Annual Institute on Mineral Law

Volume 45 *The 45th Annual Institute on Mineral Law* Article 6

3-26-1998

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Louisiana Mineral Code Article 122: The Concept of Mutuality

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An oil and gas lease is, by its very nature and by definition, at least judicial definition, a cooperative joint venture between the lessor and lessee for the exploration and exploitation of oil and gas from the land.[2] It is a synallagmatic contract out of which both parties intend and contemplate obtaining benefits.[3] The controlling intentions of the parties, as manifested in a lease, is to make the extraction of oil and gas from the premises of mutual advantage and profit.[4] Thus, the relationship between lessor and lessee is contractual.[5] However, as in any contract, it is not only that which is expressly set out in the contract which governs that relationship, but there are matters that are "implied" as well.[6] As Judge (later Supreme Court Justice) Van Devanter stated in the landmark case of *Brewster v. Lanyon Zinc Co.*:

> "whatever is necessary to the accomplishment of that which is expressly contracted to be done is part and parcel of the contract, though not specified."[7]

Also, an underlying principle of an oil and gas lease is that of cooperation between the parties to that contract.[8] This is based not purely upon oil and gas law but rather general contract law. That is, covenants implied but not explicitly spelled out in oil and gas leases reflect a broader principle of law applicable to all contractual arrangements – the principle of cooperation found in the law of contracts.[9] This principle requires that parties to a contract cooperate in order to carry out the purposes of the agreement and is based upon the reasonable expectations of the parties

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2 Frey v. Amoco Production Co., 603 So.2d 166 (La. 1992) and Henry v. Ballard & Cordell Corp., 418 So.2d 1334 (La. 1982) and the authority cited therein. See also, Harrell, Developments in Non-Regulatory Oil & Gas Law, 30 INST. on Oil & Gas L. & Tax'n 311 (1979).

3 Louisiana Civil Code Article 1908.

4 Brewster v. Lanyon Zinc Co., 140 F. 801 (8th Cir. 1905).

5 Louisiana Civil Code Article 1908. See Frey, 603 So.2d at 172, and Odom v. Union Producing Co., 243 La. 48, 141 So.2d 649 (1961).

6 Louisiana Civil Code Article 2054.

7 id. at 809. See also McDonald v. Grande Corp., 148 So.2d 441 (La. App. 3d Cir. 1962), cert denied 244 La. 128, 150 So.2d 588 (1962).

8 Williams and Meyers, *Oil and Gas Law*, Sec. 802.1.

9 Williams and Meyers, §802.

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when they enter into an agreement, as well as the ethical concepts of conduct.[10] As pointed out,

> the requirement of cooperation may properly be said to impose a duty in addition to that imposed by the terms of the express promise.[11]

This idea or concept of cooperation has generally been considered the main basis for the imposition of what are referred to as implied covenants in contracts in general, and in oil and gas leases in particular[12].

From the recognition of the existence of implied covenants comes the problem of interpreting how they affect the obligations of parties to the oil and gas lease contract and how such obligations have served to create the "reasonable and prudent operator" standard imposed on all leases; that is, that the lessee must perform his obligations under the lease contract in good faith and as a reasonably prudent operator on behalf of and for the *mutual* benefit of *both* himself and his lessor.[13]

As stated, the basis of this reasonable and prudent operator standard with which a lessee must comply and the recognition that implied covenants are an integral part of any oil and gas lease is based, in most jurisdictions, upon this concept of cooperation. Here in Louisiana, however, it is not necessary to resort to the broad principles of common law contract and equity law. Instead, we resort to our Civil Code, the basis for all of our laws. The obligations of the lessor to deliver the leased premises to the lessee, to refrain from disturbing the lessee's possession and to perform the lease contract in good faith, all obligations of the lessor specifically set out in Louisiana Mineral Code Article 119, are simply the reiteration of any lessor's obligations based upon the provisions of the Civil Code.[14] The general law of leases, in our law for almost 200 years, is the basis for the law of oil and gas leases. In Louisiana, the oil and gas lease has always been interpreted in light of the Civil Code's provisions relating to predial leases.[15] In fact, Louisiana Mineral Code Article 2 specifically provides that the provisions of the Mineral Code are "supplementary to those of the Civil Code" and, to the extent that the Mineral Code does not expressly or impliedly address a particular situation, resort must be had to the Civil

10 Williams and Meyers, §802.1.

11 Patterson, "Constructive Conditions in Contracts," 42 Colum. L. Rev. 903.

12 However, some authorities suggest that the principle of cooperation may be an ill-founded basis for imposing the prudent operator standard upon lessees. See discussion infra.

13 Louisiana Mineral Code Article 122.

14 Louisiana Civil Code Articles 2475 and 2692.

15 Davis v. Lassiter, 242 La. 735, 138 So.2d 558 (1962); Williams v. Humble Oil & Refining Co., 290 F.Supp. 408 (E.D. La. 1968), affirmed 432 F.2d 165 (5th Cir. 1970), rehearing denied, 435 F.2d 772 (5th Cir. 1970), cert. denied, 402 U.S. 934 (1971). See also, Frey, supra at 172.

Code.[16]

In the same vein, the obligations of the mineral lessee found in Article 122, wherein the lessee is obligated to perform the contract in good faith and to develop and operate the property as a reasonable and prudent operator for the *mutual* benefit of himself and his lessor, are likewise based on provisions of the Civil Code that provide that any lessee must enjoy the thing leased as a "good administrator".[17] That is the basis in Louisiana for the implied obligations imposed upon the lessee, to act as the proverbial "reasonable and prudent operator". In fact, as the late noted and well respected Judge Rubin stated in *Williams v. Humble Oil & Refining Co.*

> [v]iewed in this light, [i.e. that of the "good administrator" standard established in the Civil Code] the lessee's duty to act as a good administrator is not a separate and distinct obligation imposed in addition to the implied obligations announced by the Louisiana courts: it is the basic obligation of the lessee and all of the implied obligations already drawn are merely elaborations or reflections of it.[18]

Professor Patrick Martin of the LSU law faculty and a noted author in the field of oil and gas law throughout the country, suggests that the oil and gas lease, being a contract, establishes certain covenants and/or agreements by and between the parties and that the implied obligations imposed upon a lessee actually arise in the context of attempting to determine whether or not the lessee has fulfilled the covenants to which he has agreed in the contract.[19] Therefore, it has been argued that the implied covenants creating the standard of prudent operation do not arise as a matter of extending the conscious intention of the lessor and lessee to cover matters not mentioned in the agreement, but as a matter of determining the duties that should be incident to the relation of the parties.[20]

It is true that the search by any court, in dealing with questions of oil and gas leases, and, indeed, any contract, is to determine the true intentions of the parties. However, it is submitted that the "good administrator" or the "reasonable and prudent operator" standard is probably never consciously made a specific part of the lease contract by the parties. It is intrinsically part and parcel of any such contract. That is, it is doubtful that the parties to an oil and gas lease specifically intend to, say, provide that the lessee will develop the lands in a particular manner, by drilling a certain number of wells or, say, market production to a certain purchaser or under certain

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16 Louisiana Mineral Code Article 2.

17 Louisiana Civil Code Article 2710.

18 290 F. Supp. at p. 414.

19 Martin, *A Modern Look at Implied Covenants to Explore, Develop, and Market Under Mineral Leases*, 27 Sw. Legal Fdn. Oil & Gas Inst., 177 (1976).

20 Kuntz, "Professor Merrill's Contribution to Oil and Gas Law," 25 Ok. L. Rev. 484 (1972).

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terms. In fact, they seldom address these issues; and, most printed lease forms deal very little with the obligations of the parties after production is established. Of course, this is so because in almost every such situation, the lessee and lessor simply cannot determine, when they enter the lease, how it should be operated in the future. However, it can hardly be said that both parties, when entering into the contract, did not fully expect that any operations thereunder would be pursued in such a manner as to fulfill the expectations of the parties to the contract, i.e. for their mutual advantage.

Furthermore, it is this author's thoughts that the obligation of the lessee to work not only for his own benefit but also that of his lessor, has some basis in the jurisprudential and legislative intentions evidenced over the years to impose greater contractual obligations on the party to the contract who is in the better position to fulfill them. Thus, we have the vast array of cases dealing with what are referred to as contracts of adhesion.[21] In oil and gas matters, the nature of the oil and gas business lends itself to such a situation since the lessee is almost always in the unique position of having virtually all the knowledge and also the control regarding the matters of the lease, e.g. drilling, completing, producing, marketing, developing and exploring. This is so because of the nature of the business, i.e. geology, contracts with oil and gas purchasers, the effects of faulting, 3-D seismic, production rates and the like. Except in the few cases of large, sophisticated landowner/lessors, it is the lessee, and (generally) only the lessee, who knows enough about these matters to deal with them. The lessor and lessee are *not* always on an equal footing. The lessor leases his land and gives the lessee the right to retain what might be considered a disproportionate part of the production to be obtained (e.g. 75% or 80%), in exchange for and with the expectation that the lessee will perform under the contract in such a manner as to benefit both of them. Otherwise, the lessee, because of his superior and unique knowledge and capabilities, could take complete advantage of the lessor. Therefore, the reasonable and prudent operator standard, with all that implies, has been imposed on the lessee. He is, if you will, the "captain of the ship".

In fact, Professor Martin states that the law of implied covenants does not actually arise from the intent of the parties, nor from an analogous principle in contract law but

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21 *See*, for example, *Golz v. Children's Bureau of New Orleans, Inc.*, 326 So.2d 865 (La. 1976) at 869 wherein the court stated that "[b]roadly defined, a contract of adhesion is a standard contract, usually in printed form, prepared by a party of superior bargaining power for adherence or rejection of the weaker party. Often in small print, these contracts sometimes raise a question as to whether or not the weaker party actually consented to the terms. *See* LSA–C.C. Arts. 1766, 1811; S. Litvinoff, 6 Louisiana Civil Law Treatise–Obligations (Book), §194, pp. 346-349 (1969)." *See also* the discussion concerning the "power" of the lessee and the higher standard emenating therefrom at Footnote 27 herein below.

> [r]ather it grows out of an attempt on the part of the courts to promote what they perceive to be justice and fair dealing by requiring lessees to adhere to a particular norm of conduct, the prudent operator standard.[22]

Also, it should be kept in mind that the prudent operator standard is apparently not one of merely good faith. It is an objective and not a subjective test. That is, the lessee may be in good faith in its assessment as to whether or not, for example, it is appropriate that a second or third well should be drilled for the development of the leased premises but nevertheless, he may well lose the lease for not meeting the prudent operator test if it can properly be shown that a prudent operator would have drilled such a well or wells, based upon an objective assessment of all relevant facts.[23]

Under these standards, it is a valid question to determine whether or not a mineral lessee is held to a higher standard than in most other contractual relationships, at least in connection with the cases or situations dealing with development and further exploration. That is, good faith is the usual test to be used in general contract law. Therefore, it would appear that the situation regarding the prudent operator standard is, in fact, one where courts apparently feel that lessees are in a better position to negotiate and have more control over the relationship created by the oil and gas lease and, consequently, will look to these matters for the enforcement of the promises made by the lessee to the lessor and will attempt to "protect" the lessor under these circumstances.[24]

It is interesting to note that Professor Martin suggests that perhaps the test should, indeed, be one of good faith, recognizing that the prudent operator standard was established in the very early part of the century when the only motive of lessees, especially corporate lessees, was, or at least was expected to be, profit. Thus, if a corporate lessee saw that there was an opportunity to make profit, it was expected to go forward and, for example, drill a well in order to make such profit for both the lessor and lessee. Consequently, instead of the good faith standard recognized in general contract law, the prudent operator was held to a greater standard based upon whether or not, despite good faith, the well should have been drilled if there was a reasonable chance for profit to be made. Instead, Professor Martin suggests that in the latter part of the century, particularly in the last twenty or thirty years, many more factors become important, especially to a

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22 Martin, *Sw. Legal Fdn.* at p. 197-198.

23 See, for example, *Wier v. Grubb*, 228 La. 254, 82 So.2d 1 (1955); *Carter v. Arkansas-Louisiana Gas Co.*, 213 La. 1028, 36 So.2d 26 (1948); *Gennuso v. Magnolia Petroleum Co.*, 203 La. 559, 14 So.2d 495 (1943); *Coyle v. North American Oil Consolidated*, 201 La. 99, 9 So.2d 473 (1942); *Caddo Oil & Mining Co. v. Producer's Oil Co.*, 134 La. 701, 64 So. 684 (1914). *See also*, *Williams & Meyers*, § 806.3.

24 *See*, Kuntz, 25 Okla. L.Rev. 484 (1972), *supra*.

corporation, such as public opinion, environmental concerns, governmental regulations, and other such matters. Thus, a corporation may or may not do things that it might otherwise do because of such considerations and, therefore, the test, he suggests, should be whether the lessee has acted in good faith and had a reasonable basis for its judgment.[25]

Indeed, a review of this situation reveals that many times it may be that a lessee might be forced to give up what it considers long-term stability arising out of what he considers more reasonable but perhaps slower development of a lease, for the rapid profitability expected by the lessor. The question which arises is whether or not this may lead to waste and the drilling of unnecessary wells, the prevention of which are the hallmarks of our conservation Act.[26] This may be particularly relevant since oil and gas are presumably finite resources and quick exploitation thereof may not necessarily be the most prudent method by which to develop and produce them.

Despite the various theories that exist concerning the basis for the reasonable and prudent operator standard, nevertheless, there is no question that such a standard exists and one with which a lessee must comply in connection with its operations under an oil and gas lease. In Louisiana, that standard is stated as part of the statutory scheme of the Louisiana Mineral Code under Article 122 (hereinafter referred to merely as Article 122). That article states

A mineral lessee is not under a fiduciary obligation to his lessor, but he is bound to perform the contract in good faith and to develop and operate the property leased as a reasonably prudent operator for the mutual benefit of himself and his lessor. Parties may stipulate what shall constitute reasonably prudent conduct on the part of the lessee.

The author specifically refers you to the phrase wherein the lessee is required to operate the lease for the "mutual benefit" of both the lessor and lessee. That is the portion of Article 122 which is the main subject of this paper and the point upon which the author intends to focus. Much has been written concerning the various implied obligations that have been recognized (or imposed?) over the years by the courts, such as full exploration and development, marketing, and the like. However, this paper intends to concentrate and focus upon the issue of "mutuality", of which those other obligations form only a specific and, by now, well-defined part.

Over the years, many lessors have argued that the relationship is more in the nature of a fiduciary one (or certainly have styled pleadings and arguments as such if not utilizing those exact words). However, no court has gone quite so far as to agree with that contention and, in fact,

25 Martin, 27 *Sw. Legal Fdn.* at 205 (195).

26 La.R.S. 30:9.

Article 122 specifically states that the lessee is not under a fiduciary obligation to his lessor. However, the courts do seem to recognize a "higher" standard or duty than what might exist in other contracts.

Of course, a fiduciary relationship is one where one party must put the other party's interest primary and may even have to suffer some detriment for the benefit of the other. In effect, a fiduciary is basically a person who undertakes to act in the interest of another person. Under such circumstances, by acting in the interest of the other person, he must do what is in the best interest of such other person, even, under certain circumstances, at his own cost. Suffice it to say that it implies the utmost of good faith and fair dealing.[27]

Although speaking at the time of the fiduciary relationship, and although we realize that the reasonable and prudent operator standard prevails in Louisiana and that there is no such fiduciary relationship between a lessor and lessee, nevertheless, the underlying basis or reason for our current rule may have been said best by Professor Scott in his address to the California Bar Association in 1949:

> Whenever the owner of an interest in oil and gas has a *power* with respect to another person's interest in oil and gas, the courts are quick to imply a *duty* in connection with the exercise of such power. Power begets responsibilities and duties. A fiduciary principle becomes applicable. The person having the power is restricted in his conduct; he is not permitted to base his conduct exclusively on self-interest. He must give consideration to the effect of his conduct upon the interest owned by another with regard to which he has a power.[28]

Having recognized the general basis for the reasonable and prudent operator standard imposed on lessees and that the oil and gas lessee has imposed on him certain implied obligations; we will now discuss the effect of these on lessees both in general as well as in certain specific situations.

There have developed over the years several well recognized obligations which are binding on the lessee, even though not spelled out in the lease. These are the implied obligations of reasonable development, further exploration, protection against drainage, diligence in marketing and restoration of surface.[29] In fact, these have been so well recognized that they are specifically enumerated and discussed in the official Comment to

27 H. Williams, *The Fiduciary Principle in the Law of Oil and Gas*, 13 S.W. Legal Foundation Oil and Gas Institute, 201 (1962). *See also*, *Kaplan v. Fine*, 643 So.2d 438 (La. App. 3d Cir. 1994) and *Office of the Commissioner of Insurance v. Hartford Fire Insurance Company*, 623 So.2d 37 (La. App. 1st Cir. 1993), writ denied, 635 So.2d 1131 (1994) for a discussion regarding the meaning of a fiduciary.

28 H. Williams, *The Fiduciary Principle in the Law of Oil and Gas*, 13 Sw. Legal Fdn. Oil & Gas Inst., 201 at 374 (1962).

29 *See* the official Comment under Louisiana Mineral Code Article 122.

Article 122 in the Mineral Code and are the subject of numerous articles and commentaries.[30] These are not, except perhaps by reference, the main thrust of this paper. You are referred to the various excellent articles written on them for specific discussions on these various topics. It is this author's experience that, apparently since these are so well known, many lessees or at least landmen feel that these are the only implied obligations imposed on a lessee. It is also this author's experience that many lessees are familiar with the phrase "reasonable and prudent operator" and are perhaps of the opinion that fulfillment of aforementioned specific and recognized obligations, without more, satisfies the reasonable and prudent operator test. That is not so and it is because of that thinking that the author has included such a detailed discussion above about the history of this matter and the development of and reason for the standard and the basis for the imposition of the obligation placed on lessee to be a "good administrator". Recognizing the reason for a rule often allows one to understand and determine its applicability to various situations. It appears, at least to this author, that many lessees look at this "list" as an exclusive one and as defining what a reasonable and prudent operator is. Instead, however, a lessee should look to the general rule or obligation and view these specific, enumerated ones as merely illustrative examples thereof. The cases and commentaries dealing with these matters should be reviewed critically for discussions about the reasonable and prudent operator standard in order to determine how a court will apply that standard to the situation at hand.

The essence of the rule is that a lessee *must* conduct *all* of its operations in connection with the lease, for the *mutual benefit* of both himself and his lessee – the key words in this sentence being "*all operations*" and "*mutual benefit*". It is not only in development, exploration, marketing and the like that a lessee must consider the position of the lessor; rather, it is in the entirety of his operations. It seems that often lessees decide on a particular course of action based solely, or almost solely, on self-serving considerations – examples are unitization, additional drilling (both to prevent drainage and in development, and exploration), marketing, and the like – and only after having made these decisions, and even after beginning the implementation thereof, do they consider the effect this will have on the lease in question and their lessors in particular. This may be akin to "shutting the gate after the horses are out". Granted, in most cases, the interest of the lessor and the lessee will coincide; but not always, as will be shown in more detail below. The point of this – and if this paper can make any lasting impression – is that the considerations as to the effect on the lease and the lessor's interest should be dealt with *before* and not after

30 *See* William & Meyers, *supra* §§ 801, et seq. and matters cited therein. *See also*, *Willey, The Lessee's Implied Obligations under the Mineral Code*, 23 L.S.U. Inst. on Min. Law 155 (1976).

these decisions are made and action taken. Remember, the test is an objective one – that is, even if the lessee is in perfect good faith still, if the action taken is found not to be in the best interest of *both* the lessee and the lessor, or at least if it is found to be for the lessee's benefit at the expense of the lessor, the reasonable and prudent operator standard may not be met and the lease may be placed in jeopardy. This is the idea this author is trying to convey in the title of this paper by use of the term "mutuality". A lessee simply cannot make decisions with impunity if they are made in a vacuum, so to speak, and without a factor in such decision-making process being the effect it will have on the lessor's interest.

Having now recognized that there is a standard set by which a lessee must conduct himself and having reviewed the basis and reason for the rule, we now turn to the more difficult issue of just what is meant by insuring compliance with that standard as it applies to "mutuality". First, all courts dealing with these matters make it clear they will determine such compliance or non-compliance on a case by case basis in light of all of the circumstances at hand.[31] Obviously, there can be no hard and fast rule because of the nature of the obligation. That is, for example, a court determining, say, whether an operator has sufficiently explored the leased premises must necessarily review how many wells have been drilled, whether the wells on or off the leased premises, what horizons have been explored, etc. No two situations dealing with these matters are alike so it is obvious why each separate situation must be reviewed individually. Unfortunately, perhaps, this may allow a court to feel more free to decide on the basis of "gut feeling" rather than on more technical definitions and pre-set conduct with which a lessee may be more familiar. Therefore, it becomes even more important to the lessee's position that he not only insure such compliance but also insure the clear appearance thereof.

These matters can perhaps best be discussed and clarified by using a few examples. In some of the instances discussed, there may not be a clear answer, but you should see, from the examples, what the concerns are and why more thought should be given by lessees to the "good administrator" standard and the effect these standards may have on any action a lessee may take in connection with a lease. It may also shed some light on how we, as attorneys, should advise clients and try cases dealing with these matters.

We will start with a situation that was the subject of a very recent decision by the Second Circuit Court of Appeals, *Mattie Connell Caskey,*

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31 *See, Broussard v. Northcott Exploration Co., Inc.*, 481 So.2d 125 (La. 1986). In fact, the test for the prudent operator standard is generally, "whatever *in the circumstances* would be reasonably expected of operators of ordinary prudence, having regard to the interest of both Lessor and Lessee". *See*, Brown, *The Law of Oil & Gas Leases*, §16.02. *Caddo Oil & Mining Co. v. Producers Oil Co.*; *Coyle v. North American Oil Consolidated*, supra at footnote 22.

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et al v. Kelley Oil Company, et al.[32] In that case, the plaintiffs owned a tract of land covered by an oil, gas and mineral lease granted in 1972. Kelley Oil Company ("Kelley") was not the operator but owned an undivided interest in that lease. There were several wells producing on the surface of the leased premises (the "Connell Tract"), which wells were accessed by a locked gate on the north boundary of the tract and an unimproved road. Kelley also apparently owned a lease on a tract situated to the south of the Connell Tract. The lease form at issue was a Bath's Form Louisiana Spec. 14-BR1-2A-PX (10/65) which contains a provision in the granting clause thereof that is common in many leases and which effectively stated that the lessee could use the leased premises in connection with its operations on the leased premises "*or on any adjacent lands*". Despite the language in the lease, for some six years, Kelley apparently asked permission from the owners of the Connell Tract for use of the surface to build a road to gain access to the tract to the south for the drilling of a well thereon. Such permission was denied but, nevertheless, the gate was torn down, trees felled, ditches improved and a shale surface was laid on the previously unimproved road which was extended to the drillsite location on the tract to the south of the Connell Tract. It was not clear who did this but Kelley began using the road for access to its drillsite on the tract located south of the Connell Tract. The owners of the Connell Tract filed suit against Kelley to enjoin it from entering the tract "solely" for access to an adjoining tract and for damages. At the hearing on the injunction, Kelley's defense was that the lease on the Connell Tract specifically granted the lessee the right to use the surface of the leased premises to construct roads in connection with mineral operations on "adjacent lands". The District Court upheld Kelley's right to do this and denied the injunction. However, on appeal, that decision was reversed. In its decision, the Second Circuit Court of Appeals referred specifically to Article 122 and emphasized the portion thereof concerning the requirement that the lessee develop the leased premises "for the mutual benefit of himself and his lessor" and, in fact, elevated that duty or obligation of "mutuality" perhaps a notch higher than it had been taken before when it stated that

> [t]he duty of mutual benefit under R.S. 31:122 is a matter of public policy governing the burden that real rights may impose on the property. The duty may be contractually defined, but not abrogated.

The court noted that the term "adjacent lands" did not express a clear and unambiguous intent of the parties "to define mutual benefit as it relates to the use of [the] leased premises as access, and nothing more, to adjacent lands" and found "that it was incumbent upon Kelley to demonstrate, by a preponderance of the evidence, what benefit (if any) accrued to the Connells from Kelley's use of the surface for no other purpose than as a

32 La. App., Second Cir., Docket No. 30278; Feb., 1998.

road to the Crichton tract."

Thus, we see that the obligation of the lessee to operate the lease as a "good administrator" and for the "mutual benefit" of both himself and his lessor, has now become a matter of public policy. Of course, if a particular matter is considered public policy, mere contracts between parties cannot abrogate it.[33]

From a close reading of the court's decision, it is fairly obvious that the court was not impressed with the manner in which Kelley dealt with its lessors and this case stands not only for the proposition cited above, but also for the fact that, as is often the case, "bad facts make bad law".[34] However, it also indicates the manner in which these types of cases should be tried, perhaps in anticipation of a court imposing certain unanticipated requirements of proof. It appears crucial to the decision that Kelley failed to put on evidence regarding any positive effect its operations may have had on the Connell Tract. Kelley apparently relied solely or almost solely on the language of the lease wherein it was specifically granted the right to use the surface of the Connell Tract in connection with operations on "adjacent lands". With all due respect, that would seem to have been enough since the language is fairly clear, at least in this author's view. However, it may now appear necessary to show not only that you have a certain right under the lease but also how, in the exercise of that right, the lessor will be "benefited". Also, elevating the obligation of "mutuality" to the status of public policy presumably now means that, despite the introductory phrase of the second sentence of Article 122 (to the effect that the parties are free to determine what will constitute reasonable and prudent operations), such an agreement between the parties will be upheld only to the extent that it does not conflict with the higher "public policy" standard of "mutual benefit".

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33 La. Mineral Code Article 3.

34 It is interesting to note that the further argument regarding the reasonableness of Kelley's use of the surface was also placed at issue and the court noted that the other lessees who were operating on the Connell Tract (i.e. the leased premises) were much less intrusive than that of Kelley and that Kelley's operations were much more invasive, damaged more of the property and "diminished the desirability of the tract for the Connells' future retirement homes". The court further found that the testimony by the Connells showed that the Crichton tract (i.e. the drill site tract to the south of the Connell Tract) could have been accessed by an alternate route. Thus, the court found that Kelley failed to prove by a preponderance of the evidence that building the subject road across the Connell Tract, *only* for access to operations on another tract of land, conferred any benefit whatsoever upon the Connells. (The court noted, for example, that there was no showing that the road in question would facilitate development of other wells on the Connell Tract or that the well that Kelley drilled would be unitized with any of the leased premises.) The author questions whether the same result would have been reached had all the lessees of the Connell Tract or, at least, the operator, joined Kelley in its operations. Presumably not, based on the language the court used, but one cannot help but wonder.

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Obviously, there are a number of arguments that Kelley could have made regarding the benefits of its operations that would have inured to the owners of the Connell Tract. For example, drilling operations within the immediate vicinity thereof could be presumed to be "beneficial" in that drilling such a well would obviously influence or have an impact or effect upon the tract and the development thereof; for example, by unitization of portions of the tract with the subject well. (Of course, whether that impact is beneficial may not be known until the well is drilled.)[35] In fact, it is submitted that the reason that the phrase "on adjacent lands" is included in printed lease forms may well be the fact that parties recognize, particularly in light of unitization, that drilling on lands "adjacent" to or "adjoining" the leased premises is, in a way, development of the leased premises. A lessee will, it is presumed, attempt to develop a geologic "play" by drilling at what he feels is the optimum location for success. Furthermore, he presumably is familiar with his obligation to prevent drainage from the leased premises and if the well were successful, would presumably unitize it with the leased premises, if and as appropriate. This could[36] certainly benefit the leased premises. Given the nature of unitization and the fact that almost all units include more than one tract of land, are not the odds fairly good that an "adjacent" or "adjoining" tract will be included in the unit? Is not the hope of participation in production by unitization sufficient reason for a lessor to include this clause in a lease?

Also, could not a well on this adjacent tract "set up" a well on the leased premises? For example, if this well is drilled, even if a dry hole and even if the leased premises were not included in the unit for the well (something that would not be known, usually, until the well is actually drilled), it might reveal that the optimum location for another, perhaps better, well is on the leased premises. The list could go on but it would appear obvious that a well on an "adjacent" tract of land could very well benefit the leased premises.[37] The beneficial effect may not be known until

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35 This makes such obligation akin to the implied obligation of further exploration in that the "benefit" to be realized by fulfillment of such an obligation (if any) to, for example, drill an exploratory well will not be known until after the well is drilled. However, in such a situation (i.e. further exploration), since the lessor would have no exposure for well costs, the "benefit" may well be solely to the lessor if the result is a dry hole. Nevertheless, since the test is an objective one, based not on the lessee himself but rather on the ubiquitous "reasonable and prudent operator", and since the lessee's interest, including the chance of success, profit to be made, etc. must be considered in determining whether the obligation exists, then for a court, to impose that obligation, it must find that the lessee, too, will "benefit"; therefore, the result should not be one-sided.

36 Is the proper word here "could" or "would"? Can the lessee simply show that the operation "could" or "might" benefit the lessor or must he show a definite, positive effect i.e. "would"? The author suggests that the former should be sufficient, especially with the availability of unitization, at least in this situation.

37 For an interesting discussion concerning the words "adjoining" and "adjacent" in the context of oil and gas leases. *See Arceneaux v. Shell Oil Co.*, Docket No. 96-CV-753

the well is drilled, but shouldn't the lessee be allowed to drill it especially since the lease allows it? Could this not be similar to the famous "sale of a hope"? If one buys the catch of a fisherman's next cast, is he not bound, regardless of the amount of fish caught? And if so, is not this clause similar? Further, it seems somewhat illogical that Kelley should have had to put on evidence to prove the obvious, especially when the right to do this is spelled out in (despite the court's finding to the contrary, what, it is submitted, is) clear language.

It is noted that this decision is now being appealed to the Louisiana Supreme Court. Nevertheless, even if it is ultimately overturned, it should be viewed as a definite indication of how our courts will deal with this issue of mutuality. In any event, a lessee should, in all instances, be prepared to show how the action, or inaction, taken by him benefits not only his own interest but also that of his lessor.

Another situation similar to the *Connell* case, at least regarding the effect of specific language in a lease not overriding the reasonable and prudent operator standard, is that found to be the subject of *Dawes v. Hale.*[38] In fact, that case was cited with approval by the Second Circuit in the *Connell* case. In *Dawes*, the lease in question originally covered eighty (80) acres and contained a retained acreage provision, a fairly common clause found in many printed lease forms which provides generally that in the case of cancellation or termination of the lease for any cause, the lessee nonetheless has the right to retain under the terms of the lease forty (40) acres around any then drilling or producing well.[39] In that case, the lessee had drilled three (3) wells in the extreme northwest portion of the eighty (80) leased premises which wells, it was apparently recognized, drained only two to three acres. The lessee released the lease as to one forty (40) acre tract but retained the remaining forty (40) acres and relied on the aforestated provision in the lease for his refusal to release any portion

(1997). *See also*, *Acree v. Shell*, 548 F.Supp. 1150 (M.D. La. 1982).

38 421 So.2d 1208 (La. App. 2d Cir. 1982).

39 For example, paragraph 3 of a Bath Form 42 CPM New South Louisiana Revised Six (6) Pooling form states, in part: "[I]n the event of the forfeiture of this lease for any cause, except for failure to pay royalties according to the requirements of this lease, Lessee shall have the right to retain around each well then producing oil, gas or other minerals or being drilled or worked on or shut in under Paragraph 6 hereof, the number of acres fixed and located by or in accordance with the spacing or unit or proration allowable order of any Regulatory Body of the State of Louisiana or of the United States under which said well is being drilled or produced, or if said well is located on a pooled unit, then Lessee may retain all of the acreage comprising said pooled unit and if no spacing or proration allowable order has been issued nor any pooled unit established, then Lessee shall have the right to retain forty (40) acres surrounding each oil well then producing or being drilled or worked on, and one hundred sixty (160) acres around each gas or gas condensate well then producing, or being drilled or worked on or shut in under Paragraph 6 hereof, each of such tracts to be in as near a square from as is practicable."

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thereof. The issue before the court, of course, was "whether the retained acreage provision in the printed form lease should be construed to preclude plaintiffs' claim that lessees have violated their statutory obligation to prudently develop the leased property".[40]

The court reviewed the history of the "good administrator" obligation of a lessee and stated that "[a]ny clause purporting to limit a primary obligation of the lease should be carefully examined to determine if the parties clearly intended such result".[41] Further, the court quoted the Fifth Circuit in its upholding of Judge Rubin's decision in *Williams v. Humble Oil & Refining Company* that "[i]t would require a clear and unequivocal clause in a lease to convince the court that the lessor intended to sacrifice that basic obligation [to act as a good administrator] owed him by his lessee".[42] The court in *Dawes* found that the acreage retention clause did not reflect a "clear, unmistakable, unequivocal intent to limit" the good administrator standard of the lessee and allowed the plaintiffs to proceed with their action.

The significance of this case and, indeed, also, of the *Connell* case, is to show us rather clearly that despite what may be rather clear and seemingly unambiguous language in a lease, courts will nevertheless read that language in the context of the "greater" obligation of operating the lease as a "good administrator" and if the two conflict, the latter will prevail. Therefore, in making decisions regarding lease operations, a lessee may not simply resort to language in the lease. He must instead be thoroughly familiar with the reasonable operator standard and the significance of "mutuality" and insure compliance therewith.

The next situation for discussion is that concerning well costs and particularly the payment thereof. As we all know, the lessor in an oil and gas lease expects to receive his benefits, i.e. his share of production in the form of royalty, "free of expenses".[43] That is, in accordance with contract and well understood industry practices, the working or cost bearing interest owners bear all expenses in connection with operations on the land. That issue seems to be fairly well understood and, at least in more recent years, has not been the subject of much litigation. However, there are cases which address the situation about which this author is interested. The issue in

40 421 So.2d at 1210.

41 421 at p. 1211.

42 432 F.2d at 177. Note that in 1970 when the Fifth Circuit upheld Judge Rubin's decision in the *Williams* case, the court apparently felt that such an obligation could be "sacrificed" (so long as the language doing so was "clear and unequivocal") whereas in the *Connell* case, decided this year, the court stated that this was a matter of public policy, and therefore, it could not be "abrogated" or "sacrificed", no matter how clear the language.

43 *See* Louisiana Mineral Code Article 80.

question is that which was the subject of *Shanks v. Exxon Corporation*[44] That case involved a situation where the lessee had acquired an oil and gas lease on a tract of land which was subsequently placed in a unit around a well as a result of which obligations accrued for the payment of well costs to the operator of the well. It is noted that the lessee in question was not the operator of the well and that the well was not drilled on the leased premises. Thus, the key ingredient to these situations is that of unitization and the obligation arising therefrom for the payment of well costs. The author notes that the applicable statute to this situation, La.R.S. 30:10, which is often referred to as the "risk fee" statute, was amended after the filing of that suit and therefore, its new provisions did not apply to the facts thereof. Nevertheless, the situation is worth discussing, particularly to compare it to the situation when the lessee and operator of the well on the drill site tract is also the lessee of the leased premises in the immediate vicinity of the well. In the *Shanks* case, Exchange Oil & Gas Corporation ("Exchange") was the lessee of the leased premises which tract was in the vicinity of the tract upon which Exxon drilled its Tommy J. Strain No. 1 well. After the successful completion of the well, Exxon applied to the Commissioner of Conservation for a unit which resulted in the leased premises being included in the unit.[45] Pursuant to the authority of La.R.S. 30:10, as it read at the time, Exxon withheld the proceeds of production attributable to the leased premises until it recouped that tract's proportionate share of well costs.[46] Exchange paid royalties to the plaintiffs the for some time until it made the decision that the well would not "pay out" and elected to simply release the lease in order to be relieved of any further responsibility in connection therewith. Since that previously leased tract's share of well costs had not yet been fully recouped, Exxon continued withholding such costs from the share now owned by the plaintiffs in their capacity as unleased mineral owners. The plaintiffs sued TXP (as successor to Exchange's interest in the lease) for such well costs arguing that such costs were incurred during the existence of the lease and therefore, were the responsibility of the lessee.

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44 674 So.2d 473 (La. App. 1st Cir. 1996), *writ denied*, 679 So.2d 436 (1996). *See also*, *Willis v. International Oil & Gas Corp.*, 541 So.2d 332 (La. App. 2d Cir. 1989).

45 It is noted that the lessee did not participate in nor consent to Exxon's drilling operations and did not participate in the unitization proceedings in any way, two significant factors the court noted in ruling for the lessee. However, the author questions whether such failure to participate, at least in the unitization hearing, may not itself have been a breach of the lessee's implied obligations under the lease, i.e. to properly and fairly represent the lessor before administrative bodies or, at least, to prevent drainage. *See Breaux v. Pan American Petroleum Corp.*, *supra*, and *Williams v. Humble Oil & Refining Co.*, *supra*, and particularly the discussion thereof in the official Comment following Article 122 in the Louisiana Mineral Code.

46 It is noted that there was no provision for a "risk fee" in the statute at the time as would be the case presently and therefore, the lessee would have been responsible for well costs, but only out of production.

Of course, TXP's defense was that it was relieved of this responsibility prospectively from the date of the release. Exchange argued that since Exxon could only recoup such funds by withholding production attributable to the tract in question, the obligation arose only as production was obtained and therefore, it had no obligation to continue paying for such well costs after the release. The court agreed with TXP and found that the release of the lease resulted in the discharge of any further obligations in connection therewith, including those dealing with the subject well costs.[47]

Again, although the author recognizes that the applicable statute has since been amended, nevertheless, slightly different circumstances could provide a different result. That is, it is common knowledge in the industry that a lessee will normally put a lease block together and acquire oil, gas and mineral leases covering a substantial area comprising what he feels is the prospective productive area in order to pursue the development and exploration of a geological idea or play. Before he can justify the expenditure of what may be millions of dollars to develop such a geological idea, it is necessary for him to protect his interest by the acquisition of leases over a large enough area to insure that, if the prospect is a success, he will be the sole party (or, at least, sole lessee) to share in the production attributable thereto. Consequently, he may acquire leases covering, say, for purposes of this discussion, a contiguous thousand acres from, for example, ten different lessors. Suppose he drills his well in the center of the thousand acre block and unfortunately, the idea proves to be only marginally successful. An analysis of the logs, pressures, production, etc. may reveal to him that it is quite likely that the well, if it even reaches payout, will not be very profitable. Having been given the opportunity, by the acquisition of the leases, to pursue his idea and participate in the potential largesse that a successful well would create, would such a lessee who drills only the marginal well, then be free to release, for example, all of the leases except the drillsite lease, and then, once the non-drillsite tracts are included in a unit, recoup the now released tracts' share of well costs out of production? Such a situation is, of course, different from the *Shanks* case. In this example, unlike the situation in *Shanks*, the lessee and the operator are one and the same; therefore, the lessee obviously "participated" in the drilling operations. Thus, the obligation (by agreement) to pay well costs may have been incurred while the lease was in effect. (However, the well was not on the complaining plaintiff's lands.) Also, if the unit was in effect at the time the well was drilled, the risk fee statute would now be applicable and could be used for a determination of participation prior to drilling, even if the lessee is not the operator. What if, however, there was but one lessee, no unit and an off-premises well was drilled and not the operator but a third

47 The court cited the case of *Davis Oil Company v. Steamboat Petroleum Corporation*, 583 So.2d 1139 (La. 1991) as controlling authority.

party landowner, as an interested party, called for the unit that ultimately included the leased premises? Could the lessee, under such circumstances, release the lease and retain the formerly leased lands' proportionate share of production for well costs? Would it be any different if the lessee had released the lease prior to the calling of the hearing for unitization, or during the pendency of the unitization proceedings? Most leases provide that a lessee may, at any time, release the lease and be relieved of any further obligations thereunder. It is submitted that, in the example given, despite such a release, the operator/lessee should *not* be allowed to recoup such well costs. It is admitted that that submission has not gone unchallenged. Discussions of this issue have been had with various other oil and gas attorneys in the state and many, if not most, have stated that the clear language in the lease regarding the right of the lessee to release it and be relieved of further responsibility settles this issue.[48] It might, but no doubt Kelley thought that the "clear" language in its lease in the *Connell* case likewise settled the issue of use of the surface of the leased premises for operations on adjacent lands. The author is not unmindful of the fact that, in the example, after the release, there simply is no longer a lease in effect. Therefore, how would the landowner be paid – as a royalty owner in the amount of the royalty provided for in the prior lease, or as an unleased owner or even some other way?[49] It is doubted that it would be as an unleased owner because then the prior lessor/landowner would "have his cake and eat it too", i.e. by receiving his share of the proceeds without paying his share of the costs.[50] The author has simply no concrete answer and, as yet, has not had to face the issue. The author is aware of one situation where this occurred but none of the landowners pursued it. It simply seems that, given the mandate of Article 122 and the requirement of mutuality, it can hardly be argued that such a lessee can have the benefit of the lease which allowed him to drill the well to test the prospect and then, when it does not turn out as well as he expected, abandon the lessor solely for his own gain. Perhaps the remedy of the landowner is one for breach of the lease and resultant damages for failure to comply with the obligations of

48 *See* Willis, *supra*, p. 344 when the court stated that "the plain wording of the lease specifically created the right to execute a release at any time".

49 In *Shanks*, TXP, apparently recognizing the problem, reconvened against the plaintiffs (i.e. its prior lessors) averring that if the plaintiffs were successful in requiring TXP to pay the well costs in question, then TXP was entitled to its share of the production, subject to the payment of royalties to the plaintiffs under the previously existing lease. Thus, TXP requested that if the plaintiffs were successful, the court should declare the previous release void and of no effect. *Quere* – is this "breathing new life into a dead horse"?

50 La.R.S. 30:10A.2. *See also Willis, supra* and the cases cited therein, especially at 335, wherein the court stated that "to the extent that the Willises are co-owners of the minerals at issue, and have not participated in the expenses incurred in producing those minerals, they are not entitled to a proportionate share of the proceeds without paying a proportionate share of the expenses".

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Article 122 but, of course, the breach (i.e. the actionable offense - the release) does not occur until after (or, at least, simultaneously with) the termination of the lease. As noted, the author does not have the answer to the question and it is conceded that the language regarding releases contained in most leases would ostensibly allow this. However, it is submitted that the matter is not free from doubt. It is suggested that there are problems with this issue. Of course, under such circumstances, the threat of loss of the lease is not present but perhaps a suit for damages would be available. Nevertheless, the issue is presented in order to evidence the kind of situation which may be envisioned by the obligation of mutuality mentioned in Article 122.

Yet another issue anticipated as a concern is that dealing with unitization. This is not specifically mentioned in the official Comment to Article 122. However, it probably falls under the ambit of the obligation to prevent drainage. In fact, in *Breaux v. Pan American Petroleum Corp.*[51] it was suggested that under certain circumstances, a lessee might be under a duty to unitize, or at least to attempt to unitize, the leased premises with an off-premises well draining the tract. It is submitted that the word "might" is probably no longer applicable in Louisiana law. Since unitization is available to prevent the drilling of unnecessary wells, and to insure each tract's just and equitable share of production, it is submitted that representation of the lessor (and presumably himself, as well) at a unitization proceeding is an obligation of the lessee. Of course, the real dilemma is when the operator of the well is also the lessee and particularly if the lease in question provides for a greater royalty than that affecting the drillsite tract. The lessee then has a built-in conflict – his profit increases as the percent of participation by the leased premises decreases. In such circumstances, a lessee must properly represent the lessor and attempt to include as much of the leased premises in the unit as is productive. Given the inexact nature of geology and since so much of unitization is a matter of interpretation, it is suggested that good records be kept to insure that the obligation is fulfilled. This may be fairly easy to do – so long as it is done in good faith. Nevertheless, the dissatisfied lessor may have a greater incentive to sue because of the potential conflict. True, once the Commissioner establishes a unit, it, by definition, establishes the legal limits of the production and any attempt to show that more of the leased premises should have been included in the unit formed would be considered a collateral attack on the Commissioner's order with all the problems that entails.[52] However, if pleadings are properly drafted to limit a claim to the

51 163 So.2d 406 (La. App. 3d Cir. 1964).

52 *Trahan v. The Superior Oil Company*, 700 F.2d 1004 (5th Cir. 1983). *See also*, *Savoy v. Tidewater Oil Company*, 218 F.Supp. 607 (W.D. La. 1963), *aff'd per curium*, 326 F.2d 757 (5th Cir. 1964), and *Mayer v. Tidewater Oil Company*, 218 F.Supp. 611 (W.D. La. 1963).

fulfillment of the obligation of the lessee to adequately represent the lessor at the hearing, a sufficient cause of action against the lessee should be recognized, a result which could place the lease in jeopardy.[53]

An example with which this author is familiar is one where the lessee was the operator of an off premises well and there was another tract in the vicinity of the well which was unleased and which, it was discovered (based on the information obtained from the drilling of the well) should be included in the unit, along with a portion of the leased premises. In the negotiations between the operator and the unleased landowner, the potential unit participation of the unleased tract in the unit was discussed. The operator apparently told the unleased owner that he would propose a greater participation of that owner's tract in the unit if he leased the land to the operator and would do so by rearranging his structure map and other evidence, all at the expense of the leased premises.[54] Of course, being a matter of interpretation, the operator would presumably justify his action by arguing that his ultimate submittal embodied his true interpretation. Obviously, this is quite egregious and would certainly be a breach of the duty to the lessor to properly protect the leased premises or to act for the benefit of both lessee and lessor. Granted, the Commissioner and his staff simply receive the testimony and independently determine the unit configuration. Nevertheless, it is submitted that, as difficult as it may be to prove, such action by a lessee is in direct violation of the obligations of a reasonable and prudent operator and especially the portion of that obligation which requires actions be taken for their "mutual" benefit, not to mention the "good faith" requirement of Article 122. Furthermore, in viewing the obligations of the lessee and determining whether the lessee has complied therewith, it has been suggested that the proper method by which to view the situation is as if the subject lease was the only lease owned by the lessee in the area. Having been involved in unitization matters, particularly, representing operators, the author simply wonders (and the question is posed for your consideration) whether the operator views the situation and prepares his evidence in the same manner when he owns leases on all the tracts within the productive area as when he owns a lease on only one.

The point to be made here is simply that a lessee, particularly one who drills an off-premises well in the vicinity of the leased premises, must be acutely aware of his obligations to his lessor (or actually to all his lessors)

53 In *Trahan*, there is an excellent discussion concerning these very matters. It is particularly noted how the court went to some lengths to distinguish situations where the rule preventing collateral attacks on the Commissioner's orders would not bar properly plead claims by a lessor against a lessee on the basis of the lessee's obligation to act as a reasonable and prudent operator. See, for example, footnote 27 at p. 1025.

54 The owner of the unleased tract and the owner of the leased premises were neighbors and good friends and the unleased owner told the lessor about his discussions with the lessee/operator.

to operate for their mutual benefit and insure that he not only complies with these obligations but also preserves evidence thereof, because of the increased possibility of suit in light of the built-in conflict discussed above.[55]

Another instance closely akin to the foregoing is that of obtaining an allowable for the production of and actually producing a well which will be unitized. Assume, for example, a party owns leases over the entire productive area covered by several leases for a well drilled at a legal location on one of the leases. The operator knows that he must initiate unitization proceedings to insure that the proper parties receive their fair and equitable share of the production. There are several pipelines in the area and therefore, the well can fairly quickly be placed in production. It takes the lessee/operator some time before the actual filing of the proceedings, to, for example, meet with other participants in the well to arrive at an acceptable plan for unitization, determine and identify the interested parties he must notify, and the like. Of course, the Office of Conservation's current rules regarding the issuance of an allowable for a well provides that if the request therefore is made prior to the filing of an application for a hearing before the Office of Conservation, the allowable will be on a lease basis (remember, the well is at a "legal" location, i.e. more than 330 feet from a "property" line) and if the request is made after such filing, the allowable will be conditioned on the applicant's agreement or obligation to distribute the funds attributable to such production on the basis of the equities to be set by the unit ultimately created. This really places the lessee in a difficult position. Of course, if production is commenced before the filing, all proceeds will be due the drillsite owner (based on the rule of capture) until the effective date of the order.[56] The non-drillsite owners, of course, will be deprived of production proceeds they would otherwise receive. It becomes even more difficult when the royalty due the various lessors is different for the drillsite owner and the others. This exact situation occurred fairly recently in south Louisiana.

55 The author is aware that the lessee does not have a fiduciary duty to his lessor. The court in *Trahan*, discussed this at length and compared the situation of the lessee's action before the Commissioner to that of an attorney representing a client in court and, of course, distinguished those situations. It is recognized that sometimes the interest of the lessee and lessor at a particular hearing on unitization may vary substantially and a lessor has as much opportunity to present evidence at such hearing as the lessee. Therefore, his interest can presumably be adequately protected. Nevertheless, the rather extensive discussion of these issues in the *Trahan* case reveals the troubling aspects a court may have with completely barring a lessor from asserting these claims and should serve as a warning or at least a guide of how to handle matters regarding unitization.

56 *See* La.R.S. 30:1 and La.R.S. 30:9. *See also*, *Frost-Johnson Lumber Co. v. Salling's Heirs*, 150 LA. 756 91 So. 207 (1922); *Pierce v. Goldking Properties, Inc.*, 396 So.2d 528 (La. App. 3d Cir. 1981), writ refused 400 So.2d 904 (1981); and *Desormeaux v. Inexco Oil Company*, 298 So.2d 897 (La. App. 3d Cir. 1974), writ refused 302 So.2d 37 (1974).

The operator was being pressured from both sides. It so happened that when all preparations for unitization were finalized, the well had not quite been completed, or "hooked-up", and ready for production and, with an adjacent owner threatening to initiate the unitization proceedings himself and the operator, wanting to be the applicant and gain whatever advantage, if any, that might have, filed the application for the hearing prior to receiving the allowable and therefore proceeds from the date of first production was distributed on a unit basis.[57]

Obviously, there is substantial room for abuse in these circumstances, just as there is in connection with the unitization matters previously addressed. There is no hard and fast rule governing these situations except that of the "reasonable and prudent operator". However, these matters are addressed here to show the difficulty that may arise because of this obligation of "mutuality". Remember that good faith may be irrelevant if, under an objective standard, the action of the lessee is found not to be that of a reasonable and prudent operator. Therefore, the author suggests that the lessee/operator in this instance not only be aware of his obligations but also be prepared to defend them. Probably the best solution is to simply move forward with unitization and production activities independently and allow "the chips to fall as they may". That would seem to be the easiest position to defend.

What about the situation which arose in connection with the *Neomar Resources, Inc. v. Amerada Hess Corporation*?[58] This author questions whether perhaps the lessor in that case may not have had a cause for concern and may have been the party who should have complained. In that case, Amoco Production Company ("Amoco") owned the leased and had subleased the shallow rights to Neomar. Amoco and its partner, Amerada Hess Corporation ("Amerada"), drilled a well to the deeper horizons which resulted in a dry hole but revealed (by logs) potential production in the shallower horizons. Although Neomar requested of Amoco to take over the well, Amerada apparently never responded to Amoco's notice thereof and thereafter Amoco simply proceeded to plug the well. Neomar subsequently drilled its own successful well to the horizon shown productive in the Amoco well and sued Amoco and its partners for breach of contract.

57 Of course, without agreement from the drillsite owner, it is quite possible that the lessee would be faced with the obligation to pay "double" royalties on some portion of the production proceeds since he would owe the drillsite owner his full royalty on the entirety of the production until the effective date of the unit and also to the non-drillsite owners for their proportionate share of unit production from the date of first production. In most instances, the operator obtains what is often referred to as an "escrow agreement" from the drillsite owner to provide for distribution of funds on a unit basis and if the drillsite owner does not agree, simply delays commencement of production until the unit is created, which, of course, may entail yet additional problems.

58 648 So.2d 1066 (La. App. 1st Cir. 1994); writ denied, 651 So.2d 277 (1995).

Neomar claimed that Amoco, et al had breached their obligation to act as reasonable and prudent operators. Neomar's suit was dismissed on the basis of no cause of action and no right of action. The court said that although Amoco (and Amerada) owed a duty to act as reasonable and prudent operators, that duty was owed, not to Neomar, their sublessee, but to the lessor.[59] However, the question which arises is whether or not the actions of Amoco and Amerada breached such duty to the lessor, in that case, the State of Louisiana. The State had a productive well on its property that was plugged. Could this, under any stretch of the imagination, be considered action for the benefit of the lessor, or for that matter, the lessee as well? Presumably, by turning over the well, the lessees could have at least saved the plugging and abandoning and surface restoration costs. Thus, what may have happened was the flip side of the Article 122 coin – the operations may have been to the detriment of both lessor and lessee.[60] Does the affirmative statement in Article 122 to act for the benefit of the lessor, or at least, the mutual benefit of both lessor and lessee, mean that the lessee cannot, therefore, act to the detriment of the lessor? Could the lessor have demanded that the well be turned over to Neomar rather than be plugged and abandoned? What if Neomar had not drilled the subsequent, successful well, either because of its election not to or its inability to successfully do so, by, for example, encountering mechanical or other problems in drilling the well to the potentially productive horizon? Surely, the lessor would then have suffered substantially. Or perhaps more realistically, what if the shallower, presumably productive horizon had been marginal such that the party who drilled the well would have produced it, if for no other reason, in order to obtain some return on his investment (since he had already drilled the well), but could not justify the expenditure of the necessary funds to drill a whole new well, based on the log, etc. Thus, the lessor would lose production as to which he otherwise would have been entitled. Because the lease is an indivisible agreement[61], it would seem that the state could have looked to all three of the lessees as having breached the lease because of its violation of the Article 122 obligation to act as reasonable and prudent operators. If there were equities to be worked out between the lessees, could it not be argued that they could not be worked out at the expense of the lessor?

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59 The court also stated that such an obligation was also owed from Neomar to Amoco, as its sublessor, but not vice versa.

60 The author is aware of some lessees' desire to insure compliance with the plug and abandonment and surface restoration requirements of Office of Conservation Statewide Order No. 29-B and therefore the corresponding reluctance to turn over operations in a well without satisfaction of adequate protection with regard thereto. However, a bond or insurance might address that concern. There are specific statutes dealing with an operator's limitation of liability for future restoration and the like such as the Louisiana Oilfield Site Restoration Law found at La.R.S. 30:80.

61 Louisiana Mineral Code Article 130.

Perhaps the author is influenced in his opinion of the case by what seems to be the very questionable action of plugging an otherwise productive well, but it seems that the ultimate result was wrong, or rather that the ultimate result would have been wrong had the lessor brought the action instead of Neomar. In all likelihood the decision to plug the well was made without any, or with very little, thought given to the effect it would have on the lessor and the lease itself. It is because of situations such as these that the author stresses the importance of the lessee keeping in mind the necessity for "mutuality" in oil and gas leases and operations conducted, or not conducted, thereunder.

There are several other situations which could be addressed, but time and space prohibit the author from doing so. For example, what about split-streaming gas production where the prices paid for the gas to different lessees differ? There may be valid reasons for doing so by one of the lessees but is this at the expense of the lessor and, if so, is the entire lease placed in jeopardy? As a partner in a well as to which production is sold to two different purchasers, a lessee should be acutely aware of the potential problems this may cause. Additionally, unitizing a leased tract at the very end of the term of the lease perhaps for reasons other than conservation could cause a lessee problems.[62] And what about a lessee's obligations regarding the use of secondary or tertiary recovery methods, or a lessee farming out a lease in exchange for a guaranteed overriding royalty interest of a certain percentage of the entire production from a well regardless of subsequent unitization? By posing the questions, the author is not suggesting that the lessee must share with the lessor whatever profit he makes as a result of his ownership of the lease. However, in view of the trend in the jurisprudence toward the "higher" standard imposed on the lessee, and particularly the language by the Louisiana Supreme Court in the landmark case of *Frey v. Amoco Production Co.*[63], wherein the court discussed the obligation of the lessee to share in the "economic benefits" derived from the lease (at least as to take or pay contracts and settlements).[64] What the author is suggesting is that situations such as these must be addressed very carefully.

In conclusion, it should be kept in mind that all operations under and pursuant to a lease must be conducted for the <u>mutual</u> benefit of both the

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62 *Debetaz v. Chevron U.S.A., Inc.*, 891 F.2d 562 (5th Cir. 1990). *See also, McDonald v. Grande Corp., supra* at Footnote 6.

63 603 So.2d 166 (La. 1992).

64 In discussing the "sharing" obligation of the lessee in the "take-or-pay" settlements, the Court in *Frey*, at p. 174, stated that "[t]he lease represents a bargained-for exchange, with the benefits flowing directly from the leased premises to the lessee and the lessor, the latter via royalty. An economic benefit accruing from the leased land, generated solely by virtue of the lease, and which is not expressly negated . . . is to be shared between the lessor and the lessee . . ."

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lessee and the lessor. The lessee does not have to suffer any detriment in order that the lessor benefit. However, he cannot act solely for his own benefit. It has been this author's experience that lessees often address situations with a rather cavalier or at least casual attitude toward the effects which certain actions may have on the interest of their lessors. Furthermore, it should also be kept in mind that the same relationship exists between sublessors and sublessees and therefore, so do the same obligations.[65] Perhaps engineering and/or geological decisions may make perfect sense from a engineering or geological perspective but may not be sufficient, in and of themselves, to meet the objective test of a reasonable and prudent operator. It is the duty of the attorney or the landman to be aware of these obligations and insure that the decisions made by lessees are with due consideration thereof.

The obvious trend in the jurisprudence, as evidenced above, is to place a higher duty on the lessee because of his greater "power" in the lease contract relationship, as we can especially see in the *Frey* and *Connell* cases. Although the relationship is not a fiduciary one, the courts seem to be "pushing the envelope" closer and closer to that. It is submitted that the lessee, because of his superior and often unique knowledge of all facts in dealing with the operations under the lease, is and will continue to be expected to "take care" of his lessor. He will be expected to be a "pere de famille" kind of "good administrator" cited by Judge Rubin in the *Williams* case.[66] With the use of that kind of language, good operators and lessees will realize that the obligations of the reasonable and prudent operator will only increase and not decrease. The often heard axiom of "its getting just as hard to keep production as it is to find it" is proving to be truer in more recent times. However, the smart lessee will heed the warning and pay closer attention to the effects of his operation on his lessors. He may not like it, but would be foolish to ignore it.

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65 *Wier v. Grubb*, 228 La. 254, 82 So.2d 1 (1955).

66 *Williams v. Humble Oil & Refining Company*, *supra*, at 414. The term "pere de famille" is a French term whose literal translation is "father of the family", a pretty high obligation indeed.