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I. INTRODUCTION

In Louisiana the touchstone of an oil and gas lessee's obligations is Article 122 of the Mineral Code, which provides 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 . . . .

This article codifies jurisprudential principles recognizing that the principal consideration or return to the lessor under the ordinary oil and gas lease is a royalty or fractional portion of the minerals produced by the lessee. Accordingly, the lessor's return from the contract is dependent upon production occurring from the land. From this premise, the courts have held that the very nature of the agreement implies that the parties contemplate that the lessee will do whatever is customary and reasonable to discover and exploit the mineral deposits that might exist under the leased premises.

Much of the early litigation involving the lessee's implied obligation was concerned with the extent to which the lessee was required to drill additional wells on the premises to fully develop reservoirs which had been discovered. Before spacing, unitization, and the regulation of drilling became commonplace, the unlimited rule of capture prevailed. The rule caused lessors to demand the drilling of more and more wells on their premises in order to drain the reservoir and get as great of a proportion of the production as they could. A lessee who was satisfied that the existing wells would adequately drain the premises, or who perhaps owned interests in wells on adjacent premises, would be reluctant to spend more money on drilling merely to increase the royalty owner's income. The courts, in attempting to reach some satisfactory resolution of the matter, ultimately concluded that for the lessor to succeed in such a case, he would have to demonstrate that "a prudent operator"

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would drill additional wells. In order to satisfy this burden of proof, the lessor was generally obliged to prove that the lessee had failed to drill wells on the premises that would be both productive and profitable.

The question then arose as to whether the lessee was obligated to explore the remaining and unproductive portions of the leased premises.[1] The courts tended to hold that the lessee did have such an obligation, but then applied the same test to measure the extent of his obligation as was applied to the obligation to develop reservoirs that had been discovered—the lessor had to prove that the lessee had failed to drill a well that a prudent operator would have drilled, i.e., one that would have been both productive and profitable. This requirement ordinarily presented the lessor with an insurmountable burden of proof, since the well necessarily would be a "wildcat" or exploratory one. The odds that such a well will be successful are always small and a proper evaluation of whether an operator should drill such a well involves fairly sophisticated economic and geological analyses which few judges are competent to make, even with the assistance of expert testimony. Requiring the lessor to prove by a preponderance of evidence that such a well would be successful and profitable rendered the obligation almost meaningless.

The lessor's burden in proving that his lessee had imprudently failed to drill a well to an as yet undiscovered reservoir was heightened, as a practical matter, by another equally difficult obstacle. All jurisdictions

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1. The industry very early developed leases stipulating that the payment of rentals permits the lessee to delay the onset of his obligation to develop the property. Thus, before production was obtained during the primary term, the payment of such delay rentals permitted the lessee to refrain from action, at least in the absence of drainage. After production, however, most leases were silent as to the continuing obligations of the lessee. This pattern generally still prevails in most oil and gas lease forms. Under such leases, the implied obligations only have relevancy after the lessee has discovered and is producing oil and gas from the premises. In recent years the so-called "Pugh" clause has become a common addition to leases. This clause essentially permits the lessee to pay a rental in lieu of drilling on non-productive areas of the lease—but limits the lessee's rights to continue the lease as to such areas to a specific term. The arrangement is generally popular with both lessors and lessees because it provides the former with the assurance that unless his land is brought into production within a limited period, it will be freed from the lease. The lessee is provided with the assurance that he will not be embroiled in controversy about whether he is proceeding to explore at a satisfactory pace and lends certainty to his plans by giving him a fixed period after he discovers oil and gas to develop the premises. In essence, the Pugh clause merely extends the primary term of the lease as to the undeveloped areas, if the lessee succeeds in developing a part of the premises during the primary term. The contention encountered from time to time that the lessee still has the implied obligation to develop areas during periods in which he is paying so called "Pugh rentals" represents a complete misunderstanding of their nature and purpose—and is equivalent to contending that one has the implied obligation to drill during the primary term when delay rentals may be paid in lieu of drilling to perpetuate the term of the lease.

originally held that an oil and gas lease was a form of interest in real property. This holding led them also to conclude that the interest was essentially indivisible. If the court found that the lessee was in default of his obligations, it seemed necessary to cancel or dissolve the lease in its entirety. Since the obligation to explore did not arise until after the lessee had discovered and was producing oil or gas from somewhere on the premises, cancellation of the lease would do more than put the parties back into the position they had occupied before the lease was granted—it would transfer to the lessor the benefits of the development that had already been obtained by the lessee at substantial risk and expense. In such cases, the lessor's claim that the lease should be cancelled because the lessee had failed to drill additional wells invariably was met with the response by the lessee that the lessor was really motivated by a desire to obtain the benefits of the development that had already occurred. The lessee would then argue that the fact that he had already discovered and developed one or more reservoirs proved both his good faith and desire to develop the premises. After all, the lessee's share of production is six or seven times that of the lessor. Why would he not drill additional wells if in fact they would be productive and profitable?

In effect, in the early actions, the court was faced with depriving the lessee of the benefits of his development by substituting its judgment for his as to the propriety of drilling what were essentially wildcat or highly risky wells. There was and still is a justified reluctance on the part of the courts to do that except in the clearest of cases. Lessors, generally speaking, were so unsuccessful in their efforts that some courts and commentators doubted whether such an obligation really existed.[2]

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2. This contention was made in spite of the fact that the emergence of the delay rental provisions in the modern lease form could be directly traced to the courts' insistence that in their absence a lessee was obligated to promptly start exploration and development of the premises. See Moses, The Evolution And Development Of The Oil And Gas Lease, 2d Annual Inst. On Oil & Gas L. & Tax'n 1 (1951) for an excellent discussion of the development of the modern lease. The state of the jurisprudence relating to the obligation to explore is rather well chronicled in Williams and Meyers' well known treatise. Williams and Meyers argue for an interpretation of the jurisprudence that is somewhat more favorable to the lessor than the writer believes is justified. They also note that their views as to the existence of the covenant and its parameters are not shared by all, citing Professor Brown's treatise as one that argues against the existence of the obligation. The Williams and Meyers treatise also contains a rather complete bibliography of the articles and treatises that deal with the subject. See 5 H. Williams and C. Meyers, Oil and Gas Law, § 841 (1990). For a fairly representative cross section of modern cases dealing with the subject from other jurisdictions, see Reynolds v. Smith, 231 Ark. 566, 331 S.W.2d 112 (1960); Skelly Oil Co. v. Skoggins, 231 Ark. 357, 329 S.W.2d 424 (1959); Mitchell v. Amerada Hess Corp., 638 P.2d 441 (Okla. 1981), and Sun Exploration and Production Co. et al. v. Jackson, 783 S.W.2d 202 (Tex. 1989).

II. The Nature Of The Obligation To Explore The Premises

Some of the difficulty in interpreting the jurisprudence in Louisiana stems from the fact that the Louisiana courts have sometimes referred to the lessee's obligation to "develop" as the obligation to do what is necessary to profitably mine mineral deposits that have been discovered, i.e. to "develop known mineral deposits." At other times the term has been used to refer to the matter under consideration, i.e. "the obligation to develop or explore the premises." Although the two spring from the same source—the obligation to act as a prudent operator—and therefore are but different aspects of the same obligation, they do involve different considerations that arise from the nature of the industry, the state of geological knowledge, and the occurrence of oil and gas itself. Thus, the two obligations may be conveniently considered separately.[3] For convenience, the writer will refer to the obligation under consideration as that to explore the premises, and the obligation to develop (or to mine) discovered deposits as the obligation to develop existing reservoirs.

The lessor who claims that his lessee has inadequately developed a particular reservoir or field from which he is producing must ordinarily still show that the lessee should have drilled additional wells on the premises, since that is about all one can do to further develop a field after it has been discovered.[4] On the other hand, the Louisiana courts have rather clearly recognized that such a test is inappropriate to measure the obligation of the lessee to explore the non-producing portions of the lease for undiscovered reservoirs.[5] This is not to say that it ultimately

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3. "As noted, Williams and Meyers characterize the covenant of further exploration as being separate from the covenant of reasonable development. This is a defensible view. However, historically in Louisiana the obligation of further exploration can be viewed as an evolutionary offshoot of the obligation of reasonable development. See Carter v. Arkansas Louisiana Gas Co., 213 La. 1028, 36 So.2d 26 (La. 1948). Although the jurisprudence does not make a clear distinction between the obligation of further exploration and the obligation of reasonable development, the distinction nevertheless exists." (Citations omitted.) Comments to Mineral Code article 122.

4. "The lessor must prove . . . that a reasonable, prudent operator would conduct additional drilling operations in the productive formation." Comments to Mineral Code article 122. Even that statement is not unqualifiedly true—in every situation, the ultimate question is: what would a prudent operator do under the circumstances? For example, the courts have long recognized that a failure to utilize more modern production techniques to develop existing reservoirs might constitute a breach of the lease. See Waseco Chemical and Supply v. Bayou State Oil, 371 So. 2d 305 (La. App. 2d Cir. 1979). Recently the courts have also recognized that, when appropriate, a lessee is obligated to seek unitization of the premises with adjacent lands as an alternative to drilling on the land itself. See Pierce v. GoldKing Properties, Inc., 396 So. 2d 528 (La. App. 3d Cir. 1981).

5. A good example of the confusion in the concepts is found in a student article in the Tulane Law Review, Comment, Implied Covenants in Louisiana Mineral Leases as Affected by Conservation Legislation, 27 Tul. L. Rev. 353 (1953). Unfortunately the article

may not be necessary to drill a well. The process by which the industry goes about looking for oil and gas deposits involves many steps and requires considerable skill and the expenditure of considerable sums of money before the decision to drill can be made. The oil company that obligates itself to develop land for its mineral value must impliedly be promising not only to mine the minerals that it finds but also to do those things necessary to determine where the minerals are located.

III. Genesis Of The Obligation

The case of *Brewster v. Lanyon Zinc Co.*[6] first articulated the legal foundations for the implied obligations of the lessee. In that case, the court noted that oil and gas leases are generally silent as to any express obligation of the lessee to drill or produce from the premises and simply provide that the lease will continue so long as the lessee produces oil or gas. The court then held that the lessee, nevertheless, had an affirmative, albeit implied, obligation to diligently search for and produce minerals from the premises. The silence of the lease as to the express details of the obligation was explained on the grounds that mineral deposits occur in such a variety of situations and are so diverse in nature as to make it impossible to predict what development the premises might require, or to lay down rules as to what will, in any given situation, constitute reasonable conduct. Accordingly, the lease leaves it to implication that the lessee will do what is prudent under the circumstances in light of the objectives of the parties.

Louisiana courts have expressly recognized the accuracy of the court's perceptions in *Brewster* and consistently have refused to lay down specific rules or establish definite regulations as to what constitutes prudent conduct by the lessee, not only because it is impractical to do so, but because fixed rules would define the obligations of the lessee when the parties themselves have refused to do so, and impose upon them a bargain which they have not made. Thus, in *Carter v. Arkansas Louisiana Gas Co.*,[7] the court, expressly relying upon *Brewster*, said:

> Whether in any given case the lessee has sufficiently developed the leased property pursuant to the rule set out above, is a question of fact which must be resolved by a consideration

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was rather uncritically cited by the second circuit in Vetter v. Morrow, 361 So. 2d 898 (La. App. 2d Cir. 1978), as demonstrating the existence of a number of mechanical "factors" one could use to determine whether a lessee has prudently developed the premises. Every supreme court decision on the matter, however, has expressly refused to catalog or define what it is that the lessee must do and has insisted that it is a matter that must be determined in each case, in light of the circumstances prevailing in that case.

6. 140 F. 801 (8th Cir. 1905).

7. 213 La. 1028, 36 So. 2d 26 (1948).

of the facts and circumstances shown in the particular case.[8]

This principle has now been legislatively confirmed by Article 122 of the Mineral Code, previously quoted.

IV. The Divisibility Of The Oil And Gas Lease

In Louisiana an oil and gas lease essentially is a contract.[9] Modern forms of lease used in Louisiana customarily contain a number of provisions that indicate that the parties consider the lessee's obligations to be divisible.[10] As a result of these factors, the Louisiana Supreme Court began to grant partial cancellation of oil and gas leases when the breach by the lessee did not directly involve a failure to properly and adequately produce reservoirs that he had discovered. In the first case to do so, *Carter v. Arkansas Louisiana Gas Co.*,[11] the court really did not directly address the issue of divisibility. The lease contained the customary provision that if it was cancelled, the lessee would be entitled to retain an area around each producing well. The lessor only sought cancellation of the part of the premises outside of such areas, honoring the clause. The lessee's argument that the lease could not be partially cancelled in that manner was met with the rather sensible response that the lessor only sought cancellation in accordance with the agreement of

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8. Id. at 1035, 36 So. 2d at 28. In the *Carter* case, the court expressly approved Justice VanDevanter's characterization of the lessee's obligations in the *Brewster* case: "whatever, in the circumstances, would be reasonably expected of operators in ordinary circumstances, having regard to the interests of both lessor and lessee, is what is required." Wier v. Grubb the court stated that "[w]e recognize the difficulty of laying down any comprehensive rule . . . the merits of each case must be determined according to its particular circumstances." 228 La. 254, 82 So. 2d 1 (1955). See Sohio Petroleum Co. et al. v. Miller, 237 La. 1013, 112 So. 2d 695 (1959). "The law of this case, . . . is well settled, and hence the issue to be resolved is purely one of fact." See also Middleton v. California Company, 237 La. 1039, 112 So. 2d 704 (1959) ("This obligation . . . will vary with the circumstances of each case. . . ."); Frazier v. Justiss Mears Oil Co., 391 So. 2d 485 (La. App. 2d Cir. 1980) ("The question of reasonable development is a factual issue peculiar to each case. . . ."); Dawes v. Hale, 421 So. 2d 1208 (La. App. 2d Cir. 1982), ("Whether the lessee has sufficiently developed the leased property is a question of fact . . . ."); Allen v. Horne, 478 So. 2d 671 (La. App. 2d Cir. 1985).

9. "A mineral lease is a contract by which the lessee is granted the right to explore for and produce minerals . . . ." Mineral Code article 114.

10. Such leases commonly contain provisions permitting the payment of delay rentals on only part of the premises; giving the lessee the right to abandon part of the premises; providing that in the event of termination or forfeiture the lessee may retain his rights around then producing wells; providing that assignment of all of the rights in a given area to another will divide the lease; and stipulating that in certain cases unitization will perpetuate the lease only as to the unitized area, all of which indicate that the parties believe that the lessee's rights and obligations can be geographically divided or reduced.

11. 213 La. 1028, 36 So. 2d 26 (1948).

the parties—implying that the lessee was not required to retain the rest if it did not want to do so, since the lease also provided that the lessee could abandon the lease in whole or in part at any time.

Whether the court could fashion a remedy for breach by partially cancelling the lease without the lessor's consent was presented in the case of *Eota Realty Company v. Carter Oil Co.*[12] The court, relying upon statements in its earlier *Carter* opinion to the effect that an oil and gas lease was divisible, held that the failure to develop part of the premises justified dissolving the lease only as to that part. The principle became accepted and is codified in Article 142 of the Mineral Code in the following terms:

> 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.

The determination that the ordinary oil and gas lease is viewed by the parties as being divisible had the effect of neutralizing what was in fact the lessee's strongest argument in the exploration cases—that cancellation would deprive him of the development he had brought about merely because he was unwilling to take on what was admittedly a highly and speculative venture—and opened the door for the courts to give a more expansive construction to the lessee's obligations. The courts did not hesitate to do so.

V. Recognition In Louisiana Of The Obligation To Explore

Carter not only presaged the principle of divisibility, but also laid the foundations for, and caused some of the confusion in, the subsequent development of the principles now regulating the lessee's obligation to explore the non-productive portions of the leased premises. In *Carter* the court said:

> The law of this state is well settled that the main consideration of a mineral lease is the development of the leased premises for minerals, and that the lessee must develop with reasonable diligence or give up the contract; further, that as to what constitutes development and reasonable diligence on the part of the lessee must conform to, and be governed by, what is expected of persons of ordinary prudence under similar circumstances and conditions, having due regard for the interest of both contracting parties.[13]

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12. 225 La. 790, 74 So. 2d 30 (1954).
13. 213 La. at 1034, 36 So. 2d at 28.

The court thus squarely recognized that the lessee has an affirmative obligation to "develop" the leased premises with reasonable diligence. It is also clear from the context in which the expression was used by the court, as well as from later interpretations of the case by the court itself, that the term "develop" has a broader meaning than only drilling clearly profitable wells. Rather, to reasonably develop the premises implies that the lessee will do those things that an operator knowledgeable of the industry, having adequate resources, and actively interested in producing oil and gas would do from time to time during the term of the lease to determine the probable occurrence of mineral deposits on the leased premises and to bring those deposits into commercial production in due course and when it reasonably appears that to do so would be profitable.

VI. What Does The Obligation To Explore Entail?

In support of his argument that the lessee had failed to properly develop the premises, the lessor in *Carter* offered the testimony of another operator who declared that he had made an investigation of the mineral potential of the undeveloped parts of the premises and that he was so convinced of their value that he would in fact drill a well on the premises if they were leased to him. On the other hand, the lessee essentially denied that any obligation to explore the non-productive portion of the premises in fact existed. The court described the lessee's stance as follows:

> The record does not disclose that defendant has any present or future plans to develop this property further, and the evidence convinces us, as it did the trial court, that defendant has no intention of making any further development.
>
> Defendant argues that . . . defendant is not required to drill exploratory wells on the undeveloped portion of the tract . . . or, in other words, that the drilling of any additional wells on the property described in the lease would constitute *exploration* and not *development*.
>
> In the 10 years or more during which this defendant has had the property under lease, . . . no effort has been made and no steps taken to develop the [undeveloped part of the] property in any way . . . nor has defendant conducted geophysical work or made tests of any nature in an effort to ascertain whether production could be had therefrom.[14]

In holding for the plaintiff, the court first noted that the possible presence of oil and gas under the non-developed portion of the premises

14. Id. at 1032-37, 36 So. 2d at 27-29.

was borne out both by the willingness of another operator to drill a well and the testimony of geologists that oil and gas were frequently encountered on both sides of faults of the kind that existed under the lessor's land. The court then held that the defendant's refusal to take any steps to investigate the mineral potential of the property was contrary to its obligation to act as a prudent operator and was cause for cancellation of the lease. In doing so, the court analogized the lessee's actions to an abandonment of the lease as to those premises:

> The law of this state is well settled that the main consideration of a mineral lease is the development of the leased premises for minerals, and that the lessee must develop with reasonable diligence or give up the contract; further, that as to what constitutes development and reasonable diligence on the part of the lessee must conform to, and be governed by, what is expected of persons of ordinary prudence under similar circumstances and conditions, having due regard for the interest of both contracting parties. Pipes v. Payne et al., 156 La. 791, 101 So. 144; Stubbs et al. v. Imperial Oil & Gas Co., 164 La. 689, 114 So. 595; Logan v. Tholl Oil Co., Inc., et al., 189 La. 645, 180 So. 473. See also Merrill, The Law Relating to Covenants Implied in Oil and Gas Leases, 2d Ed., sec. 122, p. 280, sec. 123, p. 284; 2 Summers, Oil and Gas, Perm.Ed., sec. 414, p. 370.
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> . . . .
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> Although in the case of *Fox Petroleum Co. et al. v. Booker et al.*, 123 Okl. 276, 253 P. 33, 38, the lease was cancelled on the theory of abandonment, what was said in that case regarding the implied obligation of the lessee to develop the premises is pertinent here:
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> > "The principle, as we understand it, is that development of every part of the lease is an implied condition. Therefore, whether the undeveloped portion be a single tract remote from the rest, or a considerable portion of a very large tract, . . . or the east one hundred acres of a tract of 160, it is an implied condition that the lessee will test every part."[15]

VII. Amplification Of The Principles Governing The Lessee's Duty To Explore.

Notwithstanding the justifiable reluctance of the courts to enunciate particular rules to determine when a lessee has complied with his ob-

15. Id. at 1034-38, 36 So. 2d at 28-29.

ligation to explore, there are a number of general principles concerning the obligation that can be gleaned from the jurisprudence since *Carter* and that at least establish some parameters for the obligation. These principles can be summarized as follows:

A. The obligation to act prudently does not require the lessee to incur expenses or take actions that a prudent operator similarly situated would not undertake, or that are not profitable to himself, even though they might benefit the lessor. The lessee is not a fiduciary—the matter is one of the performance of the contract in good faith and the purpose of the contract is economic exploitation of the minerals.[16]

Article 122 expressly recognizes that the lessee is not a fiduciary for the lessor. He is not obligated to incur expenses or engage in activities that a prudent operator similarly situated would not undertake, or that are not profitable to himself even though they might redound to the benefit of the lessor. There is a mutuality of interest that must be balanced in judging the lessee's actions.[17]

B. The lessee who fails to prudently explore the premises has breached the lease, and the lessor must put him in default as a precedent to an action on the lease.

The courts consistently have rejected every contention that the inaction or mere failure of the lessee to explore or develop the premises results in a forfeiture or abandonment of the lease.[18] The oft quoted statement in *Carter* to the effect that the lessee must reasonably develop the lease or give up the contract refers to the fact that the usual remedy

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16. "When a mineral lease is being maintained by production of oil or gas, the production must be in paying quantities. . . ." Mineral Code article 124. "Therefore it follows that the parties to the normal type of lease do not intend that the lease can be maintained beyond the primary term by an amount of production which does not reasonably hold out the prospect of making a profit on the lessee's total investment. . . ." Comments to Mineral Code article 124. "The prescription of nonuse running against a mineral servitude is interrupted by good faith operations. . . . By good faith is meant that the operations must be (1) commenced with reasonable expectation of discovering and producing minerals in paying quantities. . . ." Mineral Code article 29.

17. See, e.g., Henry v. Ballard & Cordell Corp., 418 So. 2d 1334 (La. 1982). The "prudent operator" test implicitly recognizes the contract of lease is one directed toward commercial or economic development. Not only is the lessee not obligated to engage in unprofitable activities, if he deliberately and knowingly does so he equally is outside the limits of the contract and is acting in bad faith. Thus the lessee who continues to operate a well that is not profitable is operating no well at all and the lease will terminate for lack of production. See Mineral Code article 124 and the Comments thereto quoted above.

18. "Since the duty to develop is an implied obligation, the jurisprudence has consistently held that a breach of this duty is passive and a formal placing in default is required before judicial intervention may be sought. Trinidad Petroleum v. Pioneer Natural Gas, 416 So. 2d 290 (La. App. 3d Cir. 1982), writ denied, 422 So. 2d 154 (La. 1982); Pipes v. Payne, 156 La. 791, 101 So. 144 (1924). . . ." Taussig v. GoldKing Properties Co., 495 So. 2d 1008, 1014 (La. App. 3d Cir. 1986).

for the breach of the implied obligations is dissolution of the contract. The cases and code plainly demonstrate that one is dealing with a breach of contract, not a mere forfeiture clause. Furthermore, since it is a breach of the contract, it must be shown that the lessee has taken some action contrary to the lease or failed to do something he was obligated to do before the court will declare the lease wholly or partially dissolved.

> There is no evidence in the record that defendants' decision not to attempt any further development in the shallow sands on plaintiff's land was not a reasonable and justifiable decision on the part of the lessees. There was no testimony either geological or otherwise that anyone else considered it reasonable or prudent to conduct any further developments . . . . Without reviewing the evidence in more detail, we find plaintiff has failed to bear the burden of proving defendants have not developed the leased premises with reasonable diligence.[19]

C. The burden of proving a breach of the obligation to explore the premises is upon the lessor.

This principle is well established and actually appears to be based upon two distinct considerations.[20] The first is procedural. The burden of proof is ordinarily upon the plaintiff alleging a breach of contract by another. The second is based upon the nature of the lease itself. The lessee is required to provide all of the capital and take all of the risks of the venture. In most cases he will also receive benefits several times greater than those inuring to the lessor if his efforts are successful. Although the lessor contributes his land, he takes no risk and invests no capital in the drilling. The lessee ordinarily has a greater interest in developing the premises than the lessor, but unlike the lessor, must temper his desires for profit by weighing the likelihood of loss. On the other hand, the lessor, who has dedicated the mineral values of his property to the lease, stands to lose nothing further if the venture fails. The courts have thus recognized that the judgment of the lessee, if exercised reasonably and in good faith, is entitled to considerable weight, and in case of honest doubt should prevail.

> Where the lessee has conducted such operations in the past at substantial expense and has evidenced an intention to continue the development of the property or release the lease, the lease is not necessarily subject to cancellation because of a difference

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19. Saulters v. Sklar, 158 So. 2d 460, 463 (La. App. 2d Cir. 1963).

20. "In any event the burden of proving grounds for the cancellation of a mineral lease is on the lessor. Cox v. Cardinal Drilling Co., 188 So. 2d 667 (La. App. 2d Cir. 1966)." Frazier v. Justiss Mears Oil Co., 391 So. 2d 485, 486 (La. App. 2d Cir. 1980). See also Allen v. Horne, 478 So. 2d 671 (La. App. 2d Cir. 1985).

> of opinion with the lessors as to the proper amount of drilling activity required to constitute reasonableness.[21]

In *Taussig v. GoldKing Properties Company*,[22] the court rejected a claim that the lessee had breached the implied obligation to explore the premises, and in doing so noted:

> [T]he cancellation of a lease is a harsh remedy not to be granted without serious considerations. Those considerations which the Court should make before pronouncing dissolution are: 1) the extent and gravity of the failure to perform, 2) nature of the obligor's fault, 3) good or bad faith of the parties, and 4) surrounding economic circumstances.[23]

D. The obligation to explore is not equivalent to a continuous drilling obligation.

One of the most prevalent, but clearly erroneous, understandings of the jurisprudence is the belief that the lessee somehow is obligated to continuously or periodically drill wells upon the premises or suffer a forfeiture of the lease. The error apparently arises from taking, out of its proper context, the excerpt contained in the *Carter* opinion from an Oklahoma opinion to the effect that "it is an implied condition that the lessee will test every part of the premises."[24] The court in *Carter* noted that it did not adopt the rationale of the Oklahoma case, but merely used the opinion to rebut the argument of the lessee in *Carter* that he had no obligation to explore the undeveloped portions of the leased property. It is obvious from the portions of the *Carter* opinion previously quoted that the court's reference to the Oklahoma decision was not intended to define the lessee's duty as somehow being one that required the lessee to drill wells over every part of the premises.[25] It was quite obviously intended to affirm that the lessee had a duty to search for oil and gas over every part and reject the lessee's contention that it had no obligation with respect to the undeveloped part of the premises. It is clear that a lessee is not required to drill a well if there

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21. Fontenot v. Austral Oil Expl. Co., 168 F. Supp. 36, 40 (W.D. La. 1958), modified on other grounds, 266 F.2d 956 (5th Cir. 1959).

22. 495 So. 2d 1008 (La. App. 3d Cir. 1986).

23. The statement is actually based on an earlier opinion of the second circuit in Waseco Chemical and Supply v. Bayou State Oil, 371 So. 2d 305 (La. App. 2d Cir. 1979).

24. See supra note 15 and accompanying text.

25. Cf. Allen v. Horne, 478 So. 2d 671 (La. App. 2d Cir. 1985), where the court noted: "Here, appellants argue that the other independent drillers have offered to lease and drill, but there was no evidence of firm commitments. Such allegations alone are not sufficient grounds to reverse the judgment. . . ."

is no reasonable prospect of profit sufficient to induce a prudent operator to risk his capital.[26]

From time to time the federal courts have interpreted *Carter* as literally requiring that wells be drilled or the lease forfeited.[27] The Louisiana courts clearly have rejected this view and the jurisprudence since *Carter* unequivocally holds that the mere failure to drill, or to drill in any continuous pattern or with any particular frequency, does not imply a breach of the obligation. In *Middleton v. California Co.*,[28] the Louisiana Supreme Court observed:

> Plaintiffs' position, on the other hand, seems to be that, since there has been no actual drilling on any of these large segments of land and, in fact, no new drilling operations since 1952, partial cancellation is necessarily in order. But this view, we believe, overlooks the particular circumstances obtaining in the case which show that Calco, throughout the years of the lease, has conducted highly successful operations on the land which have redounded to the common advantage of the contracting parties and, before and since 1952, has continued its explorations by making various tests and drilling, and by contributing to the drilling upon adjacent property, all with the view of securing new production from the leased land.[29]

In *Frazier v. Justiss Mears Oil Co.*,[30] the Second Circuit Court of Appeals rejected a similar complaint by noting that, although the lessee had not drilled upon the premises for several years, it had been and was engaged in diligent and continuous efforts to identify and exploit the mineral potential of the property and that those activities were all that the lease required. In that connection the court said:

> Several dry holes were drilled in the area before and after plaintiff leased his property. Justiss-Mears [the defendant] drilled many of these dry holes and participated in other dry holes. . . .
>
> It is shown that defendant has directly participated in the drilling of 25 wells in the area, 16 of which have been farm-

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26. In a somewhat related vein, it has already been noted that Article 29 of the Mineral Code provides that a mineral owner who drills a well without a reasonable expectation that it will produce in paying quantities is not using his rights in good faith. The same thing would obviously be true of a mineral lessee.

27. See Romero v. Humble Oil & Refining Co., 93 F. Supp. 117 (E.D. La. 1950) and the recent case of Goodrich v. Exxon Corp., 642 F.Supp. 150 (W.D. La. 1986), which, although purporting to follow the more recent Louisiana jurisprudence, still gives evidence of a misunderstanding of its import.

28. 237 La. 1039, 112 So. 2d 704 (1959).

29. Id. at 1053, 112 So. 2d at 709.

30. 391 So. 2d 485 (La. App. 2d Cir. 1980).

> outs. Only three of the 25 wells have proved productive. . . .
>
> Plaintiff also overlooks the fact that . . . the defendant became aware of and began to participate in the preliminaries of a play by a major oil company for one or more tests to a much deeper, but unproven, depth in an area which would include plaintiff's land, and for that reason declined to release plaintiff's acreage. Defendant had participated in other deep tests near this area at an earlier time. The drilling of a well to the desired deep depth will cost more than $1,000,000. Defendant's geologist said it would be desirable that the venturer who conducted a deep test have about 6,000 acres in a bloc to make the test and cost of production economically feasible. . . .
>
> Defendant's participation in the preliminary play to an eventual deep test in the area fulfills, under the circumstances presented, its obligation to diligently develop the leased property as to unproven formations of greater depth.[31]

No Louisiana court since *Carter* has held a lessee in default of his obligations solely because he failed to drill a well on the premises within some particular time.[32]

E. The burden of the lessor can be met by showing that there is reason to believe that diligent investigation of the leased premises might disclose the presence of potentially profitable oil and gas deposits and that the lessee refuses or has persistently failed to reasonably investigate such possibilities, although it cannot be shown that a profitable well could be drilled or even that the results of the investigation would be favorable for development.

This principle actually is a corollary of the principle just discussed. The mere failure to drill a well does not imply a breach of the obligation to develop. Neither does the fact that the lessor cannot show that a well should be drilled mean that the lessee has complied with his obligations. After all, the lessee, by agreeing to diligently develop the premises as a prudent operator also is implicitly representing that he is

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31. Id. at 486-88.

32. See, e.g., Wier v. Grubb, 228 La. 254, 82 So. 2d 1 (1955); Sohio Petroleum Company v. Miller, 237 La. 1015, 112 So. 2d 695 (1959); Dawes v. Hale, 421 So. 2d 1208 (La. App. 2d Cir. 1982); and Morrison v. D & L Partnership, 499 So. 2d 988 (La. App. 3d Cir. 1986). The only case remotely to the contrary, perhaps, is Vetter v. Morrow, 361 So. 2d 898 (La. App. 2d Cir. 1978), in which the court upheld a finding of fact by the lower court that the failure to drill on a unit formed by the commissioner and encompassing a part of the leased premises was a breach of the lease. That case, however, did not really involve the obligation to explore, but rather involved the obligation to develop an existing reservoir. Furthermore, the lessee virtually admitted that a prudent operator would have drilled the well, and attempted to excuse its failure to do so on the ground that it was engaged in drilling elsewhere in the vicinity.

knowledgeable concerning the industry and has the resources and ability to find and produce mineral deposits if they exist on the land. Finding oil and gas deposits is, of course, where the risk in the business lies and where the expertise and willingness to invest capital is most critical. To require the lessor to demonstrate that there is an oil and gas field under his premises that can be profitably exploited before it can be said that the lessee has breached his obligation to explore the premises is to require the lessor to do the very thing that the lessee has agreed to do, and to convert the lessee's obligation into one to drill wells where he is directed to do so by the lessor, rather than to determine if the leased premises justify such drilling.[33]

The lessee customarily gets the lion's share of the production—from three-fourths to seven-eighths of the total. The reason for this is that he is supposed to do the work, provide the capital, and take the risk of locating and developing the property for its mineral values. To require the lessor to point out where the lessee ought to drill is to distort the contract and the understanding of the parties as to their respective roles as clearly and decisively as it is to say that the lessee must drill a well on the premises to see if oil or gas is there, when no one experienced in the industry and knowledgeable of the geology of the area would risk his money in doing so.

The lessee is not a fiduciary—but he is supposed to find and produce the minerals under the land if they are there. His obligation is greater than that of merely drilling—it is to make those investigations and to do those things that prudent oil men do when they are actively interested in determining if oil and gas in commercial quantities exist under a tract of land.

Courts have categorically rejected the view, occasionally advanced by a lessee, that because he has discovered and developed mineral deposits under portions of the leased premises, he is entitled to retain the balance of the premises, abandoning any effort to investigate their mineral potential and speculating on the hope that someone else may develop data indicating the existence of other valuable mineral deposits under the premises.

It is also obvious from the facts of *Carter* that the court's declaration that the lessee must develop the premises with reasonable diligence or give up the contract was not an attempt to define either the nature or extent of the activities required of the lessee, but rather was a declaration

33. The lessee who attempts to excuse his failure to do anything toward the discovery of oil and gas on the grounds that the lessor must show where a successful and profitable well can be drilled is in the same position as a treasure hunter who obligates himself to a landowner to diligently search the land for Jean Lafitte's hidden treasure in return for 3/4 of what he finds and then explains his failure to take any action whatsoever toward locating the treasure by complaining that the landowner has not told him where it is.

that a persistent refusal or failure to investigate the mineral potential of the premises in the face of facts indicating that such an investigation might lead to development is either a breach of the lease or tantamount to an abandonment of a portion of the premises.

In *Carter* the lessee had discovered and was producing oil from a reservoir on the up-thrown side of a fault crossing the premises. The lessor introduced considerable evidence that the area across the fault on the down-thrown side might be productive, including the testimony of a potential operator who averred that he would drill a well if given the opportunity. The defendant, for a period exceeding ten years, had taken the position that the area on its down-thrown side was non-productive and that it had no interest in pursuing the matter.

Although the court obviously was impressed with the testimony of the operator who said he would drill if he had the opportunity, it is significant that the court never found, nor apparently believed it necessary to find, that a reasonably prudent operator would drill a well under the circumstances. A fair reading of the case indicates that in the minds of the court, the breach was not in failing to drill, but rather in the persistent and longstanding refusal of the lessee to take any steps whatsoever to determine the mineral potential of the property in the face of solid evidence that cause for such investigation existed.

> [P]laintiffs made demand on the defendant for further development or for cancellation of the lease, which was refused, defendant taking the position that the property has been sufficiently developed. The record does not disclose that defendant has any present or future plans to develop this property further, and the evidence convinces us, as it did the trial court, that defendant has no intention of making any further development. . . .
>
> The instant case, to say the least, is unique in our jurisprudence, in that defendant to justify its refusal to develop further the leased premises relies on the existence of a fault which traverses the property, and on the testimony of two reputable and well qualified geologists . . . .
>
> These geologists do not in any way condemn the area of the leased premises . . . the testimony given by one of them, . . . is to the effect that the probabilities are against production, although this area might produce. . . .
>
> In the 10 years or more during which this defendant has had the property under lease, including the primary term which expired on November 6, 1945, no effort has been made and no steps taken to develop the property in any way . . . nor has defendant conducted geophysical work or made tests of any nature in an effort to ascertain whether production could be had therefrom. . . .

> Our analysis of all the testimony convinces us that defendant herein has failed to develop sufficiently the 1263 acres covered by the lease, . . . and that the reasons by which defendant attempts to justify its refusal to develop the property further are not adequate and sufficient, especially in view of the fact that another competent and well qualified producer is willing to drill to the north and east of the main fault line. In other words, defendant has violated the implied condition of the lease to develop the property prudently and reasonably.[34]

Virtually every case since *Carter*, that has found the lessee to have breached the obligation to explore, has done so because the facts disclosed a persistent refusal to investigate the productive potential of property, or a deliberate determination to abandon such efforts, in the face of evidence that the area's mineral potential was not positively condemned, not because the lessor proved a profitable well could be drilled. In *Wier v. Grubb*,[35] the court said:

> The record shows that the drilling of the four wells was confined within the far eastern terminus of the property, a relatively small area in comparison with the entire acreage subleased. It is also shown that other than the drilling and reworking of said wells, there was no activity whatsoever in the mineral development of the remaining area of this large acreage, nor was there any activity which would evidence any intention on the part of defendants to do so, from the time of the drilling of the fourth well (a "dry hole") in 1944 until the filing of this suit in 1946. The negative conduct of these defendants constitutes, under our law, a violation of the specified and expressed obligations, as well as the implied obligations of the contract.[36]

More recently in *Morrison v. D & L Partnership*,[37] the court ordered a lease canceled, again citing the persistent refusal of the lessee to take action to determine the mineral potential of the leased premises:

> The defendant partnership did not have an expert witness. Both partners testified. According to Long, [a partner] . . . [h]e has wanted to sell the lease for quite a while. If they had more investors they could afford to drill a salt-water disposal system, but it would not be economically feasible to do so for one well.

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34. Carter v. Arkansas La. Gas Co., 213 La. 1028, 1034-38, 36 So. 2d 26, 28 (1948).
35. 228 La. 254, 82 So. 2d 1 (1955).
36. Id. at 267, 82 So. 2d at 5.
37. 499 So. 2d 988 (La. App. 3d Cir. 1986).

> He said that drilling depends on "economics and times," and that if he had a six month lease it would be drilled during that time and if a ten-year lease ". . . you drill what is necessary and you drill it at a later time when you've got a better deal." The partnership had no definite program for drilling but did intend to drill more wells. Because they were having trouble with the one well, they were not drilling any other wells. According to Dudley, [the other partner] . . . they were doing nothing with regard to the well except maintaining it with the hope of getting more production. They were looking at other properties for salt-water. . . . To drill another well, they would need other partners. . . .
>
> The partnership members have been residents of Houston, Texas. They have had local operators but their contact with the actual working of the well has been limited. There is no overall program for development of the whole leased premises. They are awaiting a purchaser or other investors. . . .
>
> There was an admission that the partnership would only drill what was necessary to keep the lease alive. They have not tried to get back on the Flowers or Murphy salt-water disposal systems. There are a number of wells in the immediate vicinity. Most of them have access to salt-water disposal systems. Defendants have made no effort to use one of these systems. It would cost only $13,500 to drill a well to the point of knowing definitely whether it would be a possible producer or a dry hole.[38]

On the other hand, in virtually every case since *Carter* in which the court has found the lessee in compliance with his obligations to develop, the court has emphasized that the lessee demonstrated it had made diligent efforts to determine what reservoirs might exist under the property and exhibited a willingness to develop those reservoirs that he might discover and which in his judgment had economic potential. In doing so, the courts have not only considered the extent to which the lessee has drilled on the premises, but have placed equal if not greater importance on his participation in drilling on nearby lands, on his conducting geophysical and other geological activity, and in general, on the totality of his efforts to determine the location of, and to develop where justified, mineral deposits under the land.[39]

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38. Id. at 992-93.

39. Middleton v. California Co., 237 La. 1039, 112 So. 2d 704 (1959); LeJeune v. Superior Oil Co., 315 So. 2d 415 (La. App. 3d Cir. 1975); Dupree v. Relco Exploration Co., 354 So. 2d 1083 (La. App. 2d Cir. 1978); Frazier v. Justiss Mears Oil Co., 391 So. 2d 485 (La. App. 2d Cir. 1980); Allen v. Horne, 478 So. 2d 671 (La. App. 2d Cir. 1985); and Taussig v. GoldKing Properties Co., 495 So. 2d 1008 (La. App. 3d Cir. 1986).

VIII. SUMMARY

Since *Carter*, the courts have reiterated the well established principle (now codified in Article 122 of the Mineral Code) that the ordinary oil and gas lease contemplates that the lessee will develop and operate the leased premises as a reasonably prudent operator for the mutual benefit of himself and his lessor.

This has been interpreted to mean that the lessee implicitly agrees to actively and diligently do what is customary and reasonable in light of the circumstances to determine the probable occurrence of commercial mineral deposits in the leased premises and to bring those deposits into production in due course and when it appears reasonably possible to do so profitably.

Louisiana courts have categorically rejected the view, prevailing in many states, that for the lessor to prove a breach of this obligation he must show that the lessee has failed to drill a well that a prudent operator would have drilled—i.e., a profitable one. At the same time, propositions that the obligation is equivalent to a continuous drilling clause, or that there is any particular number of wells or a particular time or period in which the lessee must drill on the premises to prevent forfeiture of the lease equally have been rejected. The implied obligation to reasonably explore and develop the premises is not a substitute for either a continuous drilling clause or a so-called "Pugh" clause. Rather, it is a recognition that the lessee has a continuing duty to diligently investigate the mineral potential of the entire premises and to do those things that an operator, knowledgeable of the industry, adequately financed, and actively interested in finding oil and gas would do from time to time in light of the knowledge and information currently available to him. Seismic exploration, geological studies, participation in other prospects, and attempts to procure others to drill marginally attractive prospects through farm-outs and subleases are all things that prudent operators do to discover potentially productive reservoirs under lands, and things that the courts have recognized as being comprehended within the obligation to investigate the mineral potential of the property.

As long as the lessee comports himself in the manner of a prudent operator as described in the preceding paragraph and is otherwise producing oil or gas in paying quantities, the lease continues in accordance with its terms. If, however, it is proven that the lessee irrevocably considers the premises or some part thereof to be devoid of minerals in the face of evidence to the contrary, or if the lessee fails or refuses to take action a prudent operator would take to reasonably determine the mineral potential of the property, or if he otherwise persistently fails or refuses to exercise diligent and serious efforts, in light of the circumstances prevailing from time to time, to find oil or gas under the leased premises, and if that neglect or refusal continues after he

has been given proper notice under the terms of the lease, he will be held either to have breached his obligation with respect to that part of the premises, or to have effectively abandoned them, and the lease will be terminated to that extent.

The extent of the development that has previously taken place, the magnitude and nature of the lessee's expenditures in and around the leased premises, and the size and complexity of the premises are relevant in determining both the good faith of the lessee and the reasonableness of his actions. But no mechanical test or arbitrary program of drilling can be substituted for the ultimate question required by Article 122—whether the lessee conducted himself in a prudent manner for the mutual benefit of both himself and his lessor.

The Mineral Code does not declare, nor do any of the cases interpreting it hold, that a lease may be terminated or the lessee declared to be in default as long as he is diligently conducting himself in the manner described and the premises have some potential value which he is, under the circumstances, actively interested in pursuing. Nor has any case declared a lessee in default for failing to take some action, unless the evidence shows that a prudent operator similarly situated would have taken the action.

In the last analysis, the burden is upon the lessor to show, in some particular manner, that the lessee has failed to perform his obligations in good faith, or that he has somehow conducted himself in a manner contrary to that of a prudent operator. A mere showing of a lack of drilling or other exploratory activity, even for an extended time, is insufficient. The lessor has agreed that the term of the lease will extend for as long as the lessee produces and explores with diligence.

When leases are first negotiated and entered into, the lack of precision in defining the obligations of the lessee is usually justified for the very reasons perceived in the *Lanyon* case—the parties simply do not know what is likely to be encountered or what will be required to develop the premises. Also, at this time the interests of both parties are more or less in accord. The mere fact that the lessee is willing to pay a bonus and delay rentals, or even go to the trouble of leasing the land at all, usually indicates that he has some idea of the property's potential, and that he will either drill on the property or abandon it within a relatively short time.

Once the lessee has discovered oil or gas and has developed the reservoirs, the interests of the lessor and lessee tend to diverge. The lessor becomes confident that greater riches are awaiting him just across the road from the last well or in the next pasture and becomes impatient, not understanding why the lessee does not cover his land with wells. On the other hand, the lessee, having taken an enormous risk and won, may become less interested in taking such a risk again, unless the odds are better and the returns more certain. Each becomes convinced that

he is reasonable in his desires and that the other simply does not understand the situation.

To succeed in his demands for a release, the lessor must produce evidence that the possibility that oil and gas may be found under his land is sufficient to cause a prudent operator to investigate it further. The lessee who cannot then demonstrate that he is currently taking or has recently taken some concrete steps to explore that possibility will be presented with the following questions which he will be hard put to answer: if the land may have additional mineral potential, why has he not taken steps to bring it to fruition? If it does not, why is he so intent upon preserving his lease? A mineral lessee has no right to conduct any activities upon the land unless they are directed to the finding of economic deposits of minerals. If he ever unequivocally admits that no such minerals exist, then he has also admitted that his rights are irrelevant or have lapsed. If the lessee is to preserve his rights over non-productive areas for any length of time, he must convince the court that he is actively taking steps to develop them and that although someday they may be productive, there is not yet sufficient evidence to justify his expenditure of more effort or capital to do so than he currently is doing.

On the other hand, the lessor who can produce no evidence that minerals may be present under his land, or that there are steps that someone reasonably might take to determine the existence of oil and gas under his land, and who relies solely upon the supposed inaction of the lessee will not and should not prevail. He must point to something the lessee has failed to do—although it need not be the drilling of a well.