West's Louisiana Statutes Annotated
Louisiana Revised Statutes
Title 31. Mineral Code (Refs & Annos)
Chapter 7. The Mineral Lease (Refs & Annos)
Part 4. The Obligations of the Lessee

LSA-R.S. 31:122

§ 122. Lessee's obligation to act as reasonably prudent operator

Currentness

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.

Credits
Added by Acts 1974, No. 50, § 1, eff. Jan. 1, 1975.

Editors' Notes

COMMENT

The concept of implied covenants or obligations in other jurisdictions resulted from the view of courts that the principal expectation of the parties to a mineral lease is that the property will be developed for the mutual advantage and profit of both parties. Thus, the courts have in various common operating situations imposed upon the lessee the obligation to develop and operate the property in the manner of a reasonable, prudent operator. The general choice of an objective rather than a subjective standard of, say, good faith of the individual operator, is virtually unanimous. In other jurisdictions, this general principle is specified in the form of individual covenants, variously classified by different jurisdictions and different authorities on mineral law. See 5 Williams and Meyers, Oil and Gas Law. Ch. 8 (1969). The same authority takes the position that the root of the so-called implied covenants is the general principle of required cooperation among parties to all contracts in the achievement of their intended goals.

In Louisiana there is available in the Civil Code a general principle which can serve as a basis for achieving the result of the doctrine of implied covenants in other jurisdictions. Article 2710 requires that a lessee enjoy the thing leased as "a good administrator." This objective standard can aptly be translated into the field of mineral law as the "reasonable, prudent operator" standard which has been consistently applied by Louisiana courts to oil, gas, and mineral leases. See *e.g.*, Williams v. Humble Oil & Ref. Co., 290 F.Supp. 408 (E.D.La.1968) affirmed, 432 F.2d 165 (5th Cir. 1970); Carter v. Arkansas-Louisiana Gas Co., 213 La. 1028, 36 So.2d 26 (1948); Caddo Oil & Mining Co. v. Producers Oil Co., 134 La. 701, 64 So. 684 (1914).

Williams and Meyers divide the specifications of the prudent operator standard into (1) implied drilling covenants, including the covenant to drill exploratory wells, the covenant to reasonably develop the premises after discovery in paying quantities, and the covenant of further exploration; (2) the covenant to market the product; and (3) the covenant to use reasonable care and due diligence in conducting operations on the premises. Other authorities divide these implied covenants differently.

In Louisiana, the general obligation to act as a "good administrator" or "prudent operator" has been clearly specified in four situations: (1) the obligation to develop known mineral producing formations in the manner of a reasonable, prudent operator; (2) the obligation to explore and test all portions of the leased premises after discovery of minerals in paying quantities in the manner of a reasonable, prudent operator; (3) the obligation to protect the leased property against drainage by wells located on neighboring property in the manner of a reasonable, prudent operator; and (4) the obligation to produce and market minerals discovered and capable of production in paying quantities in the manner of a reasonable, prudent operator. Additionally, the obligation of the lessee to restore the surface of the lease premises on completion of operations may be viewed as a part of this general standard. Two differences between these observable specifications of the general duty of the lessee can be noted as compared with the division made by Williams and Meyers. One is that the Louisiana cases have not found it necessary to impose an obligation to drill an exploratory well in situations in which other courts did so prior to the more modern "drill or pay" and "unless" types of lease forms. Louisiana courts dealt with this problem through application of articles of the Civil Code dealing with potestative conditions and through the doctrine of serious consideration. See Moses, "Potestative Conditions in Louisiana Oil, Gas and Mineral Leases," 16 Tul.L.Rev. 80 (1941). The second difference is that there is little mention of what Williams and Meyers have termed the covenant to use reasonable care and due diligence in conducting operations. This should not be viewed as negating the existence of any such duty in Louisiana as a specification of the general standard to act as a good administrator. It is simply an indication that as yet there has been little litigation involving situations in which other courts have specified the general duty in that manner. See Louisiana Gas Lands v. Burrow, 197 La. 275, 1 So.2d 518 (1941), in which plaintiff contended that lessee was failing to produce the full amount of gas permitted by a statute setting maximum production levels for gas wells. The court held that the lessee was not under a duty to produce the maximum amount but indicated that if the statute had been a true proration order issued under an act such as the present Conservation Act, the lessee might have been adaptation of the obligation of permitted by the proration order. This is the only discovered situation in which the facts might be seen as involving an obligation to operate the lease with reasonable care and due diligence.

Article 122 states the general duty of the lessee to act as a reasonable, prudent operator as an adaptation of the obligation of other lessees to act as "good administrators." However, since there is jurisprudence dealing with the common specifications of this duty it is appropriate to discuss the cases briefly.

Reasonable development: There is more jurisprudence relating to development of known mineral producing formations in the manner of a reasonable, prudent operator than in connection with other specifications of the lessee's general duty. Essentially, the relevant cases hold that after production in paying quantities has been obtained from a mineral formation, it is the duty of the lessee to develop the producing formation in the manner of a reasonable prudent operator taking into consideration both his own interests and those of the lessor. See Gennuso v. Magnolia Petroleum Co., 203 La. 559, 14 So.2d 445 (1943); Wadkins v. Wilson Oil Corp., 199 La. 656, 6 So.2d 720 (1942); Coyle v. North American Oil Consolidated, 201 La. 99, 9 So.2d 473 (1942); Doiron v. Calcasieu Oil Co., 172 La. 553, 134 So. 742 (1931); Stubbs v. Imperial Oil & Gas Products, 164 La. 689, 114 So. 595 (1927); Caddo Oil & Mining Co. v. Producers Oil Co., 134 La. 701, 64 So. 684 (1914).

The obligation of further development was succinctly summarized by the Supreme Court of Louisiana in Carter v. Arkansas-Louisiana Gas Co., 213 La. 1028, 1034, 36 So.2d 26, 28 (1948):

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

Whether a mineral lessee has complied with his obligation to reasonably develop a known producing formation has been said to be a question of fact determinable by the circumstances of each case. Carter v. Arkansas-Louisiana Gas Co., *supra*. The lessor must prove to the satisfaction of the court that a reasonable, prudent operator would conduct additional drilling operations in the productive formation. If the lessor is able to sustain the burden of proof, he is entitled to cancellation of the lease. Carter v. Arkansas-Louisiana Gas Co., *supra*. See also, Fontenot v. Sunray MidContinent Oil Co., 197 So.2d 715 (La.App. 3d Cir. 1967); Sellers v. Continental Oil Co., 168 So.2d 435 (La.App. 3d Cir. 1964). These latter cases develop the concept of partial cancellation as a remedy for nonpayment of royalties. As an equitable device, there does not appear to be any reason why courts could not utilize the remedy of partial cancellation in cases where relief is being granted for nondevelopment. Indeed, in Sohio Petroleum Co. v. Miller, 237 La. 1013, 112 So.2d 695 (1959) partial cancellation, which was asked as an alternative remedy to complete cancellation, was granted. See also Romero v. Humble Oil & Refining Co., 93 F.Supp. 117 (E.D.La.1950) and Nunley v. Shell Oil Co., 76 So.2d 111 (La.App.2d Cir. 1954), in which partial cancellation was prayed for by plaintiffs.

No Louisiana court has ever awarded damages for breach of the obligation of reasonable development. The remedy of damages should, however, be regarded as available if proper proof is made. See 5 Williams and Meyers, Oil and Gas Law § 834 (1969). Damage might result from permanent loss of recoverable minerals or from deprivation of present worth of minerals through failure to produce them expeditiously. From a practical standpoint it seems that little in the way of damages can be shown in most cases unless the premises are being drained by wells on adjoining land. In that case, the dispute will be dealt with as a failure to exercise reasonable diligence to protect the property against drainage and damages could be awarded. In this regard see the discussion below of the obligation to protect against drainage.

Further exploration: As noted, Williams and Meyers characterize the covenant of further exploration as being separate from the covenant of reasonable development. This is a defensible view. However, historically in Louisiana the obligation of further exploration can be viewed as an evolutionary offshoot of the obligation of reasonable development. See Carter v. Arkansas-Louisiana Gas Co., 213 La. 1028, 36 So.2d 26 (1948). Although the jurisprudence does not make a clear distinction between the obligation of further exploration and the obligation of reasonable development, the distinction nevertheless exists. See Sohio Petroleum Co. v. Miller, 237 La. 1013, 112 So.2d 695 (1959); Middleton v. California Co., 237 La. 1039, 112 So.2d 704 (1959); Carter v. Arkansas-Louisiana Gas Co., *supra;* Nunley v. Shell Oil Co., 76 So.2d 111 (La.App.2d Cir. 1954).

The obligation to explore and test all portions of the leased premises after discovery of minerals in paying quantities was first announced by the Louisiana Supreme Court in Carter v. Arkansas-Louisiana Gas Co., *supra*. The lessor sued for a cancellation of the lease as to the entire lease premises. A main fault traversed the tract and it was admitted that full development had taken place on one side of the fault. Lessor demanded development on the other side of the fault. Based upon the evidence presented, the court felt the lessor had borne the burden of proving that a reasonable, prudent operator would further explore by drilling wells on the undeveloped side of the fault. Partial cancellation was granted as to the acreage on the undeveloped side of the fault. However, the court noted that had the plaintiff appealed from the judgment of the lower court awarding partial cancellation, he would have been entitled to cancellation of the entirety of the lease. The importance of the Carter case, however, stems from the fact that the court, in its application of the obligation of reasonable development, went further and imposed upon the mineral lessee the duty of further exploration after initial production in paying quantities had been obtained. The court quoted with approval language from the Oklahoma case of Fox Petroleum Co. v. Booker, 123 Okla. 276, 282, 253 P. 33, 38 (1926):

> "The principle, as we understand it, is that development of every part of the lease is an implied condition. Therefore, whether the undeveloped portion be a single tract remote from the rest, or a considerable portion of a very large tract ... or the east 100 acres of a tract of 160, it is an implied condition that the lessee will test every part."

The jurisprudence since the *Carter* decision has recognized that the obligation of further exploration is embodied in our law. Middleton v. California Co., *supra;* Sohio Petroleum Co. v. Miller, *supra;* Reagan v. Murphy, 235 La. 529, 105 So.2d 210 (1958); Wier v. Grubb, 228 La. 254, 82 So.2d 1 (1955); Eota Realty Co. v. Carter Oil Co., 225 La. 790, 74 So.2d 30 (1954); Nunley v. Shell Oil Co., *supra*. Federal cases applying Louisiana law are to the same effect. Cutrer v. Humble Oil & Refining Co., 202 F.Supp. 568 (E.D.La.1962); Romero v. Humble Oil & Refining Co., 93 F.Supp. 117 (E.D.La.1950).

The basic similarity between the obligation of reasonable development and the obligation to further explore is that in both instances there must be discovery in paying quantities to make the obligations operative. Some cases have been rather liberal in holding that the lessor has borne the burden of proving that a reasonable, prudent operator would further explore the lease premises. In Nunley V. Shell Oil Co., *supra*, and Romero v. Humble Oil & Refining Co., *supra*, the courts accepted testimony that lessor had a firm offer from an experienced person to take a lease with a drilling obligation on the unexplored portion of the premises. In both of those cases, it appeared that the defendants had taken the position that even if a well were drilled it would be unsuccessful. The courts seem to have viewed this as tantamount to asserting that the acreage had been condemned. In response to this it was stated that if the acreage had been condemned there was no reason why the lessee should be permitted to sit on the undeveloped acreage in the presence of an offer to drill an exploratory well. Differing circumstances are found in Middleton v. California Co., *supra*, and Saulters v. Sklar, 158 So.2d 460 (La.App.2d Cir. 1963). In the *Middleton* case considerable development had taken place, several million dollars in royalties had been paid to the lessor, and lessee presented evidence that it was engaged in a program of seismic exploration of the untested acreage on a 4,600 acre lease. In view of the large size of the lease, the amount of the royalties paid, and the demonstrated plans of the lessee, the court refused to give relief to the plaintiff lessor. In Saulters v. Sklar, *supra*, defendant lessee's response to the plaintiff's demand for further exploration was decidedly evasive. The error committed by the lessee in the *Nunley* case of taking the position that the acreage was condemned was avoided by stating that it felt that the acreage might be valuable for a deep test in the future but that lessee did not deem the present was the time to make such a test. The principal distinction which can be found between Saulters and Nunley is that in one case the lessee took a categorical position that further exploration would be fruitless and in the other the lessee indicated a willingness to consider making a deep test at a future date though that date was undefined. Additionally, the court appears to have given some weight to the fact that the offer to drill on which plaintiff relied was apparently obtained in close proximity to the time of the trial and for that specific purpose.

Protection against drainage: It was established early that a lessor could obtain cancellation for failure to protect the leased premises against drainage through wells on adjoining property. Swope v. Holmes, 169 La. 17, 124 So. 131 (1929). However, it remained unclear for many years thereafter whether a mineral lessor could recover damages for failure to protect the lease premises from drainage. See Billeaud Planters, Inc. v. Union Oil Co. of California, 245 F.2d 15 (5th Cir. 1957); Coyle v. North American Oil Consolidated, 201 La. 99, 9 So.2d 473 (1942); Louisiana Gas Lands v. Burrow, 197 La. 275, 1 So.2d 518 (1941); McCoy v. Stateline Oil & Gas Co., 175 La. 231, 143 So. 58 (1932).

However, in Breaux v. Pan American Petroleum Corp., 163 So.2d 406 (La.App.3d Cir. 1964), cert. denied, 246 La. 581, 165 So.2d 481 (1964), it was established that a cause of action for damages for failure to protect the lease premises against drainage does exist in Louisiana. To recover in such an action a lessor must show: (1) the existence of substantial drainage; (2) the quantity of oil or gas that would have been produced from an offset well if drilled at the proper time; (3) the profitability of an offset well in the sense that it would not only meet operating costs but repay investment costs; (4) the lessor's share of the minerals that would have been produced from an offset well had it been drilled at the proper time. This represents the majority view of the elements of a cause of action for damages for failure to protect against drainage. See 5 Williams & Meyers, Oil & Gas Law §§ 822, 825.2 (1964).

Traditionally, a mineral lessee has been called upon to comply with his obligation to protect the lease premises against drainage by drilling offset wells where economically feasible to do so. However, the court in *Breaux* added a new dimension to this obligation by suggesting that under certain circumstances a lessee might be under a duty to unitize a portion of the leased premises being drained with the draining well on the neighboring land. See Williams v. Humble Oil & Refining Co., 290 F.Supp. 408 (E.D.La.1968), affirmed, 432 F.2d 165 (5th Cir. 1970). This means that in those situations where a lessor might not be able to prove that drilling of an offset well would be profitable, he might nevertheless be in a position to allege and prove that a properly formed unit would have protected the premises against drainage. In cases of this kind in which the lessee has no interest in the adjoining well or wells, the basic allegations and required proof would be the same as for the drilling of an offset well, including proof of the economic feasibility of investing in the adjoining well. However, if the lessee of the drained premises is also the operator of the draining well, his money would already have been spent and there should be no requirement that the lessor prove economic feasibility.

Diligence in marketing: A mineral lessee is under a duty to exercise reasonable diligence to secure a market for minerals that have been produced or are capable of being produced in paying quantities. There is rarely a problem in this regard where oil is being produced, as ready markets can usually be found. Most problems arise in connection with the marketing of gas where the magnitude of reserves has not been proved, a market is not readily available, marketing facilities are not available, or administrative delays are involved. The existence of an obligation to exercise reasonable diligence in securing a market is recognized in the Louisiana jurisprudence. See *e.g.* Risinger v. Arkansas-Louisiana Gas Co., 198 La. 101, 3 So.2d 289 (1941); Hutchinson v. Atlas Oil Co., 148 La. 540, 87 So. 265 (1921); Lelong v. Richardson, 126 So.2d 819 (La.App.2d Cir. 1961).

Restoration of surface: The cases treating the obligation of a mineral lessee to restore the surface of the lease premises as near as is practical to original condition do not specifically include this obligation under the general obligation to act as a prudent administrator. Rather, this obligation has a foundation in Articles 2719 and 2720 of the Civil Code. However, there appears no reason whatsoever to exclude this particular obligation as being a specification of the prudent administrator standard. It is established that the mineral lessee must restore the surface even though the lease contract is silent. Smith v. Schuster, 66 So.2d 430 (La.App.2d Cir. 1953). There is apparently an economic balancing process which limits this duty. For example in Rohner v. Austral Oil Exploration Co., 104 So.2d 253 (La.App.3d Cir. 1958), the lessee leveled the site on cessation of operations. Among the damages sought by the lessor was the cost of restoring the site of the slush or brine pits to a level of fertility sufficient to grow crops. The court refused to award damages for failure to restore the land to complete fertility, noting that the use of the land was reasonable and the loss of fertility was not due to negligence. Thus, it appears that in effect the obligation to restore the surface is limited by a standard of reasonableness which balances the cost of perfect restoration against the value of the use to which the land is being put. In connection with the obligation to restore the surface, see also Wemple v. Pasadena Petroleum Co., 147 La. 532, 85 So. 230 (1920); Comment, 26 Tul.L.Rev. 522 (1952).

Notes of Decisions (199)

LSA-R.S. 31:122, LA R.S. 31:122
Current through the 2011 First Extraordinary and Regular Sessions.

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