Private Law: Mineral Rights

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MINERAL RIGHTS

Frederick W. Ellis*

JOINT OPERATING AGREEMENTS

The Louisiana Supreme Court reversed the Third Circuit Court of Appeal in Superior Oil Co. v. Cox, holding that lease acreage earned under a separate agreement by a unit operator by reason of unit drilling did not benefit the unit operator's joint venturers. The case turned on interpretation of a joint operating agreement's acreage contribution clause. The third circuit had ruled that the other joint venturers were entitled to share in the earned acreage received by Cox as a result of his drilling the unit well. The third circuit result suggested a possible tendency to favor those who had participated in the costs of the venture, because the economic result of the court of appeal decision was to apportion the benefits of the drilling venture consistently with the burden of costs. The supreme court decision incorrectly reaches an opposite result.

The third circuit's view does require a liberal reading of the acreage contribution clause, for Cox did not involve the ordinary acreage acquisition situation contemplated by a contribution clause. However, viewing the totality of the legal relations of the parties and the facts of the case, justice and correct legal analysis would have been better served had the Louisiana Supreme Court given greater weight to several important circumstances. The case involved a joint venture and the operator-defendant was an agent of his joint venturers, who had shared his costs and risks.

Clauses designed to effect economic fair play ought to be liberally construed. The unfairness of the result in Cox stems

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1. 307 So. 2d 350 (La. 1975), reversing 290 So. 2d 916 (La. App. 3d Cir. 1974).
2. "Acreage or Cash Contributions: If any party receives, while this agreement is in force, a contribution of cash toward the drilling of a well or any other operation on the subject leases such contribution shall be paid to the party or parties who conducted the drilling or other operation and same shall be applied against the cost of drilling or other operation." 307 So. 2d at 353.
from the fact that the operator was allowed to use drilling
costs and risks that were shared with his joint venturers to
obtain economic benefits (securing rights to acreage) that
were not shared with his joint venturers. Preoccupation with
definitional detail of the meaning of acreage clause verbiage,
a focus on the chronological significance of the condition the
unit drilling satisfied, and the intricacy of the facts appar-
etly all served to obsfuscate the simple truth that it is un-
reasonable to assume that parties undertaking joint risks and
costs do not intend joint benefits.

UNIT WELL COSTS

In denying a writ application in Desormeaux v. Inexco Oil
Co., a scant majority of the Louisiana Supreme Court agreed
with the third circuit's denying recovery to a unit operator
for costs prior to unitization, on the basis of the facts found
below. In concurring in the writ denial, Justice Tate noted
that he would ground the denial on a fiduciary relationship's
having been violated as a consequence of drainage by a min-
eral lessee of his lessor's lands not covered by the lease.

Inexco, Desormeaux's lessee, had completed the Desor-
meaux No. 1 well on land covered by the Desormeaux mineral
lease on September 20, 1970. Desormeaux also owned adjoin-
ing unleased acreage. On August 5, 1971, purportedly effec-
tive June 30, 1971, the Commissioner of Conservation estab-
lished a unit including a portion of the unleased land. By this
time, Inexco had already enjoyed production in excess of well
costs. The trial court rejected the argument that the Commis-
sioner's method of apportioning costs was not controlling.
This view was shared by the third circuit, which had earlier
held that the Commissioner's fact finding powers as to unit
well costs under Louisiana R.S. 30:10 related to cost deter-
mination, not apportionment. It treated apportionment as a
legal problem. Exercising its judicial discretion, the court of

4. 302 So. 2d 37 (La. 1975).
5. 298 So. 2d 897 (La. App. 3d Cir. 1974).
6. LA. R.S. 30:10 (1950): “In the event pooling is required, the cost of
development and operation of the pooled unit chargeable by the operator to
other interested owners shall be limited to the actual reasonable expendi-
tures required for that purpose, including a charge for supervision. In the
event of a dispute relative to these costs, the commissioner shall determine
the proper costs, after notice to all interested persons and a hearing.”
7. 298 So. 2d at 900-01, citing the remand at 277 So. 2d 218, 220 (La. App.
3d Cir. 1973).
appeal approved the district court’s holding that “the cost of the well prior to unitization could not be charged to the landowner since these costs had been recovered from the production prior to unitization.” The court reasoned that the operators of the well would otherwise be recovering twice. It incorrectly treated Louisiana R.S. 30:10, which permits charges to “other interested owners” in a unit, as inapplicable because it pertains to “separately owned tracts.”

The courts’ misunderstanding of economics and accounting principles has led to an erroneous view of the law. A capital cost is not expensed upon acquiring the capital item; rather, the cost should be apportioned over the productive life of the capital asset. This principle underlies the theory of depreciation expense accounting. True economic justice, the objective of Louisiana R.S. 30:10, would have been done if drilling costs of the unit well had been apportioned over the anticipated life of the well, with appropriate interest adjustments. Thus, the landowner’s unleased acreage would not have enjoyed an unfair “free ride,” and yet due weight would have been given to the pre-unitization use of the capital asset on a non-unitized basis.

The fact that the free rider was a landowner who coincidentally was the lessor of the unit operator does not detract from the correctness of this analysis. Clearly, the Third Circuit Court of Appeal erred in seizing upon the statutory language “separately owned tracts,” maintaining that there was no separate ownership because of the fact that Desormeaux owned both the leased and unleased land in the unit. The court of appeal erroneously ascribed the common understanding of “owned” or “owner” to Louisiana R.S. 30:10’s uncommon use of those terms. The Conservation Act contains a special definition of “owner.” Louisiana R.S. 30:3(8) defines “owner” as the person who has the right to drill into and produce from a pool and to appropriate the production either for himself or others. Mr. Desormeaux had this right on his unleased acreage; his lessee had the right on the leased acreage. The leased and unleased parts of the Desormeaux land in the unit were therefore “separately owned tracts” within the Conservation Act’s special definition of ownership.

As to Justice Tate’s concurring opinion in the writ denial,

8. 298 So. 2d at 901.
9. Id.
the distinguished jurist accurately sensed that drainage equities could affect the issue before the court, since the lessor of the unit operator was also the owner of the unleased acreage. However, unaided by the argument and briefing available on a full hearing of a case, the concurring opinion overkilled the issue. To extend the implied obligations of a lessee to prevent drainage to lands not covered by the lease is at least stretching that obligation. To then style the alleged breach of the lessee's obligations as a breach of a "fiduciary obligation" is to compound that error. Article 122 of the Mineral Code codifies the long-established standard that the lessee's duty is that of a reasonably prudent operator, to act in good faith with due regard for the interests of both the lessee and the lessor. His duty is less stringent than that of a fiduciary. Therefore, Louisiana R.S. 31:122 explicitly states, "A mineral lessee is not under a fiduciary obligation to his lessor . . . ."

If the position taken by the concurring opinion were accepted, no mineral lessee could safely develop leased property adjoined by unleased acreage of the lessor. Paradoxically, compliance with his duty to develop would automatically put the lessee in violation of his duty to prevent drainage. The only way he could avoid this problem would be to unitize before drilling, which is not a requirement of a mineral lease and could be poor conservation practice. Prior to drilling, geological information is untested and unit equity is a mere guessing game.

Perhaps the errors in Desormeaux resulted from excessive concern about "sticking" a landowner for well costs and a lack of concern with the need to protect an operator in the face of a quick payout. Well costs normally are borne by an oil company and not landowners. However, when the well was obviously rich, with payout in less than a year, and when doubtlessly the landowner would have had no trouble obtaining a lessee, the landowner must have preferred being "in the business" for 8/8ths rather than a mere fractional royalty; that being so, he should also be "in the business" for 8/8ths of the cost as to the unleased tract and should be afforded no special treatment. That is the law under Louisiana R.S. 30:10. Perhaps if the court had granted and received the benefit of full argument, the 4-3 writ denial decision would have been different, as it should be in the next case.

Justice Tate correctly sensed that drainage considera-
tions can affect the problem. Truly, the obligation to offset and prevent drainage to the leased premises should not appertain to the prevention of drainage on non-leased acreage. Although the lessee’s duty is not a fiduciary obligation, he has a duty to perform the contract in good faith, as a reasonably prudent operator for the *mutual* benefit of a lessee and his lessor. Conceivably drainage facts might be coupled with clear bad faith and might be gross enough to find a violation of this duty. However, it is hardly ill treatment of a landowner to drill a highly successful well at a location on a lease that qualifies the lessor’s unleased lands to participate in a unit which is then promptly formed. This is a landowner’s dream come true.

The only real argument that the landowner might make to the contrary is that he has paid his share of the well costs on the leased tract as a part of the consideration for the granting of the mineral lease. However, absent explicit provisions in the lease, this argument should not prevail in the face of the clear intent of the Conservation Act for unit costs to be apportioned on a tract basis.

**ROYALTY PAYMENT DELAY**

*Canik v. Texas International Petroleum Corp.* involved a five month delay between the time production commenced and the date on which twelve lessors demanded cancellation. Less than two months expired from the time the Department of Conservation approved the unit plat until initial royalty payments were made. Division order work had proceeded in that interim. Payment was made before demand and unit participation could not correctly be ascertained until the Department approved the unit plat. The court of appeal denied cancellation, finding no appreciable time had expired without justification, even though drilling opinion title work had been done earlier and even though *some* of the lessors in the unit could have been paid earlier. The Louisiana Supreme Court denied writs.

The disposition of this case confirms an earlier observation that the courts and the legislature, in viewing the cases

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12. *Id.*
of the past decade, have not seen sufficient lessee abuses to outweigh the "lying in wait for a killing" image lessors had acquired.\(^{13}\) However, the supreme court's qualified language in its denial of a writ suggests a residual germ of concern for fair lessee practices which could again flower in proper factual soil, although present Mineral Code requirements of notice and time to comply make suits of this nature improbable.\(^{14}\)

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