opinion, however, could have ended after the court's conclusion that Chesapeake is an assignee. By adding at the end of its analysis that Chesapeake and Goodrich were co-owners of the lease, and therefore liable *in solido* for that reason as well, the Court is opening another can of worms: though the Mineral Code provides that mineral rights are real rights, can one "own" these rights, and therefore be co-owner of them? It is good news that the case could be solved without answering to this tricky question.