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§. A Review of Selected Lease Clauses

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I. Introduction

The mineral lease is quite possibly the most frequently used contract in any mineral producing jurisdiction. There are innumerable forms currently in use including both standard and custom drafted lease forms. Within the myriad of lease forms certain “standard clauses” have emerged, such as the habendum clause, royalty clause, Pugh clause, and Mother Hubbard clause, but even these standard clauses vary widely. No specific meaning may be given to any clause without an examination of its particular terms and provisions. And, as with any contract, careful drafting is necessary in light of the issues that have been raised by the jurisprudence addressing the clauses.

It would takes weeks of time and hundreds of pages to give even the most cursory treatment to every standard clause contained in any of the many standard lease forms. This paper will not endeavor to provide the reader with exhaustive treatment of each provision of the mineral lease but, instead, will address selected issues arising under the habendum clause, the shut-in royalty clause, the Pugh clause, the Mother Hubbard clause, and the adjacent land clause by examining Louisiana case law where our courts have addressed issues arising thereunder and examining case law in other states where Louisiana courts have yet to address an important issue.

III. Selected Issues under the Habendum Clause

The Louisiana Mineral Code provides that all mineral leases must have a term.¹ The term of a lease is generally fixed by the habendum clause of a mineral lease.² A typical habendum clause in an “unless”³ type lease reads:

It is agreed that this lease shall remain in force for a term of ten years from date and as long as oil, or gas, of whatsoever nature or

¹ La. Min. Code art. 115 (La. Rev. Stat. § 31:115 (2007)).

² 8 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW at 465 (2006); 2 W.L. SUMMERS, LAW OF OIL AND GAS § 14.1, 186 (3 ed. 2006); Patrick S. Ottinger, *Production in “Paying Quantities” - A Fresh Look*, 65 LA. L. REV. 635 (2005) (“A ‘habendum’ clause is that provision which dictates the duration of a mineral lease.”).

³ An “unless” clause follows the general format that, if operations for drilling are not commenced on or before the anniversary date of the contract, the lease shall then terminate *unless* on or before such anniversary date lessee pays or tenders to lessor the delay rentals called for in the lease. See *Mattison v. Trotti*, 262 F.2d 339, 340 (5th Cir. 1959).

kind, or either of them is produced from said land or drilling operations are continued as hereinafter provided.⁴

The ten year period in the above clause is the primary term.⁵ The primary term is the period of time during which a lease may be maintained “even though there is no production in paying quantities by virtue of drilling operations on the leased land or the payment of rentals.”⁶ Such a term is limited under Louisiana law to a maximum of ten years unless the lease is being maintained by “drilling or mining operations or production.”⁷ The standard mineral lease typically provides for the production of minerals from the lease premises as a means to extend a mineral lease beyond its primary term.⁸ This is often referred to as the secondary term of a lease.⁹

The issue thus arises as to what is meant by “production” for the purposes of the habendum clause in light of the policy that leases may not be held for purely speculative purposes. Though many hadendum clauses provide that production must be in “paying quantities,” the drafters of the Louisiana Mineral Code have provided for a default rule which requires such a level of production to maintain a lease even in the absence of such language in the actual leases.¹⁰ Indeed, “[e]ven if ‘paying quantities’ is not appended to the term production in a lease, article 124 of the Mineral Code and pre-Code jurisprudence add that requirement.”¹¹ Article 124 of the Louisiana Mineral Code provides:

When a mineral lease is being maintained by production of oil and gas, the production must be in paying quantities. It is considered to be in paying quantities when production allocable to the total original right of the lessee to share in production under the lease is sufficient to induce a reasonable prudent operator to continue production

⁴ 8 WILLIAMS & MEYERS, *supra* note 2 at 465.

⁵ *Id.*

⁶ *Id.* at 803.

⁷ La. Min. Code art. 115 (La. Rev. Stat. § 31:115 (2007)). *See also Caldwell v. Humble Oil & Ref. Co.*, 155 So. 2d 228 (La. App. 2d Cir. 1963).

⁸ *See* La. Min. Code art. 124 Cmt. (La. Rev. Stat. § 31:124 (2007)).

⁹ *See* 8 WILLIAMS & MEYERS, *supra* note 2 at 952.

¹⁰ “Many leases expressly require that the production be in paying quantities to maintain the lease. However, even though the phrase ‘in paying quantities’ is not present, the courts will read it into the lease with the result that “production” sufficient to maintain a lease must be in paying quantities.” (La. Min. Code art. 124 Cmt. (La. Rev. Stat. § 31:124)) (*citing Coyle v. N. Am. Oil Conso.*, 9 So. 2d 473 (1942); *Brown v. Sugar Creek Syndicate*, 197 So. 583 (1940); *Logan v. Tholl Oil Co.*, 180 So. 473 (1938); *Caldwell v. Alton Oil Co.*, 108 So. 314 (1926)).

¹¹ LUTHER MCDUGAL, LOUISIANA OIL & GAS LAW § 3.6, 137 (1995).

in an effort to secure a return on his investment or to minimize any loss.¹²

In article 124, the drafters codified the long standing policy of the State of Louisiana to “prohibit the lessee from speculating with mineral interests or otherwise acting in a selfish manner, without regard for the lessor.”¹³ As stated in the official comment to article 124:

One of the prime motivations of the requirement that there be production in paying quantities is that the lessee should not be permitted to maintain the lease indefinitely merely for speculative or other selfish purposes. By establishing a primary term, beyond which the lease cannot be maintained without drilling or production, the parties have prohibited holding the property merely for speculative purposes. Therefore, it follows that the parties to the normal type of mineral lease do not intend 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 existing investment or of minimizing any loss he might suffer on that investment.

Therefore, production is considered to be in paying quantities when the lessee’s share of production is sufficient enough to induce a prudent operator to continue production in order to secure a return on his investment.

To determine if production is sufficient to maintain a lease beyond its primary term, all matters which would influence a reasonable and prudent operator must be considered.¹⁴ “The standard by which paying quantities is determined is whether or not under all the relevant circumstances a reasonably prudent operator would, for the purpose making a profit and not merely for speculation, continue to operate a well in the

¹² La. Min. Code art. 124 (La. Rev. Stat. § 31:124 (2007)).

¹³ Ottinger, *supra* note 2 at 637-38 (citing *Caldwell*, 108 So. 2d at 142). The court in *Caldwell* explained:

A development that falls short of a reasonable production which would bring a net profit to the lessee and furnish an adequate consideration to the lessor of the continuance of the lease might well be said to be no development at all within the contemplation of the parties To hold that any production, however small, and in less than paying quantities, gives to the lessee the right to continue the lease indefinitely and with no obligation to further development, would be contrary to the established rule of jurisprudence, and would be writing for the parties a contract they never intended to make It was never contemplated that the lease under consideration should be continued for all time to come upon the mere production of oil in quantities not sufficient to compensate the lessee and totally inadequate as a consideration to the lessor for continuing the lease.

Caldwell, 108 So. 2d at 142.

¹⁴ *Wood v. Axis Energy Corp.*, 899 So. 2d 138, 142 (La. App. 3d Cir. 2005) *cert. denied*, 904 So. 2d 702 (La. 2005).

manner in which the well in question was operated.”¹⁵ In determining whether this standard is met the following factors are typically reviewed: (1) the reserves at issue and the price the lessee can obtain for the production, (2) the relative profitableness of other wells in the area, (3) the operating and marketing costs of the lease, (4) the lessee’s profit, (5) the actual provisions of the lease at issue, (6) a reasonable time period under the circumstances, and (7) whether or not the lease is being held strictly for speculation.¹⁶ Most importantly, the lessee must demonstrate that its production income exceeds its operating expenses.¹⁷

What Time Period Is Considered?

Before embarking on the comparison of production income and operating expense, a time frame must be established in which such evaluation will be limited. The minimum time period considered in determining whether a mineral lease has produced in paying quantities is between eight and eighteen months.¹⁸ While the maximum period that can be considered is not entirely clear in the jurisprudence,¹⁹ it is clear that courts can look to periods after the institution of a lawsuit in the analysis as long production has not been affected by lessor’s institution of a lawsuit.²⁰ “It has been suggested that the courts should consider only such period of past production as would shed light on the present status of production and then only as one of the factors in determining present status.”²¹

How is Production in Paying Quantities Calculated: Income versus Operating Expenses?

¹⁵ La. Min. Code art. 124 Cmt. (La. Rev. Stat. § 31:124 Cmt. (2007)) (citing *Clifton v. Koontz*, 325 S.W.2d 684, 691 (Tex. 1958)).

¹⁶ *Id.*; See also *Wood*, 899 So. 2d at 142 (citing *Lege v. Lea Exploration*, 631 So. 2d 716, 717 (La. App. 3d Cir. 1994)).

¹⁷ “Implicit in the term “paying quantities” is that the lessee is required to show a profit; production income must exceed operating expenses.” *O’Neal v. JHL Enter., Inc.*, 862 So. 2d 1021, 1027 (La. App. 2d Cir. 2003)(citing *Menoah Petroleum, Inc. v. Mc Kinney*, 545 So. 2d 1216 (La. App. 2d Cir. 1989)).

¹⁸ *Edmundson Bros. P’Ship v. Montex Drilling Co.*, 672 So. 2d 1061, 1064 (La. App. 3d Cir. 1996) *rev’d on other grounds*, 679 So. 2d 1364 (citing *Brown*, 197 So. at 583; *Smith v. Sun Oil Co.*, 116 So. 379 (La. 1928); *Caldwell*, 108 So. at 314; *Menoah Petroleum*, 545 So. 2d at 1216; *Smith v. W. Va Oil & Gas, Co.*, 365 So. 2d 269 (La. App. 2d Cir. 1978) *rev’d on other grounds*, 373 So. 2d 488 (La. 1979); *Noel v. Amoco Prod. Co.*, 826 F. Supp 1000 (W.D. La. 1993)).

¹⁹ *Id.* (Citing *Noe’s Estate v. Murray*, 65 So. 2d 886 (1953); *Vance v. Hurley*, 41 So. 2d 724 (1949); *Coyle*, 9 So. 2d at 473; *Lege v. Lea Exploration Co.*, 631 So. 2d 716 (La. App. 3 Cir. 1994)).

²⁰ “A lessor is estopped from complaining about any alleged cessation of production in paying quantities that is the result of the lessee’s failure to maintain and repair wells during the pendency of the suit by the lessor.” *Noel*, 826 F. Supp at 1015.

²¹ *Ottinger*, *supra* note 2 at 647 (quoting Leonard Wells, *Production in Paying Quantities – A New Look at an Old Subject*, 13 INST. ON MIN. L. 88, 100 (1966)).

Production income is the revenue from “production allocable to the total right of the lessee to share in production” minus “adjustments for severance tax and marketing costs.”²² This must be the actual income received for the product sold during the period which is being analyzed.²³ It is the value of the lessee’s working interest after taxes and royalty payments.²⁴

The most litigated aspect of this analysis involves what is considered an “operating expense” and what is not. In order to be deemed producing in “paying quantities,” a lease must be producing in such a manner as to yield a profit to the working interest owner over current operating expenses.²⁵ Under general accounting principles of the oil and gas industry, expenses related to producing leases are usually categorized in to four general categories: (1) lease operating expenses, (2) repair and remediation expenses, (3) equipment purchases, and (4) completion or re-completion (workover) costs.²⁶ “Generally speaking, the operating expenses are distinguished from the other three categories in that the other three categories are considered extraordinary expenses, that is, expenses that would not be thought of as normal operating costs.”²⁷ Only operating expenses may be considered in the analysis.

“When categorizing an expense as an operating expense to determine if production was in paying quantities, ordinary and reoccurring expenses are generally distinguished from expenses that are extraordinary and largely non-reoccurring.”²⁸ Work over²⁹ expenses are generally

²² *Menoah Petroleum*, 545 So. 2d at 1220-21. “Ad valorem taxes should be considered when determining whether a reasonably prudent operator would continue to produce a well for the purpose of making a profit and was not merely holding a lease for speculation. A prudent operator would consider the amount of past due taxes when deciding whether to continue to operate the lease or not. The annual recurring taxes are expenses which a prudent operator cannot ignore in an evaluation of whether to continue to operate the lease.” *Id.*

²³ *Id.* at 1221 (rejecting the lessee’s attempt to look at total production in 1986 rather than at the total sales of 1986).

²⁴ *CCH, Inc. v. Heard*, 410 So. 2d 1283, 1282 (La. App. 3d Cir. 1982).

²⁵ La Min. Code art. 124 Cmt. (La. Rev. Stat. § 31:124 Cmt. (2007)).

²⁶ *Lege*, 631 So. 2d at 718.

²⁷ *Id.* at 718-19. (finding that the “cost of conversion of the saltwater disposal well, as well as workover expenses, are a capital expenditure and should not be included as an operating expense for the purpose of determining there was production in paying quantities”).

²⁸ *O’Neal v. JLH Enter., Inc.*, 862 So. 2d 1021, 1028 (La. App. 7th Cir. 2003).

²⁹ A “reworking operation” or “work over” can be defined as an activity “physically associated with the well site and intimately connected with the resolution of the difficulty which caused the well to cease production.” *Id.* (Citing *Jardell v. Hillin Oil Co.*, 485 So. 2d 919 (La. 1986) (citations omitted)).

considered extraordinary expenses and therefore are generally are not included as an operating expenses.³⁰

Another instructive tool in classifying expenses as current operating expenses or not, is whether the expenses have been actually billed by the operator.³¹ For example, overhead expenses are typically not considered an operating expense in the analysis of whether or not a well is producing in paying quantities.³² However, if the well is being operated by party who is not a lessee, such expenses are considered an "operating expense."³³

In *Lege v. Lea Exploration Co.*,³⁴ the Louisiana Third Circuit Court of Appeal addressed the issue of whether a particular expenditure was an ordinary operating expense or a capital expenditure. The expense at issue in *Lege* was the cost of conversion of a saltwater disposal well.³⁵ The lessor argued that, if the lessee had not installed the saltwater disposal system, the saltwater would have had to be transported away from the wellsite.³⁶ The lessor reasoned that "since lifting and trucking are undisputed 'operating expenses,' by analogy, so should be the expenditures which replace them."³⁷ The court rejected the lessor's argument stating:

We are unable to accept the premise of plaintiff's position, that the nature of a lessee's cost is determined strictly by the substitution accomplished. Instead, we choose to follow the more traditional understanding that a expenditure's classification is generally determined more by whether it is ordinary and recurring or extraordinary and largely non-recurring in nature.³⁸

The court found that due to the nature of these expenses as "non-operating" the well at issue was producing in paying quantities, and the lease was not subject to cancellation.³⁹

³⁰ *Id.* (Citing *Lege* 631 So. 2d at 716.).

³¹ *Menoah Petroleum*, 545 So. 2d at 1221 (finding the defendant's operating expense report "a more accurate reflection of the unit expenses since the report contains the actual charges billed by the operator.")

³² *Id.*

³³ *Id.* (Citing 2 KUNTZ, THE LAW OF OIL & GAS, §26.7 (1964); 43 A.L.R.3d 8 (1972)). See also *Edmondson Bros.*, 672 So. 2d at 1064. ("We start with the proposition that where the lessee is also the operator, the operator's overhead cannot be included in the operating expenses charged to the lease. This rule does not apply where the unit is being operated by a party other than the lessee.).

³⁴ *Lege*, 631 So. 2d at 716.

³⁵ *Id.* at 719.

³⁶ *Id.* at 718.

³⁷ *Id.*

³⁸ *Id.* at 719.

³⁹ *Id.*

While courts have looked at various factors in examining whether or not a lease is producing in paying quantities, the most important requirement throughout the jurisprudence appears to be the favorable comparison of production income to operating expenses. In order for a lease to be deemed producing in paying quantities, it must be producing enough revenue to cover the operating expenses and provide a small profit for the lessee. If the lease is not producing in paying quantities, production is insufficient to hold the lease beyond its primary term.

III. *Selected Issues under the Shut-In Clause*

As noted in Section I above, the typical habendum clause in an oil and gas lease provides that the lease will terminate at the expiration of its primary term unless oil and gas is being produced or reworking or drilling operations are in progress.⁴⁰ In the absence of a special provision to the contrary, termination would occur even if a well had been completed on the leased premises capable of producing in commercial quantities if the lessee is unable to produce the well.⁴¹ Thus, modern oil and gas leases almost invariably contain a shut-in or in lieu payment provision allowing the lessee to maintain the lease through the payment of a sum of money when production has been discovered, but the well in which such production has been achieved has to be shut-in.⁴² The advent of the clause dates back to the 1930s, but it did not come into wide use until the 1940s or 1950s.⁴³ And, the clause remains in common use today.

The justification for inclusion of shut-in clauses arises from the difference between oil and gas.⁴⁴ While oil can be stored in tanks and transported by trucks, pipelines, or tank cars, the only significant storage place for natural gas is the underground reservoir in which it is found.⁴⁵ If there is no available pipeline, the gas must remain in the ground until a

⁴⁰ D. Douglas Howard, *Problems of Interpreting and Applying Shut-in Clauses*, 11 LA. INST. ON MIN. L. 3 (1964); Leslie Moses, *Problems in Connection with Shut-In Royalty Provisions in Oil and Gas Leases*, 23 TUL. L. REV. 374 (1948) (Moses I); Wilmer D. Masterson, Jr., *The Shut-In Royalty Clause in an Oil and Gas Lease*, 4 ROCKY MT. MIN. L. INST. 1315, 321 (1959).

⁴¹ See *Smith v. Sun Oil Co.*, 135 So. 15 (1931). See also 3 WILLIAMS & MEYERS, *supra* note 2 § 631 at 469.2-98; Moses I, *supra* note 40 at 375. It should be noted that in some states – Montana, Oklahoma, and West Virginia—courts have held that a lease may be maintained beyond its primary term by discovery alone if only the lack of a market prevented production. 3 WILLIAMS & MEYERS, *supra* note 2 § 631, 469.2; Masterson, *supra* note 40 at 321-22.

⁴² Robert E. Beck, *Shutting-In: For What Reason and for How Long?* 33 WASHBURN L.J. 749 (1994); Masterson, *supra* note 40 at 323. (“The main reason for including a shut-in clause is to give a lessee a way to continue a lease beyond its primary term where there has been a shut-in well.”)

⁴³ *Id.*; 3 WILLIAMS & MEYERS, *supra* note 2 § 631 at 400.3.

⁴⁴ Moses I, *supra* note 40 at 376.

⁴⁵ *Id.*

market can be secured.⁴⁶ Even where a pipeline may be available, off-spec gas may be rejected by the pipeline company, requiring continued shut-in of the well.⁴⁷

There are “almost innumerable variations” in the form a shut-in clause may take.⁴⁸ While several Louisiana courts have addressed the operation of the clause, the cases often turn on the specific language employed in the provision.⁴⁹ This section of the paper will address select issues that have arisen in Louisiana jurisprudence dealing with the shut-in or in lieu payment clause.

Is the Payment a Royalty or a Rental?

One issue addressed by courts and other authorities in Louisiana and elsewhere is whether the payment should be construed as the payment of royalty or as a rental payment.⁵⁰ The comment to Article 192 of the Louisiana Mineral Code indicates that shut-in royalty clauses in leases commonly used in north Louisiana provide for payment regarded as the constructive equivalent of production when there is a shut-in well, while the shut-in clauses of leases commonly used in south Louisiana treat a shut-in well as a dry hole or a well incapable of commercial production with shut-in payments operating as delay rentals.⁵¹ One author has opined

⁴⁶ *Id.*

⁴⁷ See e.g. *McDowell v. PG & E Res Co.*, 658 So. 2d 779 (La. App. 2d Cir. 1995).

⁴⁸ Beck, *supra* note 42 at 749. (Citing 3 WILLIAMS & MEYERS, *supra* note 2 § 632. A typical shut-in provision used in a Louisiana lease form reads:

Where gas from the leased premises is not sold or used, Lessee at his election from time to time, before or after the expiration of the primary term, pay as royalty, a sum payable in advance in the same amount and manner as the delay rentals payable hereunder on or before the anniversary of the rental date (provided that for a fractional part of the beginning year, proportionate royalty payment may be made on the next succeeding payment date) and so long as such payments are made, it shall be considered that gas is being produced within the meaning of Paragraph hereof; but said lease shall not be held in force for a longer period than five years by such payment in lieu of sale of gas; and such payment shall not limit or discharge Lessee from the obligation of reasonable development.

3 WILLIAMS & MEYERS, *supra* note 2 § 631 at 400.1.

For other examples of representative shut-in provisions see 3 WILLIAMS & MEYERS, *supra* note 2 § 631 at 339-400.3.

⁴⁹ See e.g. *Davis v. Laster*, 138 So. 2d 559 (1962); *Odom v. Union Producing Co.*, 141 So. 2d 649 (La. 1962) (on rehearing); *Acquisitions Inc. v. Frontier Exploration, Inc.*, 432 So. 2d (La. App. 3d Cir. 1983); *Nortan-Lawton Oil & Gas Corp. of Texas v. Miller*, 272 F. Supp. 125 (W.D. La. 1967).

⁵⁰ See *Davis*, 138 So. 2d 558; *Acquisitions, Inc.*, 432 So. 2d 1095; *Carlisle v. United Producing Co.*, 278 F.2d 893 (10th Cir. 1960); *Morris v. First Nat'l Bank of Mission*, 249 S.W.2d 269 (Tex. Civ. App. 1952).

⁵¹ La. Min. Code art. 182 Cmt. (La. Rev. Stat. § 31:182 Cmt. (2007)). 3 WILLIAMS & MEYERS, *supra* note 2 § 632.10 at 440.2. It should be noted, however, that numerous courts addressing shut-in provisions in leases covering land in south Louisiana have de-

that, given that the payment is made in lieu of production for a well fully capable of producing, it is nonsensical to treat the well as a dry hole.⁵² And, a leading oil and gas treatise notes that the payment should usually go to the royalty owner because great difficulties are created if the shut-in payment is classified as “rent.”⁵³

Indeed, the distinction carries with it significant effects. The most profound effect of the classification as a “rental” is the possibility of automatic termination of the lease for late payment.⁵⁴ If the payment is a royalty, rather than a rental, the lessee should be entitled to notice and an opportunity to cure a defect in performance before the lessor may seek cancellation.⁵⁵ Further, the characterization of the payment as a rental or royalty may affect who is entitled to payment⁵⁶ and affect the continued rights of royalty and possibly servitude owners.⁵⁷

The leading case in Louisiana addressing the classification of a shut-in payment is *Davis v. Laster*.⁵⁸ The *Davis* court addressed the classification of shut-in payments under a lease dated January 16, 1947, affecting 772 acres in DeSoto Parish, Louisiana, which had a primary term

scribed such payments as “royalties” without expressly holding that they should be characterized as such. See *LeBlanc v. Haynesville Mercantile Co.*, 88 So. 2d 377 (La. 1956) (covering land in Vermilion Parish, Louisiana); *Union Oil Co. of California v. Touchet*, 86 So. 2d 50 (La. 1956) (covering land in Vermilion Parish, Louisiana); *Melancon v. Texas Co.*, 89 So. 2d 135 (1956) (covering land in Lafourche Parish, Louisiana); *Bollinger v. Texas Co.*, 95 So. 2d 132 (La. 1957) (covering land in Lafourche Parish, Louisiana); *Bernard v. Marathon Oil Co.*, 381 So. 2d 1286 (La. App. 3d Cir. 1980) (covering land in Vermilion Parish, Louisiana).

⁵² Moses I, *supra* note 40 at 379.

⁵³ 3 WILLIAMS & MEYERS, *supra* note 2 § 632.10 at 442.

⁵⁴ *Acquisitions, Inc.*, 432 So. 2d 1095. See also *Matheson v. Placid Oil Co.*, 33 So. 2d 527, 529-30 (La. 1947) (citing La. Civ. Code art. 1767).

⁵⁵ *Acquisitions, Inc.*, 432 So. 2d 1095. See also *Lapeze v. Amoco Production Co.*, 842 F.2d 132, 133, n. 3 (5th Cir. 1988); La. Min. Code arts. 137-141 (La. Rev. Stat. § 31:137-141 (2007)).

⁵⁶ 3 WILLIAMS & MEYERS, *supra* note 2 § 632.10 at 440.1-444. In Louisiana, for example, the holder of an executive right would be entitled to rentals but not royalties. La. Min. Code art. 105. (La. Rev. Stat. § 31:105 (2007)). Thus, the characterization of a shut-in payment as royalties or rentals would control who was entitled to receive payment. A royalty owner under article 80 of the Louisiana Mineral Code (La. Rev. Stat. § 31:80 (2007)), as owner of a non-executive right, would be entitled to the shut in payment *only if* it were characterized as a royalty. See also Min. Code arts. 105 and 108. (La. Rev. Stat. §§ 31:105, 108 (2007)).

⁵⁷ See *LeBlanc v. Haynesville Mercantile Co.*, 88 So. 2d 377 (La. 1956). Compare *Union Oil Co. of California v. Touchet*, 86 So. 2d 50 (La. 1956). See also 3 WILLIAMS & MEYERS, *supra* note 2 § 632.10 at 440.2. But see La. Min. Code arts. 34 and 90 (La. Rev. Stat. §§ 31:34, 90 (2007)) and La. Min. Code art. 34 Cmt. (La. Rev. Stat. § 31:137 Cmt. (2007)) (suggesting that the interruption of prescription should not be dependent on characterization of shut-in payments as constructive production).

⁵⁸ 138 So. 2d 558.

of ten years.⁵⁹ In September 1948, the defendant lessee drilled a well (the "Pegues No. 1 Well") on the leased premises capable of producing in paying quantities between five and six million cubic feet of gas daily on open flow tests conducted by the Louisiana Department of Conservation.⁶⁰ The Pegues No. 1 Well was then shut-in for lack of a market.⁶¹ At the time of its completion, the Pegues No. 1 Well was the only well producing gas in the area, and no purchaser would undertake the expense of laying a pipeline to receive and market production from this well alone.⁶² The defendant lessee drilled nine additional wells on neighboring tracts of land in an effort to find additional gas reserves, but none of the wells were productive.⁶³ A second producer with neighboring leases ultimately discovered two additional gas wells in the area, and the producer joined with the defendant to secure a gas line to the three wells.⁶⁴ The line was being laid at the time the suit was filed in February 1958.⁶⁵

After the completion and shutting-in of the Pegues No. 1 Well, the defendant lessee continued to pay annual delay rentals until the expiration of the primary term on January 16, 1957.⁶⁶ The plaintiff lessor accepted these payments without protest. On December 28, 1956, the defendant lessee tendered a check to the plaintiff lessor purporting to be a shut-in royalty payment for the period commencing on January 16, 1957 and continuing through January 16, 1958.⁶⁷ Plaintiff lessor refused the payment and, by letter dated October 30, 1957, demanded that the lessee release the lease.⁶⁸ By check dated January 2, 1958, the defendant again tendered shut-in royalties for the period from January 16, 1958 through January 16, 1959.⁶⁹ The well commenced actual production on May 13, 1958.⁷⁰

The pertinent provisions of the lease read:

2. Subject to the other provisions herein contained, this lease shall be for a term of ten years from this date and as long thereafter as oil, gas, or other minerals are produced from said lands or lands pooled hereunder.

⁵⁹ *Id.* at 559.

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.* at 559-560.

⁶⁵ *Id.* at 560.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.*

3. The royalties to be paid by lessee are:

(c) Where gas from a well producing gas only is not sold or used because of no market or demand therefore, lessee may pay as royalty \$50.00 per well, per year, payable quarterly, and upon such payment it will be considered that gas is being produced within the meaning of Article 2 of this contract.⁷¹

The Court of Appeal held that the lessees' failure to pay shut-in royalties under these provisions during the primary term of the lease constituted a breach of the lease for which the lessor was entitled to cancellation.⁷² On appeal to the Louisiana Supreme Court, the defendant lessee argued that it had the option of maintaining the lease either by paying delay rentals or by the payment of shut-in royalties.⁷³ The Louisiana Supreme Court ultimately rejected this argument holding that the payments under Article 3(c) were royalties and that the lessee was not permitted to pay delay rentals when royalties were actually owed.⁷⁴

The *Davis* court found it significant, however, that Article 3(c) designated the shut-in payments as "royalties."⁷⁵ Moreover, the fact that Article 3(c) was contained within Article 3, concerning the payment of royalties, supported the conclusion that the parties intended payments under Article 3(c) to be royalties.⁷⁶ The court determined that there was no support for the argument that the language of Article 3(c) permitted the interpretation advanced by the defendant.⁷⁷ The court concluded that once a well capable of producing is discovered, the lessee is "relegated to continuing drilling operations, or the payment of shut-in royalties, or ac-

⁷¹ *Id.* at 561.

⁷² *Id.*

⁷³ *Id.* at 561-2. For additional cases discussing the alternative obligations of the lessee under the shut-in clause, see *Sohio Petroleum Co. v. V. S. & P. R. R.*, 62 So. 2d 615, 620 (La. 1952) (as discussed in *Davis*, lease was held by continuous drilling obligation) and *Lelong v. Richardson*, 126 So. 2d 819, 824-25 (La. App. 2d Cir. 1961) (lease was held by the payment of shut-in royalties).

⁷⁴ *Davis*, 138 So. 2d at 563. Although the court held that the lessee was required to pay shut-in rentals under Article 3(c), the court went on to find that the parties varied the terms for performance of the shut-in royalty provision by their course of performance under the contract and ultimately rejected the plaintiff lessor's demand for forfeiture. *Id.* at 564. Note that the lessee in *Davis* could have argued that non-payment of royalties does not result in automatic termination of a mineral lease; however, *Davis*, predates the Louisiana Mineral Code. Prior to the enactment of the Mineral Code there was authority that the failure to pay royalties for an extended period of time was an active breach of the mineral lease for which a putting in default was not required. See *Melancon*, 89 So. 2d 135 and *Bollinger*, 95 So. 2d 132. See also La. Min. Code art. 137 Cmt. (La. Rev. Stat. § 31:137 Cmt. (2007)).

⁷⁵ *Davis*, 138 So. 2d at 562.

⁷⁶ *Id.*

⁷⁷ *Id.*

tual royalties to maintain the lease” and, only if production ceases, does the lessee have the option of resuming the payment of delay rentals.⁷⁸

The court further rejected the defendant lessee’s alternative argument that it may resort to the payment of delay rentals after a well is shut-in on the basis that the well ceased to produce.⁷⁹ In rejecting this argument, the court noted that “A shut-in well is not dry, and although not actually producing, it is unrealistic to say that production has ceased within the established meaning of these words. The very purpose of the shut-in well clause of oil and gas leases is to permit the lessees to maintain the lease as though it were producing.”⁸⁰ Shut-in payments, the court reasoned, are a substitute for actual production royalties and are considered as “constructive production.”⁸¹ The court also found it important that the payments were to be made quarterly as opposed to annually as with delay rental payments.⁸² The court concluded that the parties had agreed to apply rental payments to one situation and royalty payments to another, and after production – either actual or constructive – is achieved the lessee no longer had the option of making rental payments.⁸³ The court reasoned that the only option allowed under Article 3(c) is the option to pay shut-in royalties or resume drilling operations under the terms of the lease.⁸⁴

The court recognized the importance of the characterization of the payment as royalties stating:

[T]he fact that the shut-in payments which the lessee may make, having been designated by the parties as royalty, allow others besides the mineral owner-lessor to become entitled to these payments. In many instances the mineral-owner lessor has sold royalties, and the royalty owners thereby created do not enjoy the right to participate in bonus and rentals under the lease due the mineral-owner lessor, but these nonparticipating royalty owners do become entitled to their acquired portion of royalties. To permit the lessees to elect to pay rentals where royalties are due would be to invest them with the power to foreclose nonparticipating royalty owners from receipts to which they are entitled under the lease.⁸⁵

While the *Davis* court classified the shut-in payment therein considered as a royalty, the case hinged on the language of the provision under

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.* at 562-63.

⁸⁴ *Id.* at 563.

⁸⁵ *Id.*

consideration and left open the possibility that other shut-in clauses may be given a different construction. In the more recent case of *Acquisitions Inc. v. Frontier Explorations, Inc.*,⁸⁶ the Louisiana Third Circuit Court of Appeal likewise found that the shut-in provision provided for the payment of royalty as distinguished from rental. However, this court again declined to hold that all shut-in payments should be considered royalties. Instead, the *Acquisitions Inc.* court, like the court in *Davis*, was careful to preserve the right of contracting parties to determine the nature of this provision through their individual choice of language.⁸⁷ While a leading treatise on oil and gas law notes that the payments should generally be treated as royalty,⁸⁸ care should be taken in determining whether a unique shut-in clause should be interpreted as a royalty or a rental. The careful drafting of shut-in provisions is necessary to ensure that there is no doubt as to the nature of the right involved.

Triggering the Shut-In Clause: Is there Production in Paying Quantities?

Another issue which has arisen in relation to shut-in payments is how much production is necessary to trigger the operation of a shut-in clause. As detailed in Section I hereof, in order to preserve a lease through actual production, production must be achieved in paying or commercial quantities. The payment of a shut-in royalty is viewed as payment for "constructive production." Thus, it is generally understood that a shut-in well must be capable of achieving commercial production in order to take advantage of a shut-in payment provision.⁸⁹ Indeed, even when the provision fails to state that the well must have the capacity to produce in paying or commercial quantities, it is generally thought that payment of shut-in royalties will not hold the lease unless the well is actually capable of producing in paying quantities.⁹⁰ Louisiana case law supports this proposition.⁹¹

How and When Must Production in Paying Quantities Be Proved?

The Louisiana Second Circuit Court of Appeal addressed the need to show that a shut-in well is capable of producing in paying quantities.

⁸⁶ 432 So. 2d 1095.

⁸⁷ *Id.* at 1098. (Citing article 3 of the Louisiana Mineral Code (La. Rev. Stat. § 31:3 (2007)), under which parties remain free to contract as they see fit unless doing so is expressly or impliedly prohibited or contrary to public policy).

⁸⁸ 3 WILLIAMS & MEYERS, *supra* note 2 § 632.10 at 442.

⁸⁹ *Id.* at 407; *Moses I*, *supra* note 40 at 376.

⁹⁰ 3 WILLIAMS & MEYERS, *supra* note 2 § 632.3 at 407.

⁹¹ See *Taylor v. Kimbell*, 54 So. 2d 1 (La. 1951); *Webb v. Hardage Corp.*, 471 So. 2d 889 (La. App. 2d Cir. 1985); *Auzene v. Lawrence Oil Co.*, 179 So. 2d 533 (La. App. 3d Cir. 1965).

In *Webb v. Hardage Corp.*,⁹² the court explained that the term “production” as used in royalty and shut-in royalty provisions must be understood in the context of Louisiana Mineral Code article 124 (La. Rev. Stat. 31:124). As detailed in Section I, article 124 provides that when a lease is being preserved by production such production must be in paying quantities and provides the basic factors that a court must consider when determining whether commercial production exists.⁹³ Reading article 124 in conjunction with the terms of the leases at issue in *Webb*, the court concluded that the leases could only extend beyond their primary terms if the wells were capable of producing in paying quantities.⁹⁴ The court found that the lessee bears the burden of proving by a preponderance of evidence that, prior to the expiration of the primary term of the lease or the continuous drilling operation term of the lease, a well was completed and surface tested and that the well was demonstrably capable of producing in paying quantities at that time.⁹⁵

In *Webb*, the lessee brought in three wells one month before the expiration of the primary term.⁹⁶ The wells were cored, logged, casing was set, the wells perforated for production, and the formation fracked; however, the only surface testing that the lessee performed was a flare test lasting only four or five hours.⁹⁷ The flare did not comply with the state-required regulatory surface production test, which consists of a quantitative measurement of gas production over a twenty-four hour period and which is required to be done within a few days after a well is drilled.⁹⁸ After the short flare test, the lessee shut-in the wells for lack of a market.⁹⁹ The lessee tendered shut-in royalties, which were rejected by the lessors.¹⁰⁰ The lessors subsequently notified the lessee in writing of its noncompliance with the lease, but the lessee took no further steps to test production, until two years later when it performed initial regulatory surface tests on one of the wells.¹⁰¹ When the lessee attempted to perform the regulatory surface test on another well, its company officials were escorted from the site by a sheriff's deputy called by the lessors.¹⁰²

⁹² 471 So. 2d 889.

⁹³ *Id.* at 891-92.

⁹⁴ *Id.* at 892.

⁹⁵ *Id.*

⁹⁶ *Id.* at 890.

⁹⁷ *Id.*

⁹⁸ *Id.* at 890-91.

⁹⁹ *Id.* at 890.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 890-91.

¹⁰² *Id.* at 891.

Thereafter, the lessors filed suit seeking a declaration that the leases had terminated.¹⁰³

Although the lessor generally has the burden of proving that a lease has terminated, the court determined that an exception existed in this situation.¹⁰⁴ Without expressly establishing a bright-line test for determining the productive capacity of a gas well,¹⁰⁵ the court found that generally the initial potential surface test required by the Louisiana Department of Conservation is sufficient to carry the lessee's burden that the well is capable of commercial production.¹⁰⁶ The regulatory surface test is performed only days after the well is completed under standard conditions, over a twenty-four hour period, and is witnessed by a representative of the Louisiana Office of Conservation.¹⁰⁷ The test is a prerequisite for having the well classified as an oil or gas well and for obtaining an allowable and the authority to sell oil or gas from the well.¹⁰⁸ The test should be conducted during the primary or continuous production period of the lease in order to thereafter continue the lease through the payment of shut-in royalties.¹⁰⁹ "Without such test the status of the well would ordinarily remain uncertain while the well is shut-in."¹¹⁰

Noting the inconclusive results of the logs and cores on the subject wells, the limited flaring of the wells, and the poor production history in the field, the court in *Webb* ultimately concluded that the lessee had insufficient evidence during the primary term to prove that the wells drilled were capable of producing in paying quantities.¹¹¹ The court found it of no moment that the one production test that had been performed revealed that the well was indeed capable of producing in paying quantities concluding that such production capacity must be established during the primary or continuous operations period.¹¹² The court found that a "lessee should not be able to rely on the shut-in clause to hold a lease beyond the primary term where the well's capacity to produce in paying quanti-

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 892.

¹⁰⁵ The court held open the possibility that production potential could be proved through other evidence, such as the results of logs and cores, the flaring of wells for extended periods of time, and the favorable production history of the wells completed in the same productive zone in the field. However, the court stressed the importance of testing of surface production and indicted a strong preference that a lessee be able to present this type of proof. *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Id.* at 892-93.

¹¹² *Id.* at 893.

ties cannot be determined until further testing and procedures are carried out at some later date.”¹¹³

Although *Webb* did not establish a mandatory evidentiary rule requiring the lessee to establish the ability of a shut-in well to produce in commercial quantities through surface testing in compliance with the Louisiana Department of Conservation’s statutory and regulatory scheme, a lessee would be well advised to complete surface testing during the primary or continuous drilling terms of its lease before shutting in a well. In the absence of such test, a lessee may rely on other evidence to establish commercial production but runs the risk of having a court reject its proof as insufficient.

Triggering the Shut-In Clause: Does *De Minimus* Production of Other Substances Prevent the Application of a Shut-In Clause?

The issue of whether a well is producing in paying quantities arises in another context relating to the shut-in clause: whether a well may be maintained by the payment of shut-in rentals when the shut-in well produces both gas and other liquid hydrocarbons. As noted previously, most shut-in clauses are applicable only to gas wells.¹¹⁴ Variations of the clause include such language as:

“While there is a gas well on this lease but gas is not being sold or used”;

“Where gas from a well producing gas only is not sold or used”;

“For all wells on the said lands where gas only or primarily is found”;

“Gas from a well or wells, capable of producing gas only”;¹¹⁵

The question thus arises as to the meaning of the term “gas” or “gas only.” In Louisiana, a shut-in well producing both gas and liquid hydrocarbons is nonetheless a “gas” well or a well producing “gas only” when the liquid products are not being produced in paying quantities.

This question was addressed by the Louisiana Supreme Court in *Davis v. Laster*.¹¹⁶ In *Davis*, the lessor contended that, because the well produced condensate, as well as gas, it was not “producing gas only” under the terms of the lease.¹¹⁷ The court accepted for the sake of argument that liquid condensate was not “gas” for the purposes of the shut-in provision;¹¹⁸ however, it recognized that almost all gas wells produce

¹¹³ *Id.*

¹¹⁴ 3 WILLIAMS & MEYERS, *supra* note 2 § 632.3 at 402; Masterson, *supra* note 40 at 323.

¹¹⁵ 3 WILLIAMS & MEYERS, *supra* note 2 § 632.3 at 402.

¹¹⁶ 138 So. 2d 558.

¹¹⁷ *Id.* at 567-68.

¹¹⁸ The argument was made by the lessee that, because the condensate was produced in

some liquid condensate.¹¹⁹ “A holding that the constructive production provision applies only to wells producing no liquid condensate would render the provision almost nugatory.”¹²⁰ Given the purpose of the provision is to maintain the lease in the absence of actual production, the need for the protection still exists when a well is producing only a negligible amount of condensate.¹²¹ The *Davis* court thus held that a well produced “gas only” unless it was capable of producing condensate in paying or commercial quantities.¹²² The burden of proof is on the party attacking the lease to show that the well was capable of producing products other than gas in paying quantities, and because the plaintiff in *Davis* had failed to present any evidence to support its attack, the court rejected its claim.¹²³

Triggering the Shut-In Clause: Is the Well Shut-In, and What Is the Reason for the Shut-In?

The issues sometimes arise of whether the well is actually shut-in and whether the reason for the shut-in is covered by the shut-in clause. This issue is largely controlled by the specific language contained in the shut-in provision. Most shut-in well clauses provide for the payment of royalties when a gas from a shut in well is “not being sold or used.”¹²⁴ But again, there are innumerable variations of the shut-in clause.¹²⁵ Some

a gaseous state and later separated at the wellhead, the condensate was gas for the purposes of the shut-in clause. Because it was unnecessary to the ultimate decision of the case, the court did not address whether the condensate produced by the well should be classified as something other than gas. Ostensibly, an argument still exists after *Davis* that condensate should be classified as gas for the purposes of shut-in provisions. The court recognized that:

The Commissioner of the Department of Conservation has classified the well as a gas well. The Legislature, in another context, has defined ‘Oil’ and ‘Gas’ as follows:

(4) ‘Oil’ means crude petroleum oil, and other hydrocarbons, regardless of gravity, which are produced at the well head in liquid form by ordinary production methods.

(5) ‘Gas’ means all natural gas, including casinghead gas, and all other hydrocarbons not defined as oil in paragraph (4) above. LSA-R.S. 30:3.

Davis, 138 So. 2d at 568.

¹¹⁹ 138 So. 2d at 567, quoting *Vernon v. Union Co. of California*, 270 F.2d 441 (5th Cir. 1959) and citing SUMMERS, *supra* note 2 § 299.

¹²⁰ *Id.* at 567, quoting *Vernon v. Union Co. of California*, 270 F.2d at 441.

¹²¹ *Id.* at 567-568.

¹²² *Id.* at 568.

¹²³ *Id.*

¹²⁴ 3 WILLIAMS & MEYERS *supra* note 2 § 632.4 at 410.

¹²⁵ Beck, *supra* note 42 at 752; Nancy Forbis, *The Shut-In Royalty Clause: Balancing the Interests of Lessors and Lessees*, 67 TEX. L. REV. 1129, 1133 (1989). For examples of variations, see 3 WILLIAMS & MEYERS *supra* note 2 § 632.4, at 410-11.

clauses contain no express reason for shut-in.¹²⁶ Others refer expressly to the lack of a market; others refer to lack of an adequate market.¹²⁷ Still others refer to transportation difficulties, availability of a pipeline, force majeure, or other problems.¹²⁸

In *Melancon v. Texas Co.*,¹²⁹ and its companion case *Bollinger v. Texas Co.*,¹³⁰ the Louisiana Supreme Court considered the effect of a shut-in clause allowing shut-in payments when gas is “not being sold or used.” In both cases, the lessee paid shut in royalties even though the well was open for production into the lessee’s fuel line and gas and distillate were being used by the lessee and others.¹³¹ On various intermittent occasions, the well was temporarily shut-in, and it was during these occasions that the lessee paid shut-in royalties.¹³² Based on these facts, the court held that the lessees breached the leases for non-payment of production royalties for gas being used by the lessee and other operators.¹³³ The court found that the shut-in clause had no application when gas was being used by the lessee and others. The court held that the lessee could not pay shut-in royalties when production royalties were actually due.¹³⁴

In *Nordan-Lawton Oil & Gas Corp. of Texas v. Miller*,¹³⁵ the court construed a similar provision in a lease providing for payment of in lieu (or shut-in) royalties reading: “when a market cannot be secured for gas from a well or well producing gas only, and such gas is not being used or sold on or off the premises.”¹³⁶ The lessee in *Nordan-Lawton* had negotiated a favorable gas purchase contract, obtained a certificate from the Federal Power Commission, and had the facilities available to transport production.¹³⁷ The lessor, nonetheless, contended that the wells involved were shut-in for lack of a market, and thus, shut-in royalties were owed.¹³⁸ The lessee countered that a market had been obtained when it

¹²⁶ Beck, *supra* note 42 at 752; Forbis, *supra* note 125 at 1133.

¹²⁷ Beck, *supra* note 42 at 752; Forbis, *supra* note 125 at 1133.

¹²⁸ Beck, *supra* note 42 at 752.

¹²⁹ 89 So. 2d 135 (La. 1956).

¹³⁰ 95 So. 2d 132 (La. 1958).

¹³¹ *Melancon*, 89 So. 2d at 137-38; *Bollinger*, 95 So. 2d at 134.

¹³² *Melancon*, 89 So. 2d at 138; *Bollinger*, 95 So. 2d at 134.

¹³³ *Melancon*, 89 So. 2d 135; *Bollinger*, 95 So. 2d 132.

¹³⁴ Interestingly, in *Bollinger* the shut-in payments exceeded that which would have been owed for production royalties; the court, however, held that such payments did not satisfy the terms of the lease. *Bollinger*, 95 So. 2d at 136.

¹³⁵ 272 F.Supp 125 (W.D. La. 1967) *aff'd*, 403 F.2d 946 (5th Cir. 1968).

¹³⁶ *Id.* at 130.

¹³⁷ *Id.* at 131.

¹³⁸ *Id.*

secured the gas purchase contract and that the wells were shut-in for other operational and economical reasons beneficial to both the lessee and the lessor.¹³⁹ Specifically, the lessee alleged that evidence from the shut-in wells indicated fewer reserves than originally estimated.¹⁴⁰ As a result, both lessee and lessor would have realized lower profits from the lease as a whole if the wells were placed on production.¹⁴¹ The district court agreed with the lessee's argument concluding that the wells were not shut-in for lack of a market but for other operational reasons, and thus, no shut-in royalties were owed.¹⁴²

In *McDowell v. PG & E Resources Co.*,¹⁴³ the court construed a more detailed shut-in provision that allowed the lessee to make shut-in royalty payments "by reason of force majeure or lack of either a market at the well or wells or of an available pipeline outlet in the field."¹⁴⁴ The facts of the *McDowell* case are somewhat complex and warrant detailed treatment.

In *McDowell*, the producing well on the lease produced only "wet" gas, which had to be combined with "dry" gas from another well to meet the specifications for the available pipeline in the field.¹⁴⁵ In the early 1990s the well from which the dry gas was obtained ceased to produce, and the pipeline company refused to accept the unmixed wet gas from the producing well on the lease.¹⁴⁶ In March of 1990, the lessee was required to shut-in the well and, thereafter, undertook numerous steps to reestablish a market, including the drilling and reworking of wells from which it hoped to obtain dry gas.¹⁴⁷ The lessee entertained gas purchase offers by two different purchasers, but the construction of a pipeline would have been necessary.¹⁴⁸ By December 4, 1990, the lessee reached an agreement with a gas carrier to purchase the production, but no pipeline was available at that time.¹⁴⁹ In January 1991, the lessee tendered shut-in royalties in accordance with the lease provisions.¹⁵⁰ On April 28,

¹³⁹ *Id.* at 136-37.

¹⁴⁰ *Id.*

¹⁴¹ *Id.* This case presents the unusual situation in which shut-in royalties were owed even though the lease is otherwise being held by production. This issue will be discussed in greater detail in Section II.E., *infra*.

¹⁴² *Id.*

¹⁴³ 658 So. 2d 779 (La. App. 2d Cir. 1995).

¹⁴⁴ *Id.* at 782, n. 5.

¹⁴⁵ *Id.* at 781.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *Id.* at 781, n. 2.

1991, the lessee placed the well back on line after the construction of the pipeline, and in May 1991, the lessee resumed paying production royalties.¹⁵¹

Approximately one month prior to the resumption of production, the landowners executed another lease in favor of a third party covering the same lands as defendant's lease.¹⁵² Thereafter, the new lessee mailed demand letters to the defendant demanding release of its leases.¹⁵³ When the defendant refused, the landowner filed suit claiming that the leases had expired under their terms as a result of cessation of production for more than 90-days.¹⁵⁴

The plaintiff landowner contended that gas purchase offers made in the 1990s demonstrated that a market existed at that time and precluded the application of the shut-in royalty provision.¹⁵⁵ Focusing on the precise language of the shut-in clause, the court in *McDowell* rejected the plaintiff's argument.¹⁵⁶ According to the shut-in provision, "absent the availability of a pipeline, only a market 'at the well' would negate a shut-in situation." Because the offers from the gas purchasers required the installation of a pipeline, they did not end the shut-in situation.¹⁵⁷ "[T]he mere existence of potential buys in the area did not suffice."¹⁵⁸ Rather, until the "market" was brought to the well by the installation of the pipeline, the shut-in clause was operative.¹⁵⁹

Although no cases in Louisiana directly address shut-in clauses containing permissible grounds for shutting in a well, it poses another interesting issue. Scholarly writings suggest that attention should be paid to the possibility of its inclusion when drafting the clause.¹⁶⁰ There may be persuasive reasons to include a provision in an oil and gas lease that allows some discretion on the part of the lessee when shutting-in a well, but if such provision is included, it is advisable that it should include reference to "the lessee's good faith judgment that it is unadvisable to produce and sell products for the time being."¹⁶¹

When Must the Shut-In Payment Be Made?

¹⁵¹ *Id.* at 781.

¹⁵² *Id.*

¹⁵³ *Id.* at 782.

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ 3 WILLIAMS & MEYERS, *supra* note 2 § 632.4 at 411; Beck *supra* note 42 at 766-68.

¹⁶¹ 3 WILLIAMS & MEYERS, *supra* note 2 § 632.4 at 411; Beck *supra* note 42 at 766-68

Another important variation of shut-in payment clauses is the provision concerning the timing of such payments; these variations bring with them attendant problems.¹⁶² In some instances, the contract is silent as to the date upon which payment is to be made. It has been suggested that the “ultimate test” for timeliness is whether actual production on the date of payment would have been sufficient to maintain the lease in force.¹⁶³ This seems a dangerous test to rely on, particularly if such payment is later deemed a rental and not a royalty.¹⁶⁴ There is authority in Louisiana that, absent a specific requirement that payment is to be made in advance, no such requirement exists.¹⁶⁵ Nonetheless, caution may dictate that in instances of doubt, where the contract is otherwise silent, payment should be made in advance of shutting in the well.¹⁶⁶

The Louisiana Supreme Court’s decision in *Odom v. Union Producing Co.*,¹⁶⁷ involved a lease granted on May 26, 1947 with a ten year primary term.¹⁶⁸ On May 1, 1957, a well completed on a neighboring tract was shut-in, and a unit including a portion of the plaintiff’s land was formed on May 20, 1957.¹⁶⁹ The lessee tendered a shut-in royalty payment on June 11, 1957 – after the well was shut-in and after the primary term expired.¹⁷⁰ The lease provided that the payments were to be “payable quarterly” but contained no express provision that the payments were to be made in advance or at any other specific time within the quarter.¹⁷¹ Relying on the general provisions of the Louisiana Civil Code as well as other authorities relating to leases, the court concluded on rehearing that the payment was properly made at any time within the quarter.¹⁷²

¹⁶² Barney Hebert, *Who Gets Paid When? The Timing of the Shut-In Gas Royalty Payment*, 8 MISS. C. L. REV. 175, 184 (1988); 3 WILLIAMS & MEYERS, *supra* note 2 § 632.6 at 418.

¹⁶³ Howard, *supra* note 40 at 6. (Citing *Moses, Shut-In Gas Well Problems*, 33 MISS L.J. 267(1962)).

¹⁶⁴ See discussion in Section II. A. herein, *supra*. If the payment is characterized as a royalty, the lessor may be obligated to provide notice and an opportunity to cure in the event of an untimely payment. La. Min. Code art. 136 (La. Rev. Stat. § 31:137 (2007)); See also *Lapeze v. Amoco Production Co.*, 842 F.2d 132, 133, n. 3 (5th Cir. 1988). Conversely, if the payment is characterized as a rental, untimely payment may trigger an express resolatory condition under which the lease automatically terminates. See *Acquisitions, Inc. v. Frontier Explorations, Inc.*, 432 So. 2d 1095 (La. App. 3d Cir. 1983).

¹⁶⁵ *Odom v. Union Producing Co.*, 141 So. 2d 649, 664 (La. 1962) (on rehearing).

¹⁶⁶ Howard, *supra* note 40 at 6; 3 WILLIAMS & MEYERS, *supra* note 2 § 632.4 at 418; Hebert, *supra* note 162 at 7.

¹⁶⁷ 141 So. 2d 649.

¹⁶⁸ *Id.* at 650.

¹⁶⁹ *Id.* at 664.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*, citing La. Civ. Code art. 2057; *Risinger v. Arkansas-Louisiana Gas Co.*, 198

It should be noted that the law in Texas is in conflict with *Odom*. Under the Texas Supreme Court's holding in *Freeman v. Magnolia Petroleum Co.*, to avoid lease termination and to extend a lease beyond the primary term by paying shut-in royalties, the lessee must tender shut-in royalties before the end of the primary term if the shut-in provision is silent.¹⁷³ The *Freeman* court reasoned that, because there was neither actual nor constructive production at the end of the primary term, the lease terminated under its own terms.¹⁷⁴ Because Louisiana does not follow the doctrine of *stare decisis*,¹⁷⁵ there is the possibility that a Louisiana court later examining this issue could adopt similar reasoning to that of the *Freeman* court. Thus, lessees in Louisiana should remain cautious when paying shut-in royalties to maintain a lease beyond its primary term or continuous drilling term.

Where the contract specifies the timing for payments, it is incumbent upon the lessee to pay in accordance with the lease provisions. In *Bennett v. Sinclair*,¹⁷⁶ the plaintiff lessor declined to cash a shut-in royalty check which purported to represent shut-in royalties for a period of six months on the basis that it was not paid in accordance with the terms of the lease, which provided that royalties were payable "quarterly."¹⁷⁷ Plaintiff further claimed that the shut-in payment was premature because the payment was designated for a period beginning May 29, 1965, when the well was actually completed on June 13, 1965.¹⁷⁸ The court found that the completion date was a "mere technicality" as to whether completion occurred at the time the Christmas tree was installed or whether it occurred at the time the well was perforated; as such, it did not affect the timeliness of payment.¹⁷⁹ In addressing whether payment for a six month period constituted performance under the lease, the court noted that "ordinarily shut-in royalties should be tendered in accordance with the terms of the lease."¹⁸⁰ However, because the lessor could show no prejudice

La. 101, 3 So. 2d 285 (La. 1941); 52 C.J.S. *Landlord and Tenant* § 511 at 315; 32 AM. JUR. *Landlord and Tenant* § 462 at 378; 126 A.L.R. 565.

¹⁷³ 171 S.W.2d 339 (1943).

¹⁷⁴ *Id.* at 342. For a more complete discussions of *Freeman v. Magnolia Petroleum Co.*, and other cases following its reasoning, see 3 WILLIAMS & MEYERS, *supra* note 2 § 633.3 at 465-470, and Hebert, *supra* note 162 at 184-85.

¹⁷⁵ *Doerr v. Mobil Oil Corp.*, 774 So. 2d 119, 128 (La. 2000) ("Louisiana courts have frequently noted that our civilian tradition does not recognize the doctrine of *stare decisis* in our state.") See also Albert Tate, Jr., *Civilian Methodology in Louisiana*, 44 TUL.L.REV. 673, 678 (1970).

¹⁷⁶ 405 F.2d 1005 (5th Cir. 1968).

¹⁷⁷ *Id.* at 1008.

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

from the small overpayment of royalties, the lessor was denied the remedy of lease cancellation.¹⁸¹

The above described difficulties in determining the timing for payment of a shut-in royalty may be avoided by the careful drafting of clauses containing such provisions. Consideration should be given to the inclusion of a grace period or other specific language that would allow the lessee to make payment after the well is shut-in even when the lease is beyond the primary term.

Is the Shut-In Payment Necessary if the Lease is Being Held by Production?

Many shut-in provisions do not require the payment of shut-in royalties when the lease is otherwise being held by production.¹⁸² And the jurisprudence in Louisiana has established that, in the absence of a provision to the contrary, there is no obligation to pay shut-in royalties when a lease is being held by actual production.¹⁸³ But, a careful analysis of the individual shut-in provision should be made before concluding that shut-in payments are not expressly required.

In *Nordan-Lawton Oil & Gas Corp. of Texas v. Miller*,¹⁸⁴ the court held that the defendant was required to pay shut-in royalties for a shut-in well even though actual production attributable to the lease was being obtained.¹⁸⁵ The *Nordan-Lawton* case was distinguished in *Bernard v.*

¹⁸¹ *Id.* The court distinguished *Bollinger v. Texas Co.*, in which the lessee paid shut-in royalties that exceeded the amounts owed as production royalties. In *Bollinger*, though numerous demands had been made by the lessor for payment of production royalties, the lessee engaged in an intentional course of conduct of withholding royalties in an effort to obtain a favorable amendment to the lease with lessor. *Id.*

It should also be noted that the *Bennett* decision predates the Louisiana Mineral Code. A lessee would now be entitled to written notice and an opportunity to cure improper payment of royalties before the lessor would be afforded the opportunity to seek lease cancellation. La. Min. Code art. 137. (La Rev. Stat. § 31:137 (2007)).

¹⁸² See e.g., *Bernard v. Marathon Oil Co.*, 381 So. 2d 1286 (La. App. 3d Cir 1980); *Bennett v. Sinclair Oil & Gas Co.*, 405 F.2d 1005 (5th Cir. 1968); See also 3 WILLIAMS & MEYERS, *supra* note 2 § 632.14 at 453. As noted above, a lessee may also be excused from paying shut-in royalties when the lease is being maintained by continuous drilling operations. See *Davis*, 138 So. 2d 558; *Sohio Petroleum Co.*, 62 So. 2d at 620 and may also be maintained by force majeure, cf. *Webb v. Hardage Corp.*, 471 So. 2d 889 (La. App. 2d Cir. 1985) and *LeSage v. Union Producing Co.*, 176 So. 2d 777 (La.App. 2d Cir. 1965) *rev'd on other grounds*, 184 So. 2d 727 (La. 1966).

¹⁸³ *Bernard*, 381 So. 2d at 1286 (“Where there is actual production in paying quantities, the necessity for constructive production does not exist.”); *Bennett*, 405 F.2d at 1005 (“Where there is actual production attributable to a mineral lease . . . there is no obligation to pay shut-in royalties in the event another commercial capable of producing in paying quantities, is drilled on the lease premises”).

¹⁸⁴ 272 F.Supp. 125 (W.D. La. 1967).

¹⁸⁵ *Id.*

Marathon Oil Co.,¹⁸⁶ on the basis that the specific lease language in *Nordan-Lawton* contained an express provision that obliged the lessee to pay shut-in royalties in the event of a shut-in well, even when there was actual production attributable to the leased property.¹⁸⁷ No such provision was contained in the lease in *Bernard*; thus, the *Bernard* court held that there was no obligation to pay shut-in royalties when the lease was being held by production.

As demonstrated by the *Nordan-Lawton* and *Bernard* cases, different shut-in provisions may result in different obligations to pay shut-in royalties in the event that the lease is otherwise being held by production. Thus, careful consideration should be given in both drafting and interpreting these provisions.

Does Payment of Shut-In Royalties Affect the Lessee's Implied Obligations?

A final issue to be examined under the shut-in clause is what, if any, affect it has on the lessee's implied obligations to market and develop the leased premises. The issue is often raised that it is possible that the lessee may extend the lease indefinitely by the payment of shut-in royalties. In older lease forms, the shut-in royalty provision often contained no term.¹⁸⁸ In more modern lease forms, the parties are likely to state that shut-in payments will maintain the lease only for a specified period of time.¹⁸⁹ Even if the shut-in clause has no term, scholarly writings uniformly agree that the implied duty to market gas would limit the lessee's ability to hold the lease indefinitely by paying shut-in royalties alone.¹⁹⁰ Indeed, Professor Masterson refutes the suggestion that the shut-in royalty clause is unfair to the lessor because it allows the lessee to hold the lease indefinitely in the following frequently quoted passage:

A complete answer to the argument that a shut-in clause is unfair to a lessor because it would allow a lessee to hold a lease forever without producing, is that the lessee owes a duty to be diligent in searching for a market; for a breach of which he is liable for damages, cancellation or an alternative decree. Similarly the shut-in well does not excuse the lessee from the usual implied covenants to further

¹⁸⁶ 381 So. 2d 1286.

¹⁸⁷ *Id.* at 1289.

¹⁸⁸ Leslie Moses, *Recent Problems in Connection with Shut-In Gas Royalty Provisions in Oil and Gas Leases*, 10 LOY. L. REV. 1, 7 (1961) ("Moses II").

¹⁸⁹ Beck, *supra* note 42 at 783.

¹⁹⁰ 3 WILLIAMS & MEYERS, *supra* note 2 §§ 632.13 at 447-48 and 634.2 at 483-83; Beck, *supra* note 42 at 779-84; Forbis, *supra* note 125 at 1147-48; Moses II, *supra* note 188 at 7-8; Masterson, *supra* note 40 at 330.

develop, to offset and otherwise conduct himself as would a reasonable and prudent lessee under the same or similar circumstances.¹⁹¹

Louisiana case law confirms that the implied obligation to reasonably market gas and develop the leased premises is not excused when a lessor is receiving shut-in royalty payments.¹⁹²

In *Lelong v. Richardson*,¹⁹³ the court held that a lessee must comply with its marketing and development obligations when maintaining a lease by paying shut-in royalties.¹⁹⁴ Plaintiff in *Lelong* granted to the defendants a mineral lease dated July 8, 1957.¹⁹⁵ The lessees began drilling operations before the expiration of the primary term and completed a well capable of producing gas on November 27, 1957.¹⁹⁶ At the time of the well's completion there was no available market for the gas, and the well was shut-in.¹⁹⁷ On December 6, 1957, the plaintiff lessor executed an act ratifying the lease, and on January 17, 1958, the lessees tendered a shut-in royalty payment pursuant to the lease.¹⁹⁸

On May 6, 1958, the plaintiff lessor sent a demand letter to the lessees demanding additional drilling within sixty days or cancellation of the lease.¹⁹⁹ The defendant lessee complied with plaintiff's demand, beginning additional drilling operations in June 1958, but due to a blow-out and resulting difficulties with the second well, the lessees were unable to complete the well until September 1958.²⁰⁰ Like the first well, this well was completed as a gas well for which there was no market.²⁰¹ The lessees tendered shut-in royalty payments for both wells on January 2, 1959.²⁰²

The record established "that lessees, from and since the completion of [the first well] in November 1957, in good faith exerted every reasonable and diligent effort in attempting to produce a market for the gas."²⁰³ In March or April 1959, a gas purchaser expressed interest in purchasing

¹⁹¹ Masterson, *supra* note 40 at 330.

¹⁹² *Lelong v. Richardson*, 126 So. 2d 819 (La. App. 2d Cir. 1961).

¹⁹³ *Id.*

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* at 821.

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.* at 821-22.

²⁰¹ *Id.* at 822.

²⁰² *Id.*

²⁰³ *Id.*

gas from the area in which the lease was located.²⁰⁴ After protracted negotiations, this purchaser began buying gas from the first well on November 1, 1959.²⁰⁵

On April 29, 1959, the plaintiff lessor sent a demand to some but not all of its lessees notifying them that he considered the lease to be terminated for the failure of the lessees to comply with their obligations.²⁰⁶ The plaintiff enclosed with the demand the shut-in royalty checks, none of which had been cashed.²⁰⁷ Plaintiff filed suit seeking cancellation on June 1, 1959.

The court noted that, at the time suit was filed, the defendants were “ready, willing and able to prosecute operations for the development of the leased premises in accordance with reliable geological information and approved business practices in the industry.”²⁰⁸ The *Lelong* court found that the case ultimately turned on whether the lessees failed to adequately develop the leased premises.²⁰⁹ The court analyzed the lessee’s development obligation in connection with its marketing obligation — apparently finding the two obligations interconnected.

The court found that there was no real question that there was no market for the wells at the time of their completions.²¹⁰ When other wells were completed by other operators in the area, a market was created.²¹¹ And, it was clear that the lessees intended to continue the lease in effect through the payment of shut-in royalties.²¹² The court concluded that, under the circumstances of the case, the lessees had not violated their implied duty to develop the leased premises.²¹³

The court found it important that the wells were located in a wild-cat area, where no market for gas was located.²¹⁴ The lessees diligently attempted to create a market for the existing wells, but no market was available for more than a year after the wells’ completion, and a market was not formally secured by the execution of a contract until two years after such completion.²¹⁵ Following the negotiation of the gas purchase

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ *Id.*

²⁰⁸ *Id.*

²⁰⁹ *Id.* at 823.

²¹⁰ *Id.* at 824.

²¹¹ *Id.*

²¹² *Id.* at 825.

²¹³ *Id.* at 830.

²¹⁴ *Id.*

²¹⁵ *Id.*

contract, the lessees were prevented from developing the leased premises by the institution of the lawsuit for cancellation and forfeiture of the lease.²¹⁶ Under these facts, the court found that the lessees complied with the duty to develop the leased premises.²¹⁷ However, the court noted that the continued validity of the lease would depend on the lessees' future actions, which in view of the existing market would require prompt and diligent development of the leased premises.²¹⁸

Under *Lelong*, a lessor faced with a shut-in royalty clause containing an indefinite term for its application may resort to the lessee's implied obligations to market and develop for release when a lessee attempts to hold the lease by the payment of shut-in royalties alone without making efforts to secure a market or further develop the leased premises.

IV. *Selected Issues under the Pugh Clause*

Another commonly used provision in Louisiana Mineral leases is the so-called Pugh clause. The clause relates to pooling and unitization and provides that drilling or production from a unit or units will maintain the lease in force only as to that area included within such unit or units.²¹⁹ Under Louisiana law, the drilling of a well which produces in paying quantities on leased premises during the primary term of the lease maintains the lease as to all lands covered by the lease in the absence of a Pugh Clause.²²⁰ Additionally, operations on land unitized with the leased premises sufficient to maintain the lease according to its terms will preserve the lease in its entirety.²²¹ This general rule is based on the notion that a mineral lease is indivisible.²²² In *Hunter Co. v. Shell Oil Co.*, a case in which a portion of the leased premises was placed in a unit and production was obtained from unitized land other than the leased land, the Louisiana Supreme Court held that the:

²¹⁶ *Id.*

²¹⁷ *Id.*

²¹⁸ *Id.*

²¹⁹ 8 WILLIAMS & MEYERS, *supra* note 2 at 849.

²²⁰ La. Min. Code art. 114 (La. Rev. Stat. § 31:114 (2007)). This is not the general rule in some states, such as Oklahoma, which have enacted a statutory provision, sometimes referred to as a statutory Pugh clause, providing that production within a unit does not hold the portion of the leased premises outside the unit. Okl. Stat. Ann. 52, § 87.1 (2006). To illustrate, the Oklahoma's version of the statutory Pugh clause states: "[i]n case of a spacing unit of one hundred sixty (160) acres or more, no oil and/or gas leasehold interest outside the spacing unit involved may be held by production from the spacing unit more than ninety (90) days beyond expiration of the primary term of the lease." *Id.* Practitioners should refer to state law to determine whether their state has enacted such a statute.

²²¹ La. Min. Code art. 114 (La. Rev. Stat. § 31:114 (2007)).

²²² *Id.* at Cmt. See also *Smith v. Carter Oil Co.*, 104 F.Supp. 463, 466 (W.D. La. 1952).

drilling of a producing well in the unit . . . within the primary term of the lease complies with the obligation to drill assumed by the lessee under the terms and provisions of the lease and production in paying quantities from such a well constitutes production from all the property described in the lease and maintains the lease in full force and effect.²²³

However, the Louisiana Mineral Code provides that parties are free to contract for a result different from that created by the general rule in the Louisiana Mineral Code.²²⁴ Parties to oil and gas leases often do this by inserting a so-called “Pugh clause” into their leases.²²⁵ The Pugh clause is named after Lawrence C. Pugh, of Crowley, Louisiana, who is said to have included the clause in a lease to reverse the effects of *Hunter Co. v. Shell Oil Co.*²²⁶ There are various versions of Pugh clauses, but in its basic form, the Pugh clause provides that production from any part of a unit preserves the lease only as to the leased land included in the unit.²²⁷ The clause, in effect, severs the lease into parts that must be separately maintained.²²⁸ The Pugh clause usually provides that the portion of the leased land not included in a producing unit may be maintained by the payment of delay rentals or Pugh clause rentals.²²⁹

The Pugh clause is advantageous to and protective of the lessor’s interests in reasonable development of the leased premises.²³⁰ It was designed to “prevent undesirable legal consequences of unitizing for the landowner-lessor.”²³¹ “The main purpose of a Pugh clause is to protect the landowner-lessor from the anomaly of having the entire property held under lease by production from a very small portion . . .”²³² In the absence of a Pugh clause, an entire lease could be

²²³ 31 So. 2d 10 (La. 1947). See also *LeBlanc v. Danciger Oil & Refining Co.*, 49 So. 2d 855 (La. 1950).

²²⁴ La. Min. Code art 3 (La. Rev. Stat. § 31:3 (2007)); La. Min. Code art. 114 Cmt. (La. Rev. Stat. § 31:114 Cmt. (2007)).

²²⁵ La. Min. Code art. 114 Cmt. (La. Rev. Stat. § 31:114 Cmt. (2006)); See also *Will-Drill Resources, Inc. v. Huggs*, 738 So. 2d 1196, 1199 (La. App. 2d Cir. 1999).

²²⁶ 4 WILLIAMS & MEYERS, *supra* note 2 § 669.14.

²²⁷ *Will-Drill Resources, Inc.*, 738 So. 2d at 1199.

²²⁸ 4 WILLIAMS & MEYERS, *supra* note 2 § 669.14 at 47.

²²⁹ *Fremaux v. Buie*, 212 So. 2d 148, 150 (La. App. 3d Cir. 1968).

²³⁰ Patrick H. Martin, *Implied Covenants in Oil and Gas Leases: Past, Present, & Future*, 33 WBN. L.J. 639, 647 (1994). See also *Sandefur Oil & Gas, Inc. v. Duhon*, 961 F. 2d 1207, 1209 (5th Cir. 1992).

²³¹ *Fremaux*, 212 So. 2d at 151.

²³² EARL A. BROWN, EARL A. BROWN, JR. & LAWRENCE T. GILLASPIA, *THE LAW OF OIL AND GAS LEASES*, § 17-14[7] (2d. 2006) (quoting *Will-Drill Resources, Inc.*, 738 So. 2d at 1199). See also *Sandefur*, 961 F. 2d at 1209.

preserved by payment to the landowner of a potentially small portion of the royalty which is attributable to the lessor's interest in the unit.²³³ In such situation, the lessor whose lease did not contain a Pugh clause could only terminate the lease by proving that the lessee failed to develop and operate the leased property as a reasonably prudent operator.²³⁴

Because Pugh clauses are commonly included in oil and gas leases, there is a substantial amount Louisiana jurisprudence addressing Pugh clauses. This case law raises several interesting issues regarding the activation and application of a Pugh clause.

What Constitutes a Unit for Purposes of a Pugh Clause?

Voluntary versus Compulsory Units

In *Smith v. Carter Oil Co.*, the Court held that forced pooling of a lease pursuant to an order of the Commissioner of Conservation did not divide the obligations of the lease under the Pugh clause in question.²³⁵ The Pugh clause was contained within a pooling clause immediately following provisions giving to the lessee the power to pool or unitize the leased premises and setting out the procedures for such declaratory pooling. The Pugh clause considered by the court in *Smith* reads:

If operations be conducted on or production be secured from land in such pooled unit other than land covered by this lease, it shall have the same effect as to maintaining lessee's rights in force hereunder as if such operations were on or such production from land covered hereby, except that its effect shall be limited to the land covered thereby which is included in such pooled unit. This lease, during any period in which it is being so maintained as to part of the land covered hereby, may be maintained as to the remainder in any manner elsewhere provided for herein; provided, that if it be maintained by rental payment, the rentals may be reduced in proportion to the number of acres in such unit or units as to which this lease is being maintained by drilling operations or production.²³⁶

²³³ BROWN, *supra* note 232 § 17-14[7].

²³⁴ La. Min. Code art. 122 (La. Rev. Stat. § 31:122 (2007)).

²³⁵ 104 F. Supp. 463, 466 (W.D. La. 1952). *See also Odom v. Union Producing Co.*, 129 So. 2d 530, 536-537 (La. App. 2d Cir. 1961), *rev'd*, 141 So. 2d 649 (La. 1961)(on rehearing). The Louisiana Supreme Court originally affirmed the decision of the appellate court holding that the Pugh clause did not apply to compulsory units created by the Commissioner of Conservation. However, on rehearing, the Supreme Court reversed the appellate court without again addressing whether or not a Pugh clause applies to compulsory unitization. The court's holding that payment of shut-in royalties after expiration of the primary term preserved the entire lease made revisiting that issue superfluous. *See also Bennett v. Sinclair Oil & Gas Co.*, 405 F.2d 1005, 1010 (5th Cir. 1968) (holding that "the so-called 'Pugh' clause does not divide the lease in a case such as this which involves compulsory unitization by orders of the Louisiana Conservation Commissioner").

²³⁶ 4 WILLIAMS & MEYERS *supra* note 2 § 669.14 at 51 (quoting *Smith*, 104 F. Supp. at

When reading this clause separately from the rest of the lease contract, it appears that the Pugh clause would affect a division of the lease where there was either a declared unit or compulsory pooling by the Commissioner of Conservation. However, the Court reasoned that the pooling clause containing the Pugh clause applied only to declared units; thus, the Pugh clause was also applicable only to voluntarily pooling.

Similarly, the United States Fifth Circuit Court of Appeals in *Lowman v. Chevron U.S.A., Inc.*,²³⁷ held that a Pugh clause applied only to units voluntarily created by the lessee, not to units established by the Commissioner of Conservation; thus, the entire lease was maintained by unit production without the payment of delay rentals or operations on the leased land not included in the unit. The Pugh clause there was contained in a type-written addendum to the lease and provided:

Anything to the contrary elsewhere in this lease notwithstanding, it is understood and agreed that drilling, mining or re-working operations upon, or production of any mineral from any unit established by a Lessee pursuant to Paragraph 2²³⁸ hereof shall not serve to maintain this lease as to the non-unitized portion, i.e. that portion of the leased lands not included in any such unit, but only as to the unitized portion, i.e. that portion of the leased lands included in such unit. If any such unit is established, then this lease may be maintained (a) as to the non-unitized portion and (b) separately as to each unitized portion in any manner elsewhere provided in this lease.²³⁹

Though the Pugh clause in *Lowman* was not included within a pooling clause, as was the case in *Smith, Odom, and Bennett*, the specific reference to the pooling clause (Paragraph 2 of the lease) convinced the Court that the Pugh clause was only triggered by creation of a voluntary unit.²⁴⁰

There exists no general policy in Louisiana against application of Pugh clauses to compulsory units.²⁴¹ Lessors who so desire could and often do draft Pugh clauses applicable to both units created by the lessee and units compelled by the Commissioner of Conservation.²⁴² Under both Louisiana state and federal jurisprudence, a lessor should be careful to state when the Pugh clause is applicable²⁴³ and should avoid including

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²³⁷ 748 F.2d 320, 322 (5th Cir. 1984).

²³⁸ Paragraph 2 of the lease contained the pooling clause.

²³⁹ *Lowman*, 748 F. 2d at 321.

²⁴⁰ Patrick H. Martin, *Developments in Business Law 1984-1985: Mineral Rights*, 46 L.A. L. REV. 569, 584 (1986). See also *Lowman*, 748 F. 2d at 322.

²⁴¹ Martin, *supra* note 240 at 584.

²⁴² *Id.*

²⁴³ The Pugh Clause in *Will-Drill Res., Inc.*, provides an example of how to draft a clause that will divide a lease upon either voluntary or compulsory creation of a unit. The

the Pugh clause in any clause giving the lessee authority to pool the leased premises or describing the procedure for voluntary pooling.

Units Comprised Entirely of Leased Land

A common Pugh clause provision provides that a lease will be divided with the establishment of a unit that pools or combines a portion of the lands covered by the lease *with other lands*. Whether or not a unit for purposes of such a Pugh clause can be comprised entirely of land held under one lease is an interesting issue. Louisiana jurisprudence on this subject is mixed, and the conflict has not been resolved by the Louisiana Supreme Court. However, the prevailing view is that application of such a Pugh clause is triggered only where a unit combines leased lands with lands not covered by the lease, and it is inappropriate to apply a Pugh clause where a unit is formed entirely of lands included within the lease.

In *Will-Drill Resources, Inc. v. Huggs*,²⁴⁴ the Court reversed the trial court and held that the drilling of a well on a unit comprised entirely of leased land did not activate the Pugh clause in question; thus, unit drilling maintained the lease in its entirety. There, the Commissioner of Conservation established a unit, 100% of which unit was made up of land covered by the lease. In determining that the Pugh clause was inapplicable, the Second Circuit began its analysis by examining the specific language of the contract and applying Civil Code contract interpretation articles. The Pugh clause in *Will-Drill* stated that it applied when “a drilling and/or production unit be created and established, pooling and com-

clause there stated:

Any provision in this lease to the contrary notwithstanding, it is expressly agreed that if, either by an order of the Commissioner of Conservation of Louisiana, or by any other State or Federal authority having control of such matters, or in the manner hereinabove provided, a drilling and/or production unit be created and established, pooling and combining a portion of the lands covered by this lease with other lands, lease or leases in the vicinity thereof, then drilling operations on or production of oil, gas, sulphur or other minerals from such unit shall continue this lease in force and effect during or after the primary term only as to the lands covered hereby which are included in such unit, irrespective of whether such drilling operations be conducted on, or production be secured from lands covered hereby, or from other lands embraced within such unit, it being expressly agreed that drilling operations on, or production from any drilling or production unit, however created or established, shall not maintain this lease in force or effect during or after the primary term as to any of the land covered hereby which are not included in such unit. This lease, during any period in which it is being so maintained as to a part of the land covered hereby may be maintained as to the remainder of said lands in any manner elsewhere provided for herein; provided that if it be maintained by rental payment, the rentals may be reduced in proportion to the number of acres in such unit or units as to which this lease is being maintained by drilling operation or production.

Will-Drill Res., Inc., 738 So. 2d at 1197.

²⁴⁴ 738 So. 2d at 1198-1199.

binning a portion of the lands covered by this lease *with other lands*, lease or leases in the vicinity thereof. . .” and that “drilling operations on, or production from *any* drilling or production unit, however created or established, shall not maintain this lease in force or effect during or after the primary term as to any of the lands covered hereby which are not included in such unit.”²⁴⁵ The court found that the latter phrase clarified the former phrase instead of setting forth an independent application of the Pugh clause.²⁴⁶ It determined that the former phrase required a unitization of the leased land with unleased lands (or land held under a different lease).

The *Will-Drill* court next considered its contractual interpretation in light of the purposes of Pugh clauses, unitization, and pooling. The court determined that a unit for purposes of a Pugh clause should be comprised of lands covered by the lease and lands outside of the lease because the function of a unit is to merge or integrate separate rights to produce.²⁴⁷ It found further that the purpose of the Pugh clause is to prevent dilution, caused by unitization, of the landowner-lessor’s royalty interests.²⁴⁸

²⁴⁵ *Id.* at 1199. (emphasis added).

²⁴⁶ *Id.* at 1199-1200.

²⁴⁷ *Id.* at 1200. (Citing Patrick H. Martin, *Review of Recent Developments: 1991-1992: Mineral Rights*, 53 L.A. L. REV. 891, 910 (1993)).

²⁴⁸ *Id.* at 1200. See also *SMK Energy Corp. v. Westchester Gas Co.*, 705 S.W.2d 174 (Tex. Ct. App 1985). *SMK* dealt with an issue somewhat similar to the question of whether a unit for purposes of a Pugh clause can be comprised entirely of the leased premises. There, the court found that a clause providing for extension of the lease beyond the primary term only as to leased acreage which is pooled or unitized was not a Pugh clause. *Id.* at 176. The clause in *SMK* stated:

Notwithstanding any provisions in this lease to the contrary, it is understood and agreed that the lessee’s lease shall not (repeat not) extend beyond the primary term as to any part of the acreage described therein, excepting that part of the acreage which is then (at the end of the primary term) pooled or unitized for drilling, reworking operations, or production of oil and/or gas from such a unit or units then (at the end of the primary term) formed by LESSEE; and, as to that party of the acreage included within the boundaries of a unit or units so formed, such a lease shall be perpetuated and continued only so long after the expiration of the primary term as production, drilling or reworking operation are continuously conducted thereon without interruption or cessation of more than ninety (90) days.

Id. There, the lessee began drilling a well on a designated 40 acre tract wholly within the leased tract just before expiration of the primary term. *Id.* The lessee argued that the clause in question was a Pugh clause which was not activated because the leased land was not pooled or unitized with any other lands. *Id.* The lessor argued the provision was not a Pugh clause, but was provision designed to prevent the holding of the entire lease by only one producing well. *Id.* The court rule in favor of the lessor, holding that the clause was not a Pugh clause because it was not conditioned upon the exercise of pooling rights. *Id.* The leased premises outside of the 40 acre tract were tendered back to the lessor.

Where leased land has not been combined with other lands to create a unit, this purpose cannot be fulfilled.²⁴⁹

In an earlier case, *Fremaux v. Buie*,²⁵⁰ the Louisiana Third Circuit Court of Appeal addressed comparable circumstances and reached a similar conclusion. The court there held that an assignment of royalties using a description of forty acres around a producing well did not create a unit.²⁵¹ The Pugh clause in *Fremaux* applied where “a portion or portions of the land herein leased is pooled or unitized with other land so as to form a pooled unit or units.”²⁵² Like *Will-Drill*, the alleged forty acre unit was comprised only of leased land. The court found that a “unit” of acreage was formed for intra-lease division of mineral production for accounting purposes, but such “unit” did not constitute a pooled unit within the parameters of the Pugh clause.²⁵³ The court reasoned that the so-called “unit” did not affect the lessor’s interests; thus, the purpose of the Pugh clause in avoiding undesirable effects of unitization would not be advanced by application of the Pugh clause.²⁵⁴

However, an opinion rendered by the Louisiana Fourth Circuit Court of Appeal is in conflict with the holdings in *Will-Drill* and *Fremaux*. In *Banner v. GEO Consultants International, Inc.*,²⁵⁵ the Fourth Circuit determined that the creation of a “unit” comprised entirely of one party’s land triggered the application of the Pugh clause in the lease. In *Banner*, leases covering 1220 acres were granted to one party and then assigned to another. The assignee drilled a producing well on the leased premises. After expiration of the primary term, the assignee reassigned the leased premises, excluding a 160 acre square around the producing well, to the original lessee. The Court found that the 160 acre tract was a unit for purposes of the Pugh clause.²⁵⁶ In determining what constituted a Pugh clause unit, the court considered the Louisiana Mineral Code definition of “unit” in Article 213²⁵⁷ and gave great weight to the comment to

²⁴⁹ *Will-Drill Res., Inc.*, 738 So. 2d at 1200.

²⁵⁰ 212 So. 2d at 150-151.

²⁵¹ *Id.* at 151.

²⁵² *Id.* at 149.

²⁵³ *Id.* at 151.

²⁵⁴ *Id.*

²⁵⁵ 593 So. 2d 934 (La. App. 4th Cir. 1992).

²⁵⁶ The Pugh clause stated, “Anything to the contrary notwithstanding, it is provided that if any portion of the lands held hereunder should be unitized in any manner with other lands, then unit drilling or reworking operations on or unit production from any unit shall only maintain this lease as to the land included in such unit.” *Banner*, 539 So. 2d at 935.

²⁵⁷ La. Min. Code art. 216 (6)(La. Rev. Stat. § 31:213(6) (2007)) provides:

“Unit” means an area of land, deposit or deposits of minerals, stratum or strata, or pool or pools, or a part or parts thereof, as to which parties with interests therein are

Article 213, which states that “the definition includes conventional units of all kinds, whether established by declaration under a pooling power, by a contract executed by all parties affected or otherwise.” The Fourth Circuit reasoned that reference to “conventional units of all kinds” was sufficiently broad to encompass the 160 acre tract reserved to the assignee.²⁵⁸

The decision in *Banner* has been questioned in subsequent Louisiana jurisprudence and by commentators and legal scholars. The court in *Will-Drill* attempted to explain its divergent conclusion by distinguishing the language of the Pugh clause in *Banner*.²⁵⁹ The court pointed out that the Pugh clause in *Will-Drill* used the terms “pooling and combining” of leased land, whereas the clause in *Banner* did not include those terms.²⁶⁰ Because of this difference, the court stated that *Banner* was not controlling.²⁶¹ Perhaps recognizing the weakness of this argument, the court added that “to the extent *Banner* is inconsistent with our decision, we decline to follow it.”²⁶² Further, the *Will-Drill* court noted Professor Martin’s critique of *Banner* in which he stated:

The *Banner* court apparently completely misunderstood the nature of a unit, failing as it did to understand that a unit merges or integrates separate rights to produce. . . Under the approach adopted by the court, any sublease or assignment of a portion of a lease may be treated as a unit for Pugh Clause purposes. This is clearly erroneous.

This criticism seems a fair assessment of the *Banner* opinion. *Banner* appears to be based on a fundamental misunderstanding of the nature of a unit. A standard Pugh clause provides that a lease will be divided with the establishment of a unit that pools or combines a portion of the leased lands *with other lands*. Although the Louisiana Supreme Court has not resolved the issue, it seems most likely that under current jurisprudence a Louisiana court should only apply such a Pugh clause to divide a lease where a unit was made up of the leased premises combined with a tract not covered by the same lease, despite the holding in *Banner*. Moreover, given the nature of a unit²⁶³ and the purpose of a Pugh clause

bound to share minerals produced on a specific basis and as to which those having the right to conduct drilling or mining operations therein are bound to share investment and operating cost on a specified basis. A unit may be formed by convention or by order of an agency of the state or federal government empowered to do so. A unit formed by order of a governmental agency is termed a “compulsory unit.”

²⁵⁸ *Banner*, 593 So. 2d at 935.

²⁵⁹ *Will-Drill Res., Inc.*, 738 So. 2d at 1201.

²⁶⁰ *Id.*

²⁶¹ *Id.*

²⁶² *Id.*

²⁶³ Martin, *supra* note 247 at 910-911.

as set out by case law,²⁶⁴ a court could easily find that a Pugh clause which merely states that “drilling operations on or production from a pooled unit or units shall maintain the lease in force only as to lands included within such unit or units”²⁶⁵ is not activated by creation of a unit comprised only of leased lands.

Does the Pugh Clause Give Rise to a Horizontal Division of the Lease?

The vast majority of Pugh clauses in Louisiana affect a vertical division of leased land; that is, most Pugh clauses are invoked to divide the surface of the leased premises. However, in some instances a Pugh clause may divide the leased premises horizontally at a specific depth below the surface. In such cases, the clause is called a “horizontal Pugh clause” or a “bottomhole severance clause.” Where a Pugh clause is found to divide property horizontally, a few interesting issues arise, and some oil and gas-producing states occasionally differ in their resolution of these issues. These issues include (1) whether a standard Pugh clause lacking language specifically suggesting horizontal division can be applied to horizontally sever the leased land, and (2) if a lease is found to contain a horizontal Pugh clause, how is the horizontal boundary at which the leased premises will be divided determined, and is such boundary at a consistent, fixed depth or at variable depths.

Can a Standard Pugh Clause Be Given Horizontal Application?

One interesting issue that Louisiana courts have not yet considered is whether a standard Pugh clause²⁶⁶ can be used only to divide property vertically, or whether it also may be applied to horizontally divide leased premises. A Texas court in *Friedrich v. Amoco Production Company* has addressed the question.²⁶⁷ The court in *Friedrich* held that the Pugh clause in question could not be applied to divide the leased premises horizontally in the absence of specific reference in the lease to a depth limit or horizontal severance.²⁶⁸ There, two leases totaling 320 surface

²⁶⁴ *Fremaux*, 212 So. 2d at 151; *Will-Drill Resources, Inc.*, 738 So. 2d at 1200.

²⁶⁵ 8 WILLIAMS & MEYERS, *supra* note 2 at 849.

²⁶⁶ For an example of a standard Pugh Clause, *see Banner*, 539 So. 2d at 935.

²⁶⁷ 698 S.W.2d 748, 754 (Tex. Ct. App. 1985).

²⁶⁸ *Id.* The pooling clause in the *Friedrich* lease provided:

Lessee is granted the right and power to pool all or any part of the leased premises with any other lands, as to any stratum or strata and as to any mineral or minerals, and as to all or any interests therein, and by whomsoever owned, for development and operation of the same as a unit or units . . .

Id. at 750. The Pugh clause stated:

In the event a portion or portions of the land herein leased is pooled or unitized with other land so as to form a pooled unit or units, operations on, completion of a well upon, or production from such unit or units will not maintain this lease in force as to the land not included in such unit or units. The lease may be maintained

acres were assigned only as to depths from the surface to 1298 feet. All 320 acres of the leases were then pooled, and assignee paid the full amount of shut-in royalties designated by the lease. Production was not obtained from any part of the leased premises, and no delay rentals were paid for depths below 1298 feet. Upon expiration of the primary term, the lessors brought an action to terminate the lease as to the depths below 1298 feet, arguing that the Pugh clauses in the leases affected a vertical and horizontal division of the leased property. The lessor asserted that the word “land” as used in the lease should be considered as three-dimensional. The court disagreed with the lessor and, instead, it followed a prior Oklahoma Supreme Court decision.²⁶⁹ The court reasoned that where vertical division was the customary application of a Pugh clause, and where the terms used in the Pugh clause – “land” and “number of acres covered hereby and included in such unit or units” – suggested only a customary application of the Pugh clause, the Pugh clause could only be applied to affect a vertical division of the lease.²⁷⁰ Thus, the payment of shut-in royalties preserved the entirety of the lease.

Though the Texas court in *Friedrich* seemed reluctant to invoke a Pugh clause to horizontally divide leased property absent specific con-

in force as to any land covered hereby and not included in such unit or units in any manner provided for herein; provided that if it be by rental payments, rentals shall be reduced in proportion to the number of acres covered hereby and included in such unit or units. If at or after the end of the primary term, this lease is being maintained as to a part of the lands by operations on, completion of a well upon, or production from a pooled unit or units embracing lands covered hereby and other land, and if at such time there be land covered hereby which is not situated in such unit or units and as to which the lease is not being maintained by operations, completion of a well, or production, Lessee shall have the right to maintain the lease as to such land by rental payments exactly as if it were during the primary term, provided that this lease may not be so maintained in force by rental payments more than three (3) years beyond the end of the primary term. (Emphasis added.)

Id. at 750.

²⁶⁹ *Rist v. Westhoma Oil Company*, 385 P. 2d 791, 795 (Ok. 1963). The Oklahoma Supreme Court in *Rist* addressed the question of whether a Pugh clause terminated a lease as to horizons below sea level at expiration of the primary term of the lease. *Id.* The court held that parties only contemplated a vertical severance of the lease through application of the Pugh clause. *Id.* The court reasoned as follows:

[t]here is nowhere contained any language that purports to recognize or show intention that these terms are to apply or even recognize other than the customary application of vertical severance. Certainly the parties could have made reference to partial consolidation or separate horizontal structures by appropriate terms. But they say nothing as to depths, levels, or strata. The words “Tract or tracts,” “Premises,” “lands,” and “leasehold estates” do not import to our minds other than their common meaning.

Id. at 795. The holding in *Rist*, as it applies in Oklahoma, is likely moot now because Oklahoma has since created a statutory Pugh clause. *But see* La. Min. Code art. 114 (La. Rev. Stat. § 31:1.4 (2007)).

²⁷⁰ *Rist*, 385 P. 2d at 794.

tractual language demonstrating intent to horizontally sever the premises, the United States Tenth Circuit Court of Appeals was not so reluctant when applying Kansas law. In *Rogers v. Westhoma Oil Co.*, the district court found that:

the Pugh clauses were written in 'surface sounding terms' and do not 'specifically or clearly designate underground horizons' and concluded that the provisions of the Pugh clauses terminating the leases at the end of the primary terms as to ununitized nonproducing portions apply only to 'partial unitization of less than all of the surface acreage covered by the leases.'²⁷¹

The *Rogers* court reversed the trial court's decision, holding that the Pugh clauses in the leases applied to both a vertical and a horizontal severance of the leasehold estate.²⁷² There, one company held a lease covering all lands above sea level, and another company held a lease covering lands below sea level. The above-sea-level leases were consolidated, and production in paying quantities was obtained only from those units. The *Rogers* court found that the leases as to the below-sea-level horizons terminated because of lack of production and unitization.²⁷³ This finding, according to the Tenth Circuit, was in accord with the function of a Pugh clause to protect lessors from continuation of the lease over non-unitized and unused portions of the leased premises.²⁷⁴ The court reasoned that there was "[n]othing in the leases which confines the application of the Pugh clauses to surface areas and vertical divisions."²⁷⁵ It also stated that "[i]t is common knowledge that leases are divided both vertically and horizontally and that unitization is ordinarily on the basis of a common source of supply."²⁷⁶ Thus, the court concluded that the parties intended to prohibit nonuse of the leased premises, either through vertical or horizontal severance.²⁷⁷

The Texas court in *Friedrich* and the Tenth Circuit in *Rogers* seemed to use opposite assumptions when determining whether a basic Pugh clause should apply horizontally as well as vertically. The Texas court in *Friedrich*, following a previous Oklahoma Supreme Court deci-

²⁷¹ 291 F.2d 726, 729 (10th Cir. 1961).

²⁷² *Id.* at 733-734. The Pugh clause provided that if the leased premises is consolidated, the lease will be continued "as to the premises covered hereby and included in any such consolidation of estates" by a producing gas well located on a consolidated unit or by oil production from a well on leased land, and that the lease will terminate after the primary term as to any "tract or tracts not included in a consolidation held in force by production." *Id.* at 730.

²⁷³ *Id.* at 733-734.

²⁷⁴ *Id.*

²⁷⁵ *Id.* at 731.

²⁷⁶ *Id.*

²⁷⁷ *Id.* at 732.

sion, assumed that a Pugh clause only applied to divide leased property vertically unless the clause contained specific language implying the possibility of a horizontal severance.²⁷⁸ The Tenth Circuit applying Kansas law, on the other hand, assumed that a Pugh clause could divide property vertically and horizontally, absent specific language in the clause limiting its application to a vertical severance.²⁷⁹

Whether a Louisiana court faced with this issue would follow one of these two approaches or would create its own approach is undetermined as no Louisiana court has yet had an opportunity to address this issue.

What is the Appropriate Horizontal Boundary after a Release Pursuant to a Pugh Clause?

Finding the existence of a horizontal Pugh clause often leads to another complicated task: determining the location of the horizontal boundary at which severance will occur. No Louisiana state court has addressed application of a horizontal Pugh clause, but the Fifth Circuit in *Sandefur Oil Gas, Inc. v. Duhon*,²⁸⁰ had the opportunity to consider the issue and held that the Pugh clause divided the leased premises 100 feet below the base of the sand from which the well was producing, rather than the depth to which the well was drilled. The Pugh clause in *Sandefur* provided:

After expiration of the primary term, this lease will terminate automatically as to all horizons situated 100 feet below the deepest depth drilled (a) from which a well located on the land or acreage pooled therewith is producing in paying quantities, or (b) in which there is completed on the land or acreage pooled therewith a shut-in gas well which cannot be produced because of lack of market, marketing facilities, or because of governmental restrictions, whichever is the greater depth.²⁸¹

The lessees in *Sandefur* drilled a well to a total depth of 17,609 feet on land pooled with a portion of the lease tract, but the well only produced from perforations between 17,090 and 17,200 feet. And, the well was producing from a formation, the Middle Miogypsionoides Sand (the "Middle Miogyp"), located at a depth between 17,100 and 17,250 feet. Another formation was located directly below the Middle Miogyp, and though the well was drilled into the lower formation, the formations were separated by 50 feet of shale, so production was attributable only to the Middle Miogyp. After expiration of the primary term, the lessee released to the lessor all horizons below 17,700 feet. The issue in *Sandefur* was, under the horizontal Pugh clause, what was the proper horizontal lease

²⁷⁸ *Friedrich*, 698 S.W.2d at 754.

²⁷⁹ *Rogers*, 291 F.2d at 731.

²⁸⁰ 961 F. 2d 1207, 1209 (5th Cir. 1992).

²⁸¹ *Id.* at 1208.

boundary below which the leased premises was to be tendered back to the lessor. The Fifth Circuit began by interpreting the actual language of the horizontal Pugh clause. It determined that the word “depth” was modified by “deepest,” “drilled,” and “from which a well ... is producing in paying quantities.”²⁸² Reasoning that the base of the sand from which the well was actually producing in the Middle Miogyp was the only depth that met the three criteria, the court concluded that the lease would be severed 100 feet below the bottom of the Middle Miogyp (at 17,350 feet).²⁸³ The Fifth Circuit found that this interpretation was in accordance with the intent of the parties and with the purpose of a Pugh clause, to assure that lessees diligently explore and develop the leased premises.²⁸⁴

The Fifth Circuit in *Sandefer* made another important decision regarding the location of the boundary line at which the lease would be severed under the horizontal Pugh clause there at issue. The Court held that boundary was not an absolute vertical depth, 17,350 feet, throughout the entire leased premises.²⁸⁵ Instead, the boundary was 100 feet below the base of the formation from which the well was producing, at whatever depth the formation was found throughout the leased tract.²⁸⁶ In other words, the boundary was tied to the actual stratigraphy. The Fifth circuit reasoned that the parties intended the word “horizon” to mean “a body of material or a stratum found below the earth’s surface, generally considered to be a bed of sand or other material which contains oil, gas, and other minerals...” and that this meaning was consistent with use of the term in the oil and gas industry.²⁸⁷

A Texas court in *EOG Resources, Inc. v. Wagner & Brown, LTD.* recently considered issues similar to those addressed by the Fifth Circuit in *Sandefer*. In *EOG*, the court held that language similar to that considered in *Sandefer* referred to a fixed vertical depth and not to a subsurface geologic formation.²⁸⁸ Though the clause in *EOG* was part of a farmout agreement not a Pugh clause, the court’s decision is still instructive as to

²⁸² *Id.* at 1210.

²⁸³ *Id.* at 1211.

²⁸⁴ *Id.* at 1210-1211. *But see* Martin, *supra* note 247 at 911 (questioning the rationale of *Sandefer* by stating “[t]he appeals court read the clause such that ‘producing in paying quantities’ modified ‘depth’ and not ‘well.’ The court’s strained interpretation of syntax was bolstered, in its view, by the purpose of a Pugh clause to overcome the rule of Hunter v. Shell Oil and to insure diligent development.”).

²⁸⁵ *Sandefer*, 961 F. 2d at 1211.

²⁸⁶ *Id.*

²⁸⁷ *Id.* The court used the definition of “horizon” given by WILLIAMS & MEYERS MANUAL OF OIL AND GAS TERMS. *See* 8 WILLIAMS & MEYERS, *supra* note 2 at 566 (defining horizon as “a zone of a particular formation ...of sufficient porosity and permeability to form a petroleum reservoir”).

²⁸⁸ 202 S.W.3d 338, (Tex. Ct. App. 2006).

how a court may interpret a phrase intended to create a horizontal division of leased property. The provision in question stated “[t]he Assignment provided for above shall be limited in depth to 100 feet below the deepest producing interval as obtained in the test well...”²⁸⁹ The court found that the boundary was fixed at a depth of 9,829, which was 100 feet below the base of the deepest producing formation in the test well.²⁹⁰ As in *Sandefer*, the farmout agreement in *EOG* established a horizontal subsurface boundary separating the mineral rights belonging to two different parties. The assignee argued that the words “deepest producing interval” referred to the formation from which production was obtained, at whatever depth or interval the formation was found.²⁹¹ The Texas court was not, however, persuaded by this argument. It reasoned that the agreement contained no language which would indicate that the parties intended to convey interests according to a variable depth.²⁹² The court noted that the terms “horizon,” “field,” “reservoir,” and “stratigraphic layer” demonstrate intent to encompass the depth of an entire formation, but that none of these terms were used in the farmout agreement in question.²⁹³

The reasoning in *EOG* suggests that the Texas state court likely would have reached the same conclusion as the Fifth Circuit in *Sandefer* had the farmout agreement contained the word “horizon” as did the Pugh clause in *Sandefer*. Under these two cases, if a party wishes to divide the leased premises under a Pugh clause along a horizontal boundary based on the depth of a formation rather than a fixed depth, such party should take care to carefully craft language that reflects its intent. Both courts relied heavily on the specific text of the clauses in question.

V. Selected Issues under the Mother Hubbard Clause

A “Mother-Hubbard” or “cover-all” clause is often found in oil and gas leases or in mineral deeds relating to oil and gas lands. This type of clause is also known as a “catchall,” “all-inclusive,” or “all-embracing” clause.²⁹⁴ The purpose of the Mother Hubbard clause is to:

prevent the leaving of small unleased pieces or strips of land which may exist without the knowledge of one or both of the parties by

²⁸⁹ *Id.* at 341.

²⁹⁰ However, a second well in which the same sand was encountered produced at depths between 10,230 feet and 10,266 feet because of geological faulting and a structural dip in the formation. *Id.* at 341.

²⁹¹ *Id.* This was the interpretation that the Fifth Circuit gave to the horizontal Pugh clause in *Sandefer*. *Sandefer*, 961 F. 2d at 1211.

²⁹² *EOG Res., Inc.*, 202 S.W.3d at 345.

²⁹³ *Id.*

²⁹⁴ Martin J. McMahon, *Construction and Application of “Mother Hubbard” or “Cover-All” Clause in Gas and Oil Lease or Deed*, 80 A.L.R. 4th 205 §1[a] (2007).

reason of incorrect surveying, careless location of fences, or other mistake. The clause[] evidence[s] the intention of the grantor to include within the lease not only the land described by metes and bounds, but also any adjoining land mistakenly excluded.²⁹⁵

Significantly, “[c]over-all clauses are not highly regarded by the courts generally.”²⁹⁶

Nevertheless, it is wise to include a Mother Hubbard or cover-all clause in an oil and gas lease or mineral deed of oil and gas lands to avoid future expense to the lessee. Indeed, failure to include a specific description of a narrow strip of land in a lease or deed may cause extra expense to the lessee due to drainage problems, conservation principles and could result in the drilling of an unnecessary well on a strip of land leased to another.²⁹⁷ It has been suggested that an unwritten law in the oil and gas industry dictates that tracts accidentally caught in cover-all clauses should be released and that lessees have generally been willing to waive the provision as to adjacent surveys not within the specific description.²⁹⁸ However, custom is not always followed, and the lessor should take measures to ensure that property not intended to be leased is excluded from a cover-all provision.²⁹⁹

Typically, a Mother Hubbard or coverall clause is placed after a specific description of the land intended to be conveyed or affected by

²⁹⁵ Gary A. Hughes, John Kimpflen & Anne E. Melley, *Cover-All or “Mother Hubbard” Clause*, 38 AM. JUR. 2D *Gas and Oil* § 94 (2006) (citing *Peacock v. Schroeder*, 846 S.W.2d 905 (Tex. Ct. App. 1993)).

²⁹⁶ 1 WILLIAMS & MEYERS, *supra* note 2 § 221.3.

²⁹⁷ BROWN, *supra* note 232 § 4.02; *See also* 1 WILLIAMS & MEYERS, *supra* note 2 § 221:

Variations between survey lines and the lines of the tract actually owned by the landowner sometime result in this way: the landowner in fencing his tract, or in some other way indicating its boundaries, will put the fence or other monument at a convenient place, which place varies from the description in the instrument under which he claims ownership. For example, there may be a row of trees three hundred feet east of the actual east boundary line, which trees make convenient substitute for fence posts. Thereafter the landowner matures title to the strip by adverse possession. Still later the landowner executes an oil and gas lease which carries forward the description in the deed, and thus usually fails to pick up the strip which landowner has acquired title by adverse possession. It may be possible for a description to include the strip under the doctrine of agreed boundary ... or the doctrine of boundary by acquiescence ...; however, it is never safe to assume that either doctrine applies where the problem before the attorney in preparation of instruments, or advising as to the construction thereof, short of the law-suit stage.

1 WILLIAMS & MEYERS, *supra* note 2 § 221 at 300.12(3).

²⁹⁸ Barney T. Young, *Deeds – Mines and Minerals – Oil and Gas – Mother Hubbard Clause in Ambiguous Mineral Deed. – Smith v. Allison*, 26 *Tex. Sup. Ct. Rep.* 186 (1956); *modified on rehearing*, 26 *Tex. Sup. Ct. Rep.* 436 (1957), 35 *TEX. L. REV.* 595, 597 (1957).

²⁹⁹ *Id.*

the oil and gas lease or mineral deed.³⁰⁰ Moreover, a typical Mother Hubbard clause attempts to cover or convey adjacent land³⁰¹ or land that is included in the same survey, section or county.³⁰² A common Mother Hubbard or cover-all clause reads as follows:

It being the intention, however, of lessor, to include within the terms of this lease not only the above-described land, but also any and all other land owned or claimed by lessor in said survey or surveys in which the above-described land is situated, or in adjoining surveys and adjoining the above-described land.³⁰³

Is the Mother Hubbard Clause Valid?

The Louisiana Supreme Court has yet to address the validity and affect of a Mother Hubbard or cover-all clause; however, there is Louisiana jurisprudence interpreting such clauses.³⁰⁴ The most recent case in Louisiana involving the validity of a Mother Hubbard or cover-all clause is *Bergeron v. Amoco Production Co.*, a United States Fifth Circuit Court of Appeals case applying Louisiana law.³⁰⁵ In *Bergeron*, the oil and gas lease in question contained the following coverall clause in pertinent part: "All lands owned by the Lessor in the above-mentioned Section or Sections or Surveys, ... are included herein, whether properly or specifically described or not ..."³⁰⁶ The Fifth Circuit, citing the Louisiana cases of *Williams* and *Melancon*, held that a coverall clause is valid under Louisiana law.³⁰⁷ Thus, the lessor's interests in a 40 acre strip of land were conveyed under the clause.³⁰⁸

³⁰⁰ 3 WILLIAMS & MEYERS, *supra* note 2 § 665.5.

³⁰¹ See *United Gas Public Services Co. v. Mitchell*, 177 So. 697 (La. 1937); *Whitehead v. Johnston*, 467 So. 2d 240 (Ala. 1985); *Cummings v. Midstates Oil Corp.*, 9 So. 2d 648 (Miss. 1942); *Smith v. Allison*, 310 S.W.2d 608 (Tex. 1956).

³⁰² See *Bergeron v. Amoco Production Co.*, 789 F.2d 322 (5th Cir. 1986); *Luthi v. Evans*, 567 P.2d 1064 (Kan. 1978); *Gulf Production Co. v. Spear*, 84 S.W.2d 452 (Tex. Comm'n App. 1935).

³⁰³ *Brown*, *supra* note 232 § 4.02 at 4-8. See also *Brown*, *supra* note 232 § 4.03 at 4-11 (containing six variations of the Mother Hubbard or cover-all clause in deed and oil and gas leases).

³⁰⁴ All of the cases dealing with Mother Hubbard or cover-all clauses in Louisiana arise from an oil and gas lease. Indeed, Louisiana courts have not yet addressed a Mother Hubbard clause in a deed of oil and gas lands. Nevertheless, other courts have uniformly applied the law to Mother Hubbard clauses found in both leases and deeds. See e.g. *Smith*, 301 S.W.2d at 608; *Texas Osage Co-Operative Royalty Pool, Inc. v. Thomas*, 270 S.W.2d 450 (Tex. Ct. App. 1954).

³⁰⁵ 789 F.2d 344 (5th Cir. 1986). See also *Martin*, *supra* note 240 at 574-75 (discussing the facts of *Bergeron* and the reasoning of the court); Patrick H. Martin, *Developments in the Law, 1986-87 A Faculty Symposium: Mineral Rights*, 48 LA. L. REV. 387, 392 (1987) (same).

³⁰⁶ 789 F.2d at 345.

³⁰⁷ *Id.* at 346.

³⁰⁸ *Id.*

The case most heavily relied on by the Fifth Circuit and the district court in *Bergeron* is *Melancon v. Melancon*, a case decided by the Louisiana Third Circuit Court of Appeal in 1967.³⁰⁹ In *Melancon*, the court implicitly approved of the use of a Mother Hubbard clause in an oil and gas lease: "This [coverall] clause ... is inserted for the protection of the lessee should the lessor own additional property adjacent to the property described in the lease ... It was inserted in the lease to protect the lessee."³¹⁰ The Fifth Circuit, in *Bergeron*, further relied on *Williams v. Bowie Lumber Co.*, a Louisiana Supreme Court case, to support its finding that Louisiana courts have approved the coverall clause "concept."³¹¹ The court made this finding because Louisiana courts have consistently held that, as between the parties, an omnibus designation is as effective to transfer land as a precise and certain description.³¹²

Another notable Louisiana case interpreting a similar clause in an oil and gas lease is *Dees v. Hunt Oil Co.*, decided in 1954.³¹³ In *Dees*, the Western District of Louisiana interpreted the following clause: "The lease covers not only such interest in leased premises as the party constituting Lessor presently owns therein but also such additional interests as he may acquire in the future ..."³¹⁴ Although not a Mother Hubbard or cover-all clause, the above-cited clause has the same effect as to after acquired titles. The Court found that the clause covered the lessor's later-acquired mineral rights to approximately 260 acres of land.³¹⁵

Although Mother Hubbard clauses are utilized in most oil-producing states, such clauses are invariably found in oil and gas leases in Texas.³¹⁶ Thus, Texas law provides the most fertile grounds for analysis of the clause. The Texas Commission of Appeals, in 1935, decided three cases that are widely cited and accepted as precedent: *Sun Oil Co. v. Burns*,³¹⁷ *Sun Oil Co. v. Bennett*,³¹⁸ and *Gulf Production Co. v. Spear*.³¹⁹ Significant issues decided in these cases are discussed below in

³⁰⁹ *Id.*; 602 F.Supp. 551, 554-5 (La. M.D. 1984).

³¹⁰ *Melancon v. Melancon*, 199 So. 2d 573, 576 (La. App. 3d Cir. 1967).

³¹¹ *Bergeron*, 789 F.2d at 346.

³¹² *Id.* An entirely separate issue is whether the clause is effective as to third parties to the agreement. This issue is covered in Section IV C, *infra*.

³¹³ 123 F.Supp. 58 (W.D. La. 1954).

³¹⁴ *Id.* at 59.

³¹⁵ *Id.* at 61-62.

³¹⁶ See generally, Bruce M. Kramer, *The Sisyphean Task of Interpreting Mineral Deeds and Leases: An Encyclopedia of Canons of Construction*, 24 TEX. TECH. L. REV. 1 (1993).

³¹⁷ 84 S.W.2d 442 (Tex. Comm'n App. 1935).

³¹⁸ *Id.*

³¹⁹ *Id.*

more detail. Moreover, the Alabama Supreme Court has also addressed the validity of a Mother Hubbard clause and held that the cover-all clause in the standard Producers' 88 oil, gas and mineral lease is valid and enforceable.³²⁰

Several issues have surfaced nationally regarding the Mother Hubbard or cover-all clause and some but not all have been addressed in Louisiana. These issues include the following: (1) whether the size of the omitted strip matters, (2) the effect of the clause as to third persons, (3) the effect of an assignment of a lease or deed containing a coverall clause, and (4) the effect when a lease contains both a Mother Hubbard clause and a specific reservation.³²¹

Does the Size of the Omitted Strip Matter?

An often discussed issue among oil-producing states is whether or not the size of the strip omitted from the specific land description affects the enforceability or application of the Mother Hubbard or cover-all clause.³²² The Texas Supreme Court addressed this issue in 1957 in the case of *Smith v. Allison*.³²³ In *Allison*, the court held that a Mother Hubbard or cover-all clause is intended only to prevent the omission of *small* strips of land and is not intended to convey large areas.³²⁴ In making this holding, the court explained that there is a public policy in Texas that discourages separate ownership of small tracts of land.³²⁵ The court further explained:

³²⁰ *Whitehead v. Johnson*, 467 So. 2d 240 (Ala. 1985). The majority of the court in *Whitehead* found that the Mother Hubbard provision in the lease did not render the lease ambiguous. Therefore, parol evidence was not admissible to determine the true intent of the parties.

³²¹ Other issues not discussed in this paper but mentioned elsewhere include the following: (1) whether the premises falling within the general description of the cover-all clause are grammatically part of the object of the verb used as words of grant; 1 WILLIAMS & MEYERS, *supra* note 2 § 221.1; (2) whether express provision is made concerning the effects of inclusion of premises not particularly described in the lease upon the rental payments required by the lease; *Dees v. Hunt*, 123 F.Supp. 58 (W.D. La. 1954); 1 WILLIAMS & MEYERS, *supra* note 2 § 221.1; and (3) the effect of excision of a cover-all clause; 1 WILLIAMS & MEYERS, *supra* note 2 § 221.6.

³²² See *Hughes*, *supra* note 295 § 94; Edward K. Esping, 55 TEX. JUR. 3D OIL AND GAS § 55 (2007).

³²³ 301 S.W.2d 608 (Tex. 1957). See also *Young*, *supra* note 298 at 595; 1 WILLIAMS & MEYERS, *supra* note 2 § 221.3.

³²⁴ 301 S.W.2d 608.

³²⁵ *Id.* In *Smith v. Allison*, the trial court held that the instrument was ambiguous and therefore it was appropriate to look to parol evidence to determine the intent of the parties. The original opinion of the Texas Supreme Court also found the lease ambiguous. Nevertheless, on rehearing, the court did not describe the deed as ambiguous and held that the parties did not intend to convey anything but a small strip of land based on the clear language of the lease.

To give the ultimate effect contended by the respondents would result in the conveyance of one-half the minerals under the 320 acres particularly described and additionally the conveyance by the general catch-all clause of one-half of the minerals under 1,400 acres. This result does not comport with ordinary custom or practice, and we think the parties here could have had no such intention.³²⁶

The Texas Supreme Court later reaffirmed this holding in *Jones v. Colle*: “Our holding in *Smith* precludes [the defendant] from using the Mother Hubbard clause to secure title to the minerals in the 49.34 acre adjoining tract, the existence of which was known to both parties at the time the lease was executed.”³²⁷

In Alabama, Mother Hubbard clauses have also been found to apply exclusively to small tracts of land. Indeed, the Alabama Supreme Court has stated: “the [Mother Hubbard] clause was intended to apply only to small tracts of land adjacent to specifically described land, but inadvertently omitted, or small tracts of land that were said to constitute a part of the described tracts.”³²⁸

Similarly, the Mississippi Supreme Court has explained:

It is also commonly known that one of the purposes of the cover-all clause is to gather into the description *small strips* of areas forming a part of the tract as a whole, not a part of the lands particularly described, but adjacent thereto, the reason for their not being particularly described being that a particular description of them is not available but, in most cases, dependent upon a survey.³²⁹ (emphasis added)

Louisiana has yet to directly address this issue; nevertheless, the district court in *Bergeron* rejected the Texas decisions disfavoring the application of the Mother Hubbard clause to large tracts of land.³³⁰ Indeed, in discussing Texas’ public policy against separate ownership of small strips of land, the district court stated that “[t]his Court is aware of no similar public policy in the State of Louisiana.”³³¹ Accordingly, Louisiana courts may not disfavor the transfer of large areas of land under a

³²⁶ *Smith*, 301 S.W.2d at 617-18.

³²⁷ 727 S.W.2d 232, 263 (Tex. 1987). See also *J. Hiram Moore, Ltd. v. Greer*, 172 S.W.3d 609 (Tex. 2005); Eric T. Laity, *Oil, Gas and Mineral Law*, 42 SW. L.J. 425 (1988); Harry L. Reed, *Texas Oil and Gas Law in a World of Tort Reform*, 48 S. TEX. L. REV. 259 (2006); Richard F. Brown, *Oil Gas and Mineral Law*, 56 SMU L. REV. 1825 (2003).

³²⁸ *Whitehead v. Johnson*, 467 So. 2d at 242.

³²⁹ *Continental Oil Co. v. Walker*, 117 So. 2d 333, 338 (Miss. 1960).

³³⁰ 602 F.Supp. 551, 554 (La. M.D. 1984).

³³¹ *Id.*

Mother Hubbard or coverall clause.³³² Indeed, Louisiana courts have approved application of the Mother Hubbard and similar clauses to a tract of 40 acres appended to specifically described tracts of 250 acres³³³ and a tract of 262.5 acres appended to a specifically described tract of 187.5 acres.³³⁴ One leading authority is in accord with this logic and suggests that it is appropriate to allow the coverage of large strips of land under a cover-all clause if this is the intent of the parties.³³⁵

Additionally, the law is unclear as to what constitutes a “small” strip of land. It has been posited that “the question does not turn on the absolute acreage of the strip but on the relative acreage of the strip and the specifically described premises. Thus, a 5-acre tract would presumably not be viewed as “small” if the specific description was of a 1-acre parcel; however the same 5-acre tract would presumably be viewed as “small” if the specific description was of a quarter section.”³³⁶

Does the Mother Hubbard Clause Affect Third Persons?

Another issue that has surfaced concerning Mother Hubbard or coverall clauses is whether or not such a clause is sufficient to put third parties on notice that land has been previously conveyed.³³⁷ Not surprisingly, due to the well-established Public Records Doctrine in Louisiana,³³⁸ the Louisiana Supreme Court has already decided this issue.

In *United Gas Public Service Co. v. Mitchell*, the Louisiana Supreme Court held that a “vague and indefinite description in a deed, not descriptive of any particular tract of land, is **not** sufficient to convey title to any particular tract of land, especially as to third parties.”³³⁹ Thus, the court made it clear that, although a Mother Hubbard clause may be effective between a grantor and grantee, it is not sufficient to put a third party

³³² See e.g. *Id.* at 552 and *Dees*, 123 F.Supp. 58. But see *Blanchard v. Pan-Ok Production Co., Inc.* 755 So. 2d 376 (La. App. 2d Cir. 2000)(suggesting that a cover-all provisions was not intended to include an adjacent 431 acre tract).

³³³ *Bergeron*, 789 F.2d at 346.

³³⁴ *Dees*, 123 F.Supp. 58.

³³⁵ 1 WILLIAMS & MEYERS, *supra* note 2 §221.3.

³³⁶ *Id.*

³³⁷ *Id.* at § 221.8.

³³⁸ See *Gullatt v. Newell Industries, Inc.*, 688 So. 2d 1191, 1195 (La. App. 2d Cir. 1996)(“The primary purpose of the public records doctrine is the protection of third persons against unrecorded interests.”). The public records doctrine is a negative doctrine: a person may rely on the absence of a recorded instrument in a parish’s conveyance records. *Id.*

³³⁹ 177 So. 697, 658 (La. 1937)(emphasis added). The lease in *Mitchell* contained the following Mother Hubbard clause that read in pertinent part: “... but this lease shall cover and include all land owned or claimed by lessors contiguous to or forming a part of the land described or referred to above, whether the same be more or less than the estimated acreage.” *Id.*

on notice that land has been previously conveyed.³⁴⁰ Indeed, the court in *Mitchell* stated further that a grantor or grantee has a “right of action to compel specific performance [as between the parties] before the rights of third parties have intervened.”³⁴¹ This principle has been affirmed by other Louisiana cases, some dealing with oil and gas leases³⁴² and others not.³⁴³

Similar to Louisiana, the Kansas Supreme Court in *Luthi v. Evans* held that although a transfer of interests under a Mother Hubbard clause is effective between the parties,

[s]uch a transfer is not effective as to subsequent purchasers and mortgagees unless they have actual knowledge of the transfer. If, because of emergency, it becomes necessary to use a “Mother Hubbard” clause in an instrument of conveyance, the grantee may take steps to protect his title against subsequent purchasers.³⁴⁴

On the other hand, Texas and leading commentators disagree with the Louisiana and Kansas approach. In *Gulf Production Co. v. Spear*, an appellate court in Texas held that the recordation of a lease containing a Mother Hubbard clause was “enough to put subsequent purchasers upon inquiry as to the land intended to be leased.”³⁴⁵ Likewise, oil and gas scholars have stated that “[a]lthough the burden of search imposed is substantial, we are of the opinion that recordation of the instrument containing a cover-all clause should be sufficient to impart notice to a subsequent purchaser of the prior conveyance of the premises affected by such clause.”³⁴⁶

³⁴⁰ *Id.*

³⁴¹ *Id.*

³⁴² *Bergeron*, 789 So. 2d at 346 (recognizing that the analysis of Mother Hubbard clauses is different when third parties are involved); see also *Energy Development Corp. v. Quality Environmental Processes*, 777 So. 2d 481, 486 (La. App. 5th Cir. 2001) (“The Louisiana Supreme Court and other state courts have consistently held that property descriptions must be sufficiently specific so that third parties can locate and identify the property.”).

³⁴³ See *O’Meara v. Broussard*, 162 So. 2d 777, 778 (La. Ct. App. 1 Cir. 1964) (“all right, title, interest, claim or demand of any name, nature, kind or character which the late [grantor] might have in and to any land or real estate situated in the State of Louisiana ...”). See also *Williams v. Bowie Lumber Co.*, 38 So. 2d 729, 757 (La. 1948) (“We did not say that such a description rendered the sale invalid as between the immediate parties thereto. On the contrary, we merely held that an omnibus description does not provide adequate notice to third parties.”), and *Daigle v. Calcasieu Nat. Bank of Lake Charles*, 9 So. 2d 394 (La. 1942) (holding that a clause that purported to transfer “all the property that [grantor] possesses in his name at the present date in Calcasieu Parish and St. Landry Parish” was not sufficiently specific to give notice to third parties).

³⁴⁴ 576 P.2d 1064 (Kan. 1978).

³⁴⁵ 84 S.W.2d 452, 457 (Tex. Comm’n App. 1935).

³⁴⁶ 1 WILLIAMS & MEYERS, *supra* note 2 § 221.8 at 325.

What is the Effect of an Assignment of a Lease Containing a Mother Hubbard Clause?

Another issue is whether a Mother Hubbard clause may be enforced by a subsequent assignee of the lease.³⁴⁷ It is clear that when an assignment and the original lease both contain the coverall clause, the clause is effective just as if it were between the original grantor and grantee.³⁴⁸ Nevertheless, problems have surfaced when a coverall clause is contained in the original document but is omitted from the assignment.

Louisiana addressed this issue in *United Gas Public Serv. Co. v. Mitchell*.³⁴⁹ In *Mitchell*, the original lease contained a Mother Hubbard clause that probably would have transferred to the grantee an additional 7.25 acres not included within the specific description.³⁵⁰ However, a subsequent assignment of the lease omitted the Mother Hubbard clause.³⁵¹ As a result, the Court found that, although the Mother Hubbard clause was probably effective as to the original grantor and grantee, it was not effective as to subsequent assignees if the assignees did not have the Mother Hubbard clause in their assignment.³⁵² The holding in *Mitchell* is a logical extension of the well-established Public Records Doctrine in Louisiana.

On the other hand, a contrary view has been taken by cases in Texas and Mississippi and by oil and gas law commentators.³⁵³ In *Mann v. Rio Bravo Oil Co.*,³⁵⁴ the Texas Court of Appeals held that, despite the fact that an assignment of a lease contained a particular description of the property but did not include the original lease's cover-all clause, the assignment transferred the lease in its entirety, including an acre adjoining the tract covering 4/10 of an acre. The Mississippi Supreme Court came to a similar conclusion in *Cummings v. Midstates Oil Corp.*³⁵⁵ Indeed,

³⁴⁷ *Id.* at § 221.6.

³⁴⁸ See e.g. *O'Meara v. Broussard*, 162 So. 2d 777 (La. App. 1st Cir. 1964)(holding that succession sale of decedent's property and as subsequent transfer of such property by essentially the same omnibus description transferred good title); *Cities Service Oil Co. v. Hilburn*, 351 So. 2d 860 (La. App. 2d Cir. 1977) (assignment of lease containing Mother Hubbard clause did not affect court's analysis of whether land was transferred under the clause).

³⁴⁹ 177 So. 697 (La. 1937).

³⁵⁰ *Id.* at 699-700.

³⁵¹ *Id.*

³⁵² *Id.* at 700.

³⁵³ 1 WILLIAMS & MEYERS, *supra* note 2 § 221.6.

³⁵⁴ 107 S.W.2d 653 (Tex. Ct. App. 1937). See also *Union Pacific Resources Co. v. Hutchinson*, 990 S.W.2d 368 (Tex. Ct. App. 1999) (holding that original lessee transferred to assignee an identical right to pool as under the original lease because it was among the rights included in the all-inclusive description contained in her assignment).

³⁵⁵ 9 So. 2d 648 (Miss. 1942).

the *Cummings* court held that although a subsequent assignment of a lease did not contain the same cover-all clause as in the original lease, the “assigning clause transfers to assignees all rights under the lease.”³⁵⁶

What is the Effect When a Lease Contains Both a Mother Hubbard Clause and a Specific Reservation?

Another problem is encountered in dealing with a Mother Hubbard clause when a lease or deed contains a specific reservation or exception reserving some portion of the premises and this exception is followed by a coverall clause.³⁵⁷ In other words, “if the instrument conveys a described section ‘except the SE ¼,’ ‘except the road,’ or ‘except the right-of-way,’ but the cover-all clause is adequate to cover the excepted interest, will such excepted interest pass under the instrument?”³⁵⁸

This issue has yet to be addressed by Louisiana courts. In other states, whether or not an interest is transferred under a Mother Hubbard clause when there is an exception contained in the conveyance document depends on the specific facts of the case. Cases often cited on this issue include *Lewis v. East Texas Finance Co.*,³⁵⁹ *Melton v. Davis*,³⁶⁰ and *Cummings v. Midstates Oil Corp.*³⁶¹ Generally, courts confronted with this issue consider the placement of the exception and the cover-all clause within the lease, the grantor’s actual ownership of various interests in the land at the time of the conveyance, the nature of the interest excepted and the intent of the parties.³⁶²

VI. Selected Issues under the Adjacent Lands Clause

An “adjacent lands” clause is often found in standard oil and gas leases and expressly provides that the lessee may use the surface of the leased premises to conduct operations on adjacent lands not owned by

³⁵⁶ *Id.*

³⁵⁷ 1 WILLIAMS & MEYERS, *supra* note 2 § 221.2.

³⁵⁸ *Id.*

³⁵⁹ 146 S.W.2d 977 (Tex. 1941). The court in *Lewis* reversed the holding of the court of appeals that the inclusion of both the Mother Hubbard clause and the reservation resulted in an ambiguity, thus making parol evidence admissible to determine the intent of the parties. *Lewis*, 146 S.W.2d at 979-980. The Texas Supreme Court held that despite the apparent conflict between the two clauses, the document was not ambiguous and parol evidence was not admissible. *Id.* The Texas Supreme Court did not reach the issue of whether the Mother Hubbard clause was still effective when an express reservation was included in the lease. *Id.* But see *Lewis*, 123 S.W.2d 803 (Tex. Ct. App. 1938).

³⁶⁰ 443 S.W.2d 605 (Tex. Civ. App. 1969). The Court in *Melton* affirmed the *Lewis* decision and held that a conveyance of a tract “from which is accepted 4.178 acres conveyed to The State of Texas, for right of way ...” conveyed the grantor’s mineral interest in the entire tract.

³⁶¹ 9 So. 2d 648 (Miss. 1942). In *Cummings*, the court held that a Mother Hubbard clause controlled over an express reservation.

³⁶² 1 WILLIAMS & MEYERS, *supra* note 2 § 221.2 at 300.17-300.24.

the lessor.³⁶³ The purpose of the clause is to promote “efficient development of oil and gas fields and the state’s public policy of developing mineral resources. The clause was intended to permit a lessee to develop an oil and gas field without regard to property lines and without the necessity of constructing duplicative roads, pipelines, tank farms and other facilities.”³⁶⁴ Moreover, the adjacent lands clause:

resolves the impracticality for a mineral lessee to determine *in advance* which tracts of land will share in the production from a specific well, or whether a specific well will be productive, or whether the leased premises subject to the “adjacent lands” clause subsequently will be pooled or unitized with producing wells on adjacent lands.³⁶⁵

A typical adjacent lands clause reads as follows:

Lessor ... hereby grants, leases and lets exclusively unto Lessee for the purpose of investigating, exploring, prospecting, drilling and mining for and producing oil, gas and all other minerals, laying pipe lines, building tanks, power stations, telephone lines, and other structures thereon to produce, save, take care of, treat, transport and own said products and for dredging and maintaining canals, constructing roads and bridges, and building houses for its employees, and, in general, for all appliances, structures, equipment, servitudes and privileges which may be necessary, useful or convenient to or in connection with any operations conducted by Lessee thereon, *or on any adjacent lands ...* (emphasis added)³⁶⁶

The validity of an adjacent land clause is rarely litigated. Indeed, there are only two reported cases in Louisiana dealing with the enforceability and scope of an adjacent lands clause.³⁶⁷ Notably, what is meant by “adjacent” lands has not been addressed by the courts in the context of an adjacent lands clause.

***Caskey v. Kelly Oil Co.*: Is the “Mutual Benefit” Principle Applicable to the Adjacent Lands Clause?**

The Louisiana Supreme Court has expressly held that the mutual benefit principle, codified in article 122 of the Louisiana Mineral

³⁶³ *Caskey v. Kelly Oil Co.*, 737 So. 2d 1257, 1263 (La. 1999).

³⁶⁴ *Id.*

³⁶⁵ *Id.*

³⁶⁶ See *Caskey*, 737 So. 2d at 1259; *Blanchard v. Pan-OK Production Co., Inc.*, 755 So. 2d 376, 385 (La. App. 2d Cir. 2000).

³⁶⁷ *Caskey*, 737 So. 2d at 1257; *Blanchard*, 755 So. 2d at 376. See also Richard A. Lord, 17 WILLISTON ON CONTRACTS §50:58 (4D 2006); John Y. Pearce & Justin H. Homes, MINERAL LAW, 47 LA. B.J. 248 (1999); M. Christiansen et al., *Oil and Natural Gas Exploration and Production*, 2000 ABA ENV'T, ENERGY, & RESOURCES L.: YEAR IN REV. 93 (2000).

Code,³⁶⁸ is not applicable to an adjacent lands clause.³⁶⁹ In *Caskey v. Kelly Oil Company*, the lessee used and improved a road on the leased premises to gain access to a well site on a neighboring tract of land in which the lessor had no interest, and the lessor filed suit for trespass. The court of appeal held that this action violated the mutual benefit principal codified in article 122 of the Louisiana Mineral Code. The court of appeal explained that article 122 imposes the obligation upon the lessee to operate the leased property for the mutual benefit of the lessor and lessee.³⁷⁰ Indeed, the court of appeal held that although this obligation of mutual benefit can be contractually defined, the public policy underlying the obligation cannot be abrogated, and thus, the adjacent lands clause could be used only when such use benefited both the lessor and the lessee.³⁷¹ This reasoning was rejected by the Louisiana Supreme Court.³⁷² In so doing, the Court held that it could find “no authority to extend the scope of the mutual benefit requirement of Article 122 to encompass the lessee’s contractual right to reasonable use of the surface of the leased premises to operations on adjacent lands, and we conclude that the Legislature never intended for Article 122 to have such a broad sweep.”³⁷³

Moreover, the Supreme Court commented that:

[w]hen there are “adjacent lands” clauses in the leases of several tracts in a field, there is a potential benefit to all lessors, and the fact that one or more particular lessors ultimately do not receive any specific benefits from the lessee’s use of the surface of the leased premises to conduct operations on adjacent lands does not affect the validity of the contractual provision.³⁷⁴

Rather than operate for the mutual benefit of the lessor and lessee, the only limitation of a lessee’s actions under the adjacent lands clause is that such actions be reasonable. In other words, under an adjacent lands clause, the lessee has the right to use the surface of the leased premises, but only to the extent it is reasonably necessary for operations thereon and on adjacent lands.³⁷⁵ Indeed, Louisiana Mineral Code article 11 im-

³⁶⁸ La. Min. Code art. 122 (La. Rev. Stat. Ann. § 31:122 (2007)) reads as follows:

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 reasonable prudent operator for the mutual benefit of himself and his lessor. Parties may stipulate what shall constitute reasonably prudent conduct on the part of the lessee.

³⁶⁹ *Caskey*, 737 So. 2d at 1257.

³⁷⁰ *Id.* at 1261-62.

³⁷¹ *Id.* at 1260.

³⁷² *Id.* at 1261.

³⁷³ *Id.* at 1262.

³⁷⁴ *Id.* at 1263-34.

³⁷⁵ *Caskey*, 737 So. 2d at 1265.

poses upon the lessee the duty to use the leased premises and adjacent lands with reasonable care.³⁷⁶ The “circumstances which constitute an unreasonable exercise of contractual rights must be determined on a case-by-case basis.”³⁷⁷

To avoid the impact of an adjacent lands clause, the lessors in *Caskey* argued that the clause only applies to operations on lands also owned by the same lessor, equating the clause to a Mother Hubbard clause.³⁷⁸ The court rejected this argument.³⁷⁹ In distinguishing the two clauses, the court explained that a Mother Hubbard clause protects the lessee in the event the description in the lease fails to include adjacent lands *owned by the lessor*.³⁸⁰ In contrast, the adjacent land clause “refers to operations conducted on the leased land ‘or on adjacent lands,’ regardless of whether the adjacent land is owned by the lessor.”³⁸¹

The lessor in *Caskey* also argued that the adjacent lands clause should only be utilized by a lessee who is also the operator of the lease.³⁸² The court likewise rejected this argument and held that the rights of a lease operator and the lessee are indistinguishable under the lease.³⁸³ Moreover, the court stated that “such a restrained interpretation would render the ‘adjacent lands’ clause virtually without effect.”³⁸⁴

A final note on *Caskey*, although the term of the clause was not at issue in the case, the court discussed the issue in *dicta*:

the clause is limited by the term of the lease which continues in effect, after the delay rental period, only as long as there is production in paying quantities on the leased premises. Thus, a mineral lessee cannot use the “adjacent lands” clause for access to operations on other premises *unless* the basic lease is being maintained by payment of delay rentals or by production.³⁸⁵

³⁷⁶ *Id.* La. Min. Code art. 11 (La. Rev. Stat. § 31:11 (2007)) reads as follows:

The owner of land burdened by a mineral right or rights and the owner of a mineral right must exercise their respective rights with reasonable regard for those of the other. Similarly the owners of separate mineral rights in the same land must exercise their respective rights with reasonable regard for the rights of other owners.

³⁷⁷ *Id.* For Louisiana’s definition of “reasonable use” of the leased premises, *See*. La. Min. Code art. 11 (La. Rev. Stat. § 31:11 (2007)); *Broussard v. Northcott Exploration Co., Inc.* 481 So. 2d 125 (La. 1986); John McCollam, *A Primer for the Practice of Mineral Law under the New Louisiana Mineral Code*, 50 TUL. L. REV. 729 (1976).

³⁷⁸ *Caskey*, 737 So. 2d 1264.

³⁷⁹ *Id.* *See also Blanchard*, 755 So. 2d at 385.

³⁸⁰ *Id.*

³⁸¹ *Id.*

³⁸² *Id.* at 1264.

³⁸³ *Id.*

³⁸⁴ *Id.*

³⁸⁵ *Caskey*, 737 So. 2d at 1263. The Court further explained this situation in a hypo-

Thus, any lessee relying on the adjacent lands clause to support operations on adjacent land should bear in mind this limitation. In the event of lease termination, the right to use such land in connection with operations on neighboring property would also terminate. Thus, it is still important to secure a separate surface lease or right of way if available.

Blanchard v. Pan-Ok Prod. Co.: Does the Adjacent Lands Clause Give the Lessee Access to Adjacent Lands Owned By the Lessor?

Lastly, in *Blanchard v. Pan-Ok Prod. Co.*, the argument was made that the adjacent lands clause, when coupled with a Mother Hubbard clause, allows the lessee to use the lessor's adjoining land to support operations on the leased premises.³⁸⁶ The factual situation was the exact opposite to that which had occurred in *Caskey*.³⁸⁷ In *Blanchard*, the defendant lessee used a road located on adjacent lands to conduct operations on the leased premises. The court distinguished the facts in *Blanchard* from the facts in *Caskey*, and found no contractual basis for the use of adjoining land to support lease operations.³⁸⁸

VII. Conclusion

The various topics addressed herein are not exhaustive of the numerous and varied issues that can arise under selected clauses that are the topic of this paper. Rather, it is the writer's hope that the foregoing discussion gives to the reader a sampling of the issues that may arise under the selected provisions addressed.

As discussed throughout, care should be taken in the drafting of mineral leases. There are many lease forms in use today, and such forms provide the practitioners with an excellent starting point for drafting leases for their clients and provide the clients with a degree of known risk. But, blind reliance on forms should be avoided, and lessors and lessees alike should give careful consideration to the prudence of inclusion of any model form provision.

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A simple hypothetical illustrates this point. Lessee secures two separate mineral leases, with "adjacent lands" clauses, covering adjoining properties owned by two unrelated entities. Lessee uses the surface of tract A to obtain access to tract B, ultimately obtaining production on tract B. If tract A is not included in a unit, once the delay rental period has passed (or in the absence of a delay rental clause), the lessee must obtain production on tract A or the lease on tract A will terminate by its own terms.

Id. at 1263, n. 4.

³⁸⁶ *Blanchard v. Pan-Ok Prod. Co.*, 755 So. 2d at 385.

³⁸⁷ *See Id.*

³⁸⁸ The court ultimately held the lessee was entitled to a gratuitous servitude of passage over a road constructed by a prior lessee on adjacent land also owned by the lessors. *Id.*