Article 138 of the Mineral Code: A Reasonable Cause for Nonpayment of Royalties

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ARTICLE 138 OF THE MINERAL CODE:
A REASONABLE CAUSE FOR NONPAYMENT OF ROYALTIES

An oil and gas lease is maintained during production by the payment of rent to the lessor. Rent paid out of production is commonly referred to as a mineral royalty. A landowner's right to a fractional share of production generally is free of production costs but is often subject to certain costs incurred after production. Mineral leases ordinarily do not fix a specific date for the payment of production royalties. As such, a lessee is obligated to pay the royalties due his lessor according to the custom of the mining industry. This custom contemplates that an indefinite period of time will lapse between commencement of production and payment of the first royalties since the lessee must complete the administrative details necessary to effect accurate payments. Subsequent payments are due monthly unless some intervening event makes it unduly difficult for the lessee to calculate the amount due.

Louisiana courts have had difficulty with suits involving untimely payment or nonpayment of mineral royalties. Prior to the enactment of the Louisiana Mineral Code in 1975, the courts held that when a mineral lessee failed to pay royalties due his lessor for an appreciable length of time without a justifiable reason for such delay, he actively breached his obligation under the lease. Since the breach was considered an active one, the lessor did not need to put the lessee in default as a prerequisite to a judicial demand for damages or dissolu-

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2. A royalty often is 1/8 of production, but it may be any other fractional share. See 8 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW 656 (1982).

Louisiana landowners often can bargain for a larger fractional share of oil and gas production than 1/8 because Louisiana land has proved to be quite productive. See, e.g., Bayou Bouillon Corp. v. Atlantic Richfield Co., 385 So. 2d 834, 835 (La. App. 1st Cir. 1980) (leases provided for royalties of 1/5 and 1/6 of production).

3. For example, a royalty may be subject to production or gathering taxes, treatment costs to render the product marketable, and costs of transporting the product to market. See 8 H. WILLIAMS & C. MEYERS, supra note 2, at 657.


5. LA. MIN. CODE: LA. R.S. 31:123 (1974) states: "A mineral lessee is obligated to make timely payment of [royalties] according to the terms of the contract or the custom of the mining industry in question if the contract is silent." (emphasis added.)


7. See LA. MIN. CODE: LA. R.S. 31:137 (1974), comment: "The area of dissolution of mineral leases for nonpayment of production royalties has been one of the most, if not the most confused and unsatisfactory areas of Louisiana mineral law."
tion of the lease. Conversely, if the lessee had a reasonable cause for not paying the royalties when they became due, his breach was only passive and the lessor had to put him in default before seeking any type of judicial relief.

The prior jurisprudential rule left uncertain what a court would view as an appreciable length of time and what a court would consider justifiable circumstances for a delay in payment or nonpayment of royalties. The courts answered these two questions on a case-by-case basis by weighing several factors. The rule provided no guidelines for determining whether the delayed payment or nonpayment was justifiable. Thus, prior to seeking judicial relief, lessors did not know when they needed to put their lessees in default. In addition, the rule unduly burdened lessees, who (after investing large amounts of money in producing wells located on the leased land) might first learn of a mistake or oversight in paying royalties when suit was brought against them for cancellation of the lease.

By nature a delayed payment or nonpayment of mineral royalties is a passive breach of the lease. A lessee passively breaches his con-

10. See Nunez v. Superior Oil Co., 572 F.2d 1119, 1122 (5th Cir. 1978).
11. In Bayou Bouillon Corp. v. Atlantic Richfield Co., 385 So. 2d 834 (La. App. 1st Cir. 1980), the court stated:

[Each case of this type must be examined on its own facts and circumstances. Among the factors to be considered are:
1. the length of the period in which royalties were not paid;
2. the amount involved;
3. special circumstances outside the control of the lessee;
4. the lessee's motive;
5. when and under what circumstances did the lessor seek or demand royalty payments;
6. whether the person to whom the royalty was owed knew about the industry or was the footing unequal.

Id. at 839 (citation omitted).
12. LA. MIN. CODE: LA. R.S. 31:137 (1974), comment. A passive breach generally is characterized by a "not doing what was convened to be done, or not doing it at the time, or in the manner stipulated or implied from the nature of the contract." LA. CIV. CODE art. 1931 (emphasis added). See Godchaux v. Hyde, 126 La. 187, 52 So. 269 (1910); Peoples Homestead Ass'n v. Staub, 3 Orl. App. 93 (La. App. 1906). See also
tract when he fails to make royalty payments because he either omits or fails to perform his obligation under the lease. A nonpayment of royalties technically is a passive breach because a later performance by the lessee is still possible and, presumably, still useful to the royalty owner. Consistent with other civilian jurisdictions, the Louisiana Civil Code imposes a default requirement as a prerequisite to judicial relief for the passive breach of an obligation. Thus, the jurisprudential rule which categorized an unjustifiable delay or nonpayment of royalties as an active breach of the lease requiring no putting in default was wholly unsupported by the civil law and was criticized by a noted authority on Louisiana obligations law. Furthermore, the distinction between an active breach and a passive breach and the default requirement for the latter, but not the former, was criticized by this expert. From the beginning of statehood, Louisiana courts have questioned the validity of the default requirement. The difficulty

2 S. Litvinoff, Obligations § 219 in 7 Louisiana Civil Law Treatise 403 (1975): "A delay in performance is, no doubt, the clearest and most traditional example of a passive breach . . . ."


14. 2 S. Litvinoff, supra note 12, § 219 at 408.


16. LA. CIV. CODE art. 1933.

17. Professor J. Denson Smith criticized the analysis used by the courts in finding that an unreasonably delayed payment constitutes an active breach:

[How a "not doing" to use the definition attributed to "passive" in article 1931 of the Louisiana Civil Code, becomes "doing something inconsistent" [to use the definition attributed to "active" in Article 1931] when it is prolonged to an extent deemed unjustifiable leaves me wondering . . . . It is most difficult to understand why a delay deemed unjustifiable produces an active breach but if found justifiable the breach is only passive.


18. "[M]y attitude toward the [default] requirement, as applied, is about ninety percent unfriendly. . . . I do not think it has any justifiable application in most cases wherein it becomes involved, and that it stands, far too often, as a hindrance to the dispensation of justice." Id. at 4.

19. See, e.g., Erwin v. Fenwick, 6 Mart. (n.s.) 229, 231 (La. 1827). In Erwin the court stated that a defense based on the failure of the obligee to put the obligor in default "is one which cannot but be felt to have but little relation to the merits of the case, and not likely to promote equity. Yet . . . we have been compelled, though slowly and reluctantly, to come to the conclusion that it must prevail." See also Sewell v. Wilcox, 5 Rob. 87, 90 (La. 1843), in which the court, expressing its opinion on the default requirement for passive but not active breaches, stated, "[W]e have, on more than one occasion, expressed our regret that such subtleties should have found their
which Louisiana courts have had in applying the default principles cannot be blamed on the French, because the Code Napoleon made no distinction between an active breach and a passive breach of an obligation.  

The Mineral Code articles governing the nonpayment or untimely payment of mineral royalties were designed to clarify the uncertainties of the jurisprudential rule. The active/passive breach distinction made by the jurisprudence in nonpayment of royalty cases was not codified. A lessor now is required to give his lessee written notice of the latter's failure to make a proper or timely payment of royalties as a prerequisite to a suit for damages or dissolution of the lease. Article 138 of the Mineral Code provides that the lessee, within thirty days of receiving the lessor's written demand for payment, must either pay the royalties due or give a written explanation stating a reasonable cause for nonpayment.

Louisiana law, however, will be plagued with the prior rule, at least for the near future, when suits arise involving leases contracted before January 1, 1975, the effective date of the Mineral Code. More significantly, an analysis of what constitutes a reasonable cause for nonpayment or untimely payment of mineral royalties will continue to be essential in determining the appropriate remedy available to an aggrieved royalty owner under the Mineral Code. If the cause is reasonable, the lessee will be liable only for the royalties due plus interest from the date that they were due if he responds within the thirty-day period. If the cause is unreasonable, damages may consist of double the royalties due, interest on that sum from the date due, and attorney's fees. The court also has discretion to cancel the lease if it finds that the failure to pay was fraudulent, although cancellation is not a favored remedy.

The jurisprudence has been unclear as to what constitutes a

way into the Code." But see Bailey v. Stetson, 1 La. Ann. 332, 333 (1846), in which the same court stated: "The law requires, before a party can recover damages for breach of contract, that he put the other in default. This requisition is imperative and of its useful operation there can be no question."

20. Smith, supra note 12, at 6; see also 2 S. Litvinoff, supra note 12, § 207 at 381.
25. LA. MIN. CODE: LA. R.S. 31:139.
reasonable cause for an untimely payment or nonpayment of royalties. The issue has been determined on a case-by-case basis. One federal judge has noted the lack of guidance provided by the courts' use of broad terms, such as "justifiable cause" and "adequate reason," in making the determination. Arguably, much of this uncertainty is attributable to the fact that the courts deciding these cases prior to 1975 had two separate grounds for holding that a lessee had a "reasonable cause" for not paying royalties. First, if the lessee failed to pay royalties which were due because of some honest mistake which the court considered reasonable, the breach was passive. A lawsuit brought by the lessor was dismissed if he had not put his lessee in default. Second, the courts held that a lessee was reasonable in not paying royalties which were not in fact due in light of the custom of the oil and gas industry. The lessor's suit was dismissed in this situation also, as no breach had occurred. As both situations produced the same result, the courts were not forced to distinguish between the two; in both, the courts held that the lessee had a reasonable cause for nonpayment of royalties.

*Hebert v. Sun Oil Co.* is exemplary of the first situation. Royalties were not paid because, through an inadvertent clerical error, the lessee erroneously deleted the plaintiffs' land from a revised unit. The lessee tendered payment as soon as the error was discovered. The lessors refused the tender and sued for cancellation of the lease. The court found that the lessee had not acted unreasonably; hence the breach was only passive. Since the plaintiffs had not put the lessee in default, their suit was dismissed. In such a situation, however, the lessee clearly has breached his obligation to make timely royalty payments and undisputably must promptly tender payment once he is put in default.

*Canik v. Texas International Petroleum Corp.* is illustrative of the second situation. In *Canik*, royalties were not paid for four months following the creation of a new unit. During this four-month period, the lessee was engaged in the administrative work that was necessary to make payments to the ninety-three royalty owners under the newly-created unit. The court noted that the accepted policy in the oil and

30. Nunez v. Superior Oil Co., 572 F.2d 1119, 1122-23 (5th Cir. 1978): "[T]hese terms provide semantic amplification but insignificant definition for drawing precise lines. Discriminating judgment is required before their conceptual significance yields a decision."
31. 223 So. 2d 897 (La. App. 3d Cir. 1969).
32. 308 So. 2d 453 (La. App. 3d Cir. 1975).
gas industry is to not pay royalties until the Commissioner of Conservation has given final approval to the survey plat of the unit. This approval was given in the third month of the alleged delay in payment. Royalty checks were mailed within the next month, prior to any demand by the lessors for the royalties. The court apparently did not consider the lessee to have breached the lease at all, since royalties were not due according to the accepted policy in the industry. However, the question of whether a breach had in fact occurred was rendered moot because an active breach was not found and no putting in default had occurred.

Prior to 1975, the phrase "reasonable cause for nonpayment of royalties" apparently was used in a dual sense by the courts. The phrase "reasonable cause for nonpayment" utilized by article 138 of the Mineral Code obviously is taken from the jurisprudence, but its exact meaning in light of the structure of the new articles is unclear. Predictability of results in future cases inevitably may depend upon a careful examination of the factors which the courts previously considered in addressing the issue and their applicability under the Mineral Code.

Reasonable Cause as Interpreted in Pre-Code Cases

Length of Time

The length of time for which royalties are withheld has been a factor used by the courts in determining whether the delay or nonpayment is justifiable. The second circuit, in Bailey v. Meadows,33 noted that unless a lessee has a good excuse, his withholding of royalties for "any appreciable length of time"34 is unreasonable. The defendant-lessees in Bailey claimed that an eighteen-month delay in payment of royalties was due to continuing negotiations between themselves and the operator of the production unit. However, the court reasoned that the amount of royalties due the plaintiff-lesseors would be unaffected by the outcome of these negotiations. Hence, the court held that a delay of eighteen months was unreasonable and cancelled the lease.35

The rule established in Bailey, i.e., a withholding of royalties without a good excuse for any appreciable length of time is unreasonable, set the standard for future cases in which time was

33. 130 So. 2d 501 (La. App. 2d Cir. 1961).
34. Id. at 508.
35. Id. at 504-08.
considered as a factor. The case of Sellers v. Continental Oil Co. involved a lease originally covering a large tract of land owned by five brothers, four of whom were plaintiffs in the suit. Through partial releases by the lessee, the land under the lease was reduced to two noncontiguous tracts. Royalties owed on one of the two noncontiguous tracts were not paid to the plaintiffs for thirty-three months. The lessee offered no explanation for such delay; as a result, the third circuit ordered partial cancellation of the lease as to the tract for which royalties had not been paid. The Sellers holding is consistent with the Bailey standard. Certainly, a thirty-three month delay is an appreciable length of time. Since the lessee offered no explanation for such delay, withholding the royalties was unreasonable.

In Canik v. Texas International Petroleum Corp., a more recent case, the lessor's demand for cancellation of the lease because of a delayed royalty payment was denied. In Canik, the defendant-lessee had delayed payment for slightly more than four months while it ascertained the royalties due the ninety-three separate owners under a newly-created production unit. The basis for the court's decision in Canik is unclear. One interpretation is that the delay in Canik, while not in compliance with the lease, was held reasonable, i.e., only a passive breach, because it was only for a short period of time. Alternatively, the court may have believed that the lessee had a good excuse for the delay because of the complex circumstances involved in computing the amount owed to the ninety-three separate royalty owners, i.e., the royalties were not yet due. Either reason would be consistent with the Bailey standard, which considers both the length of the delay and the reason for it.

Amount Involved

The courts have been reluctant to cancel mineral leases because of an untimely or inaccurate payment of royalties when the amount in dispute is small. The court in Hebert v. Sun Oil Co., refused to

36. 168 So. 2d 435 (La. App. 3d Cir. 1964).
37. Id. at 436-38.
38. 308 So. 2d 453 (La. App. 3d Cir. 1975).
39. Id. at 456.
40. A similar question may be raised about Sellers. Alternative bases for that court's decision are that the length of the delay (thirty-three months) was unreasonable and that the defendant-lessee offered no explanation whatsoever for the delay. Similarly, the delay in Bailey may have been held unreasonable either because the court considered that eighteen months was an appreciable length of time or because the excuse offered by the defendant was unrelated to the cause of the delay in royalty payments to the plaintiff.
41. 223 So. 2d 897 (La. App. 3d Cir. 1969).
cancel the lease for unpaid royalties which amounted to less than fourteen dollars over a ten-month period. An acreage dispute was involved in Wilson v. Sun Oil Co. The lessees tendered payments for thirteen months in accordance with a survey of a smaller number of acres than that specified in the lease. The checks contained a stipulation which the lessors contended would amount to an accord and satisfaction if the checks were cashed. The Louisiana Supreme Court found that the lessors had never disputed the survey upon which the lessees relied in making the payments and, since a dispute is an absolute prerequisite to invoking the doctrine of accord and satisfaction, the lessees had made a valid tender. The area of land in dispute was less than two-thirds of a single acre; thus the withholding of royalties on the small amount of acreage not included in the survey, but included in the lease, was held to be reasonable and cancellation of the lease was denied.

Hebert and Wilson were pre-1975 cases involving suits for cancellation of the lease. The Mineral Code clearly provides that dissolution of a lease for failure to pay royalties is not a favored remedy. Lease cancellation should not be granted when only a small amount of royalties erroneously has been withheld. Although the lessee technically has failed to fully comply with the terms of his lease, courts have recognized that cancellation of a mineral lease for the nonpayment of a small amount of royalties is too harsh a sanction to impose upon the breaching lessee. Hebert and Wilson, however, are not authority for the argument that such a breach is necessarily reasonable. These cases only support the argument that lease cancellation is not an appropriate remedy for the erroneous nonpayment of a small sum. If a lessee has unjustifiably withheld even a small amount, his lessor is entitled to receive greater damages than mere interest on the royalties. In such a situation, the Mineral Code provides the lessor

42. 290 So. 2d 844 (La. 1974).
43. See 1 S. Litvinoff, Obligations § 392 in 6 Louisiana Civil Law Treatise 657 (1969).
44. 290 So. 2d at 850.
46. See LA. MIN. CODE: LA. R.S. 31:137 (1974), comment: "[T]he harshness of cancelling a lease which may involve the investment of millions of dollars because of the nonpayment of an insignificant sum of money is obvious."

But see Bollinger v. Texas Co., 232 La. 637, 95 So. 2d 132 (1957), in which the Louisiana Supreme Court cancelled a lease where not only was the amount of unpaid royalties very small but the lessor actually had received more money than was due because of an overpayment of shut-in royalties. The court found that the lessee was in bad faith in withholding the royalties. Presumably, Bollinger is limited to cases in which the lessee has acted in bad faith.
with an adequate remedy of double the royalties, interest on that sum, and attorney's fees, without cancellation of the lease. This treatment is consistent with the intent of the revision of the law governing non-payment of royalties; namely, to protect the lessor by providing an adequate remedy for him if royalties are not paid when due while avoiding the harshness which cancellation of the lease may impose upon the defaulting lessee.

Special Circumstances Beyond the Lessee's Control

The courts have been willing to consider a nonpayment of royalties reasonable when it is caused by circumstances beyond the lessee's control. In Fawvor v. United States Oil of Louisiana, Inc., the Commissioner of Conservation established a production unit in May, 1961. An error in the first survey plot subsequently was discovered, causing the lessee to be unable to determine the amount of the lessor's land included within the unit. The court held that under these circumstances, a delay of eight months in the payment of royalties was reasonable.

The land under lease in Broadhead v. Pan American Petroleum

47. See LA. MIN. CODE; LA. R.S. 31:139 (1974); "The court may award as damages double the amount of royalties due, interest on that sum from the date due, and a reasonable attorney's fee, provided the original failure to pay was . . . without reasonable grounds."

48. LA. MIN. CODE; LA. R.S. 31:137 (1974), comment, provides:

The real problem in this area is that lessors are entitled to some meaningful remedy besides recovery of interest which will assure that they will receive timely payment of production royalties.

. . .

The total effect of these articles . . . is to provide a spur to timely payment of royalties due while giving lessees a reasonable way in which to avoid the harsh remedy of cancellation. The spur is the special remedy.

49. The situations set forth in this section are by no means exclusive. Whenever royalty payments are not tendered because of circumstances beyond the lessee's control which prevent him from calculating the amount due a lessor, he has a good argument that royalties are not due in light of the customs and practices in the oil and gas industry. See text at note 68, infra.

In Canik v. Texas Int'l Petroleum Corp., 308 So. 2d 453 (La. App. 3d Cir. 1975), the court found a four-month delay reasonable; the delay was needed to enable the lessee to determine the amount of royalties owed to ninety-three separate land owners under a newly-created unit. In Bailey v. Meadows, 130 So. 2d 501 (La. App. 2d Cir. 1961), the court held that negotiations between the lessee and the unit operator did not amount to special circumstances which would be considered a reasonable cause for untimely payment because such negotiations had no effect on the amount of royalties owed to the lessors.

50. 162 So. 2d 602 (La. App. 3d Cir. 1964).

51. Id. at 607-09.
"Wildcat territory." Title problems existed as to the ownership of the royalties, and the lessor refused to help clear up his title. Furthermore, marketing the oil was particularly difficult because the land was in a low, swampy area. The court held that these conditions, all of which were outside the lessees' control, made the eight-month delay in payment of royalties reasonable.

Another such circumstance arose in *Mire v. Hawkins,* a case in which the leased property was inherited by the three plaintiffs following the deaths of their grandparents and father. The lands were sold in 1947 with the mineral rights being reserved to the plaintiffs, who still were minors at the time of the sale. Royalties were withheld by the lessee when production began in 1957 because a dispute arose as to whether the plaintiffs' mineral interests had prescribed by nonuse for ten years or whether such prescriptive period was suspended due to their minority or interrupted due to nondrilling orders issued by the Commissioner of Conservation. A clause in the lease allowed the lessee to withhold royalties if any uncertainty arose as to the ownership of the minerals. The court held that there was a genuine and bona fide dispute as to the ownership of the minerals in the tract and therefore the nonpayment was reasonable under the terms of the lease.

The Louisiana Supreme Court recognized a title dispute between claimants as a reasonable cause for withholding royalties in *Hibbert v. Mudd.* Hibbert, the lessee, instituted a concursus proceeding to determine the ownership of accrued production royalties under a lease between the lessor and himself. The defendants, the lessor's heirs, made a reconventional demand for cancellation of the lease because of nonpayment of royalties for nineteen months. Hibbert claimed that the nonpayment was a result of a serious title dispute. One set of defendants allegedly was born of a miscegenous union, and the other set was born of an adulterous union. All defendants, at best, were "irregular heirs," and the withholding of the royalties was held to be reasonable.

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52. 166 So. 2d 329 (La. App. 3d Cir. 1964).
53. "Wildcat territory" is a phrase used to describe a leased area when there has never been production on it or around it at the time the lease is executed. See 8 H. Williams & C. Meyers, supra note 2, at 834.
54. 166 So. 2d at 331-33.
55. 177 So. 2d 795 (La. App. 3d Cir. 1965).
57. See LA. CIV. CODE art. 3554.
58. 177 So. 2d at 797-804.
59. 294 So. 2d 518 (La. 1974).
60. Id. at 520-22.
In a more recent decision, *Bayou Bouillon Corp. v. Atlantic Richfield Co.*, the first circuit held that a delay in paying royalties was reasonable when undoubtedly caused by confusion arising from the application of the new federal regulations and oil price controls established by the Federal Energy Office under the Emergency Allocation Act of 1973. The new federal regulations resulted in bookkeeping problems in the lessee’s attempts to comply therewith and were held to be circumstances beyond the lessee’s control.

A recent federal decision in the Fifth Circuit, *Nunez v. Superior Oil Co.*, also involved complex circumstances. Two of the royalty owners were father and son, both of whom were named Adam Nunez. After the father’s death, the son began endorsing his father’s royalty checks as administrator of his estate. Eventually, the son acquired his father’s interest as sole heir. Some confusion resulted from the death of the father and the substitution of his son, first as administrator and then as heir. This confusion caused the lessee to make a clerical error. The new division orders issued to the son as heir of his father’s interest were misfiled; hence, royalties as to the father’s interest were not paid for twenty months. The court held that a mere clerical error by the lessee does not make a delay unjustifiable when all other conduct of the lessee is reasonable.

In most of the cases mentioned above, the lessor’s demand for lease cancellation was dismissed because no active breach was found and the lessees had not been put in default. Consequently, the courts were not required to determine whether royalties were even due. The courts did not clearly articulate whether they believed that the breach was only passive and no putting in default had occurred or that royalties were not owed and no breach had occurred. When cir-

61. 385 So. 2d 834 (La. App. 1st Cir. 1980).
63. 385 So. 2d at 840.
64. 644 F.2d 534 (5th Cir. 1981).
65. Id. at 537. But see *Pierce v. Atlantic Ref. Co.*, 140 So. 2d 19, 25 (La. App. 3d Cir. 1962), in which the court stated, “[T]he . . . bookkeeping problems of the mineral lessee should not operate as a penalty against the lessor . . . .” *Pierce*, insofar as it holds that a bookkeeping error is not a reasonable cause for delayed royalty payments, seemingly has been overruled, although not expressly, by *Huhn v. Marshall Exploration, Inc.*, 337 So. 2d 561 (La. App. 2d Cir. 1976). See also *Nunez v. Superior Oil Co.*, 644 F.2d 534, 537 (5th Cir. 1981).
66. *Mire v. Hawkins* is the only exception. The lease permitted the lessee to withhold royalties in *Mire*. Therefore, the court was required to interpret only the lease. The issue of whether a putting in default had occurred was irrelevant.
67. In *Canik*, the third circuit came the closest to clearly distinguishing these two situations. The defendant’s attorneys apparently understood the distinction and
cumstances beyond his control prevent the lessee from accurately calculating royalty payments, it is questionable whether a breach has occurred. The custom in the oil and gas industry arguably contemplates that royalties are not due when such circumstances exist. In Mire, the lease permitted the lessee to withhold royalties if uncertainty arose as to the ownership of the leased land. Lessees, as a prophylactic measure, should insert a clause in their mineral leases permitting them to withhold royalties when circumstances beyond their control make payment impractical.

Lessee's Motive

Some suits arise when a lessee, for self-serving reasons, intentionally and in bad faith withholds royalties which are due his lessor. Courts readily find such nonpayments unreasonable. In Melancon v. Texas Co., the lessee withheld royalties in an attempt to coerce the lessor into agreeing to an increase in the size of the production unit from forty acres to three hundred twenty acres. The Louisiana Supreme Court found this to be willful and coercive conduct and held that the nonpayment of royalties was unreasonable. The companion case to Melancon, Bollinger v. Texas Co., involved the same drilling unit, the same lessee, and the same coercive conduct. In this case, however, the lessor had received more in shut-in royalties than he would have received as production royalties. The court held that regardless of the larger amount of shut-in royalties paid, the lessee had not satisfied the terms of his contract; therefore, the nonpayment was unjustified, and the lessor had the right to cancel the lease.

In Nunez, the lessee-defendant had misfiled the records of an inherited royalty interest. The heir claimed that the lessee intentional-
ly had misfiled the records in an attempt to coerce him into executing a new division order. The evidence did not support plaintiff's contention, but the court, in dictum, implied that intentional withholding of royalties for such coercive purposes would be unreasonable.

The holdings in Melancon and Bollinger apparently have been incorporated into the Mineral Code. Certainly, any lessor who is faced with a situation in which his lessee refuses to pay him royalties until he succumbs to the lessee's wishes, whatever they may be, has the strongest argument that he is entitled to the maximum amount of damages allowed under article 139 of the Mineral Code. A lessee's intentional withholding of admittedly due royalties to satisfy some unilateral interest is clearly unreasonable.

Lessor's Demands for Payment

Prior to the enactment of the Mineral Code, the courts, in determining whether a delayed payment by the lessee was reasonable, often looked to see whether the lessor made a demand for payment of royalties due. The courts apparently reasoned that if a lessor made no demand for payment, he was tacitly consenting to the lessee's delay. Cases subsequent to the effective date of the Mineral Code continue to use this test as a factor in the determination. Presumably, the lessor's demand was considered a factor in these post-1975 cases only because the courts were not applying the provisions of the Mineral Code, as the leases involved were contracted prior to 1975.

76. A division order is a "contract of sale to the purchaser of oil and gas. The order directs the purchaser to make payment for the value of the products taken in the proportions set out in the division order." 8 H. Williams & C. Meyers, supra note 2, at 198.1. Superior Oil used division orders to accurately maintain its accounting records so as to ensure the payment of royalties. 644 F.2d at 537-38.

77. 644 F.2d at 537-38.

78. See LA. MIN. CODE: LA. R.S. 31:139 (1974), which uses such terms as "fraudulent" and such phrases as "willful and without reasonable grounds."

79. In Melancon, 230 La. at 606, 89 So. 2d at 139, the lessor had made oral demands at least three times in the presence of witnesses. In Pierce v. Atlantic Ref. Co., 140 So. 2d 19, 21 (La. App. 3d Cir. 1962), the lessor's attorney sent several letters to the lessees making inquiries as to payment of royalties owed to the lessor. The court stated, "Despite the repeated efforts by plaintiff's attorney to secure timely payment of royalties the royalty payments were not mailed out [on time]." Id. at 29. In both cases the courts felt that the repeated demands made by the lessors for payment of royalties were significant factors to be considered in their finding that the failures to pay royalties on time were unjustified.

80. See 2 S. Litvinoff, supra note 12, § 177 at 333.


82. 385 So. 2d at 835; 337 So. 2d at 563.
The Mineral Code specifically states the appropriate time for and requisite number of demands required by a lessor, the circumstances under which such demands must be made, and the time given a lessee to respond to such demands. Once royalties are overdue, a lessor is required to make only one written demand as a prerequisite to seeking judicial relief. A lessee, after receipt of such demand, has thirty days in which to respond with payment of the royalties due or a written explanation stating a "reasonable cause for nonpayment." With such specific guidelines set forth in the Code, the appropriate time, circumstances, and frequency of a lessor's demands for payment of royalties due should no longer be used as abstract considerations in deciding whether or not a nonpayment is reasonable. The lessee must follow the specific guidelines or the nonpayment will be unreasonable. The lessor's suit is premature unless he first makes a demand for payment.

Bargaining Power of the Lessee and the Lessor

The equality of bargaining power between the lessor and the lessee is another factor which the courts use in determining whether the nonpayment of royalties is justified. While lessees very often are large oil companies, lessors may be poor landowners. In Fontenot v. Sunray Mid-Continent Oil Co., the plaintiff-lessee was an illiterate farmer. The defendant-lessee had sent out division orders to establish the number of acres that each of the co-owners had under the lease. The plaintiff, being illiterate, did not understand the bulky, complicated documents. He refused to sign them because he distrusted the defendant as a result of the defendant's prior attempts to include a portion of the plaintiff's land in the lease against the plaintiff's will. As a result of his refusal to sign the division orders, the plaintiff did not receive his royalties for thirty months. The court stressed the unequal bargaining power between the illiterate farmer and the oil company and granted the farmer his request for cancellation of the lease.

The equal-footing factor was used to deny a request for cancellation of a lease where the lessor was experienced in the oil and gas business and had done extensive work in the field. The plaintiff-lessee in Alvord v. Sun Oil Co. refused to sign the division orders sent

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85. 197 So. 2d 715 (La. App. 3d Cir. 1967).
86. Id. at 719-20.
87. 271 So. 2d 561 (La. App. 2d Cir. 1972).
by the unit operator because he believed it was unnecessary. The court held that the delayed tender of royalties was reasonable under these circumstances and emphasized that the plaintiff was quite familiar with the procedures of the oil and gas business. Similarly, the court in Nunez, in denying the lessor's demand for cancellation of the lease, noted that the lessor had negotiated mineral leases in his law practice and had studied mineral law in school.

In Fontenot, Alvord, and Nunez, the delayed royalty tenders were caused by problems with division orders. A lessor who knows very little about the oil and gas industry has a legitimate concern as to whether he is being treated fairly by his lessee in such administrative matters. Therefore, the judiciary correctly considers the parties' respective bargaining power in determining whether the lessee's failure to make timely royalty payments is justified.

Reasonable Cause Under the Mineral Code

The redactors of the Mineral Code enacted articles 137 through 141 in an attempt to clarify the uncertainty in the prior confused and unsatisfactory jurisprudential law governing the area of nonpayment of production royalties. These articles are contained in chapter seven of the Mineral Code, which deals with the mineral lease. Part four of this chapter sets forth the obligations of the lessee under a lease contract. Article 123, contained in this part, clearly states that a lessee is obligated to make timely royalty payments in accordance with the terms of the lease or the custom in the oil and gas industry if the lease does not specify when they are due. Part six of this same chapter sets forth the remedies for violations of a lessee's obligations under the lease. Articles 137 through 141, contained in this part, set forth the procedure to be followed when a lessee breaches his obligation to pay royalties timely.

The Exposé Des Motifs, submitted in 1971 to the Council of the Louisiana State Law Institute for their assistance in drafting the Mineral Code, covered this obligation and the remedies for its breach in a single recommendation. The first subsection of the recommendation was equivalent to article 123. The third subsection was equivalent to articles 137 through 141. Clearly, these articles of the Mineral Code must be read in pari materia.

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88. Id. at 563.
89. 644 F.2d at 538.
The second subsection of the recommendation of the Exposé Des Motifs was an attempt to clarify when a putting in default was necessary in the event the lessee did not pay royalties timely. The recommendation provided that whether the lessor needed to put the lessee in default upon such a breach was to depend upon the terms of the lease contract. After further consideration, the redactors correctly did not adopt this portion of the recommendation. A nonpayment of royalties which are due is unquestionably a passive breach of the lease which requires a putting in default as a prerequisite to seeking judicial relief under the basic civil law of obligations. Article 137 makes it incumbent upon a lessor to put his lessee in default prior to seeking judicial relief for the latter's failure to pay royalties timely.

Payment by the lessee within thirty days after being put in default limits the remedies which the lessor may seek for the breach. While payment within this thirty-day grace period modifies the consequences of the lessee's breach, it certainly does not justify the breach. Of course, requiring the lessee to pay royalties within thirty days of his receipt of the demand presupposes that the royalties are in fact due and that the lessee is in default.

Article 138 clearly states that the lessee, as an alternative to payment, may respond to the lessor's demand within thirty days by stating in writing a "reasonable cause" for not paying the royalties. Since articles 137 through 141 seemingly presuppose that royalties are due and that the lessee is in default when demand is made for payment, it is most difficult to understand what the redactors contemplated in permitting the lessee to assert a "reasonable cause" in lieu of payment. Once an obligor is placed in default, he has no reasonable excuse for not performing immediately. The court in Arceneaux v. Hawkins, the only case interpreting these articles to date, was vexed with this problem. Additionally, the court found it most perplexing that these articles do not provide a remedy when a lessee does not pay within thirty days of his receipt of the demand, but responds with a reasonable cause for not paying. The court, however, did note specifically that if royalties are due, then they must

91. See text at notes 12-16, supra.
93. These articles consistently refer only to royalties which are due. The remedies available under the articles also clearly illustrate that the articles make this presupposition. Whenever damages are awarded, royalties and interest from the date due are included in the damage award.
94. 2 S. Litvinoff, supra note 12, at 405.
95. 376 So. 2d 362 (La. App. 3d Cir. 1979).
be paid within the thirty-day time period provided in article 138. The lessee's written response does not extend this thirty-day period to some future date.96

The language "reasonable cause for nonpayment" in article 138 was undoubtedly taken from the jurisprudence which, for the most part, was attempting to distinguish an active breach from a passive breach. As noted earlier, a dichotomy exists among those pre-Code cases in which the lessee was said to have had a reasonable cause for nonpayment of royalties. In some cases, the lessee made an honest mistake, constituting a passive breach for which a putting in default was required.97 Under such cases, if a demand was made, the lessee would be in default and would be required to immediately tender the royalties due. In other cases, however, the courts held that a lessee had a reasonable cause for withholding royalties because, in light of the customs and practices of the oil and gas industry, they were not due.98 Under these facts, a lessee would not be in default even though a demand for payment was made, and no contention could be made that he would be required to tender the royalties until they became due. He would have committed no breach at all.

The provision in article 138 permitting the lessee to state in writing a reasonable cause for nonpayment of royalties in lieu of payment arguably refers only to the situation where the demand has been made before the royalties have become due.99 As a practical matter, parties do not specify in the lease contract the exact date on which royalties will be paid. When the lease is signed, neither party knows if and when production will occur. Thus, the custom in the industry generally dictates the time that royalties become due according to article 123.100 The first royalties on oil and gas ordinarily are paid by lessees in the second or third month following commencement of production. Subsequent payments ordinarily are due monthly.101 These

96. Id. at 365.
97. See text at note 31, supra.
98. See text at note 32, supra.
99. Under very limited circumstances, the lessee arguably may admit that royalties are due but explain that, because of improper payments due to mere oversight for an extended period of time, bookkeeping corrections necessary to effect accurate payments will take more than thirty days. No other reasonable cause for nonpayment of admittedly due royalties is imaginable. The redactors probably were not contemplating this limited circumstance when they drafted article 138.
100. See also Melancon v. Texas Co., 230 La. 593, 611, 89 So. 2d 135, 141 (1956); Sellers v. Continental Oil Co., 168 So. 2d 435, 436 (La. App. 3d Cir. 1964).
payments are calculated from the production in the month preceding the month of payment. However, circumstances often exist which prevent the lessee from making such payments. The industry practice is to not pay royalties until the amounts due a lessor can be accurately calculated.

One possible interpretation of the redactors' intent in the enactment of articles 137 through 141 is that if royalties are due, they must be paid within thirty days from the time the lessee is put in default. Such payment does not prevent the lessor from suing his lessee because a breach has occurred. The damages, however, are limited to interest from the date the royalties were due, unless the original failure to pay was either fraudulent or unreasonable. On the other hand, if royalties are not in fact due when a demand for them is made, the lessee must state in writing a reasonable cause for not paying them. In other words, he must explain the circumstances that have arisen which prevent him from paying royalties which ordinarily would be due. The lessee should be required to pay the royalties as soon as this "reasonable cause" ceases to exist. The written statement forces the lessee to go on record as to why he is not paying. He then will be prevented from using some other reason to justify his nonpayment in the event that he subsequently is sued by his lessor. No remedy is provided in these articles when a lessee states a reasonable cause for nonpayment because a suit brought by the lessor would be premature. Finally, if, within thirty days, the lessee neither pays royalties nor states a reasonable cause for not paying them, the courts may infer that royalties are due and that the lessee has no justification for not paying them. Such inference appears to be the tenor of article 140.

The problem with the interpretation set forth above is that it is contrary to the literal wording of articles 137 through 141. The language in the articles clearly is to the effect that the lessor, in order to collect damages, must prove that royalties were due when a demand was made for them. The language implies that the lessee is put in default when the lessor inquires about his royalties.

104. "[T]he passage of an appreciable length of time without justification apparently of itself warranted an inference that the breach was willful and unjustified . . . ." LA. MIN. CODE: LA. R.S. 31:137 (1974), comment.
105. See supra note 93 and accompanying text.
lessor fails to prove that royalties are due and that a breach has occurred, he has no remedy at all within these articles, regardless of whether his lessee has made any response.

A fair solution to this dilemma would be to require the lessee to respond, within the thirty-day period, to a demand made after the time at which royalties ordinarily would be paid absent exceptional circumstances. Requiring the lessee to explain to his lessor that circumstances have arisen preventing the payment of royalties which ordinarily would be due would not be an undue burden. In addition to being fair and equitable to lessors, such a requirement would avoid useless litigation. If the lessee failed to abide by such a requirement, the courts arguably could award the lessor damages for the failure of the lessee to perform the lease contract in good faith and for the mutual benefit of both parties.

Articles 137 through 141 apparently contemplate a double meaning for the phrase “reasonable cause for nonpayment of royalties.” First, the courts must determine whether the lessee is in default when a demand is made for payment. If unforeseen circumstances prevent the lessee from making ordinary royalty payments, he has a “reasonable cause” for not paying them because they are not yet due. Second, if royalties are due when demand is made, the courts must inquire into the lessee’s reason for not paying them when they became due. This inquiry is necessary in order to determine the appropriate remedy for the breach. If the lessee has a “reasonable cause” for his breach and pays the royalties within thirty days, damages are limited to interest on the royalties from the date they became due.

One final problem in the Louisiana law governing the nonpayment of mineral royalties deserves attention. An interesting statistic was noted in one of the most recent cases addressing the issue of whether a lessee’s reason for not making timely payments of royalties was justified. The court in *Bayou Bouillon* noted that in every reported Louisiana appellate case since the late 1960s, the cause for nonpayment of royalties was found to be reasonable. Although it is not entirely clear why the courts became reluctant to find a nonpayment unjustified, perhaps this hesitancy was due to the fact that cancellation of the lease was the only remedy that was being granted in cases

106. See text at note 101, *supra*.

107. Article 122 imposes the general obligation of a lessee to perform the lease contract in good faith. Additionally, article 134 states that “[i]f a mineral lease is violated, an aggrieved party is entitled to any appropriate relief provided by law.” (emphasis added.)


109. 385 So. 2d at 839.
where the nonpayment was held unreasonable. The Mineral Code clearly provides that a court may find a nonpayment of royalties unreasonable without cancelling the lease.

In almost all other states, mineral lessors are unable to obtain a judicial cancellation of a lease for nonpayment of royalties. Oil and gas leases often contain a general forfeiture clause which terminates the lease for failure to comply with material obligations contained therein. However, even when leases contain general forfeiture clauses, common law courts have strictly construed such clauses and held them inapplicable to suits involving failure to pay royalties, thus denying cancellation.

Although cancellation of the lease is not favored under the Mineral Code, it is still a possible remedy when royalties are not paid timely. Leading experts in oil and gas law have opined that Louisiana law should not be followed by other states on this matter because other remedies for nonpayment of royalties are adequate and lease cancellation is much too harsh and in the nature of a punitive sanction.

Louisiana presumably allows the remedy of lease cancellation because production royalties are considered as rent under the Mineral Code. Previously, the Civil Code provisions applicable to ordinary leases had been applied by analogy to mineral leases. The Civil Code allows a lessor to expel a lessee from the leased property if the latter fails to pay rent when due. In 1940, the Louisiana Supreme Court stated:

This court has ... firmly established the rule that mineral leases would be construed as leases and the codal provisions applicable to ordinary leases would be applied thereto insofar as they may

110. See, e.g., Kelley v. Ivyton Oil & Gas Co., 204 Ky. 804, 265 S.W. 309 (1924); Morriss v. First Nat'l Bank of Mission, 249 S.W.2d 269 (Tex. Civ. App. 1952); see also 3 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 656.3 at 700 (1982).
112. See, e.g., Davis v. Chautauqua Oil & Gas Co., 78 Kan. 97, 96 P. 47 (1908); Wagoner Oil & Gas Co. v. Marlow, 137 Okla. 116, 278 P. 294 (1929); Castle Brook Carbon Black Co. v. Ferrell, 76 W. Va. 300, 55 S.E. 544 (1915); Headley v. Hoopengarner, 60 W. Va. 626, 55 S.E. 744 (1906).
114. See 3 H. WILLIAMS & C. MEYERS, supra note 110, § 656.3 at 699-701.
117. LA. CIV. CODE art. 2712.
be; "Until the Legislature shall have passed laws specially applicable to the industry of mining, which is a new one in this state, the parties engaged in those pursuits and the courts of the states will adhere to the jurisprudence on the subject, and treat mineral contracts as leases." 118

Obvious changes have occurred in the oil and gas industry in Louisiana since 1940. First, the oil and gas industry is no longer a new one in this state. Second, the state legislature has passed laws particularly applicable to the mining industry by enacting an entirely separate code. The courts no longer need to follow the law regarding ordinary leases when dealing with a mineral lease.

Theoretically, the idea of cancelling a lease because the lessee has failed to perform his obligations therein has its roots in the basic contract law remedy of restitution, i.e., when one party breaches his obligation under the contract, the aggrieved party may sue to cancel the contract and have both parties restored to status quo ante. 119 Restitution is an impractical remedy for suits involving an untimely payment or a nonpayment of mineral royalties. One benefit for which a landowner bargains when he grants a lease is that the lessee will determine whether there is oil and gas under his land. The economic risk involved in finding the mineral deposit is the principal consideration provided by the lessee. Production royalties are owed only if oil and gas is found beneath the surface of the land. Once it is determined that there are valuable minerals beneath a tract of land, the value of the land escalates. A landowner who unquestionably knows that his land is rich with minerals would not grant a lease for an ordinary royalty. Thus, he would have almost dictatorial bargaining power in granting future leases. Restitution for nonpayment of production royalties, therefore, is not theoretically possible because the landowner already would have received much of the consideration for which he was bargaining.

As a practical matter, cancellation of a lease, which may involve the loss of an investment of millions of dollars because a small amount of production royalties was not paid on time, is much too harsh. An alternative, adequate remedy has been provided by the Mineral Code when a nonpayment is unjustified—double the royalties, interest, and attorney's fees. 120 Even lessors would benefit from a change in the

law that would remove the remedy of cancellation of the lease for nonpayment of royalties. Courts might not be so hesitant to find a delayed payment unjustified (as they were when applying pre-1975 law) if cancellation were eliminated as a remedy. Thus, lessors would be more likely to receive double the royalties, interest, and attorney's fees. Therefore, both the lessee and the lessor will benefit from such a change. Although the Mineral Code clearly provides that cancellation of the lease for nonpayment of royalties is not a favored remedy, it should be entirely eliminated in this area of the law.

Conclusion

The Mineral Code makes it incumbent upon a lessor to put his lessee in default prior to seeking judicial relief for the latter's failure to pay royalties, because such a breach is only passive. Some of the considerations used by Louisiana courts in determining whether a pre-1975 nonpayment was reasonable, although cited by the courts in post-1975 cases, should be inapplicable to such a determination in light of the specific guidelines set forth by the Mineral Code in this area of the law. The use of more properly drafted leases containing clauses granting lessees authority to withhold production royalties under certain circumstances may avoid much litigation and dispute involving unpaid royalties. Such clauses will make both parties aware of the lessee's justifications for withholding payments. Absent such lease provisions, the courts will be required to determine whether the lessee had a "reasonable cause" for not paying royalties. This determination may involve two steps. First, the courts must determine whether royalties were due, according to the custom of the industry, when the lessor made an inquiry about them. Second, if royalties were due, the courts must determine whether the lessee had any justification for not paying them when they became due. Finally, lease cancellation should be eliminated entirely as a remedy in royalty nonpayment disputes since the Mineral Code provides an alternative, adequate remedy.

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121. See text at note 109, supra.
123. If a case arises in which the lessee acts with total disregard for the interests of his lessor and intentionally withholding royalties which are owed, lease cancellation may be an appropriate remedy. The court faced with such a case, however, should base its decision either in tort or on the breach of the lessee's obligation to perform the lease contract in good faith under article 122. Basing the decision on the failure to pay royalties timely may set a precedent which would cause courts to hesitate in finding subsequent nonpayments unreasonable.