<u>Louisiana Supreme Court Settles Two Important Questions Under the Mineral Code</u>

On June 27, 2018, the Louisiana Supreme Court resolved two important questions of Louisiana law over the scope of liability for breaches of mineral leases and over the maximum liability for unpaid royalties. In *Gloria's Ranch, L.L.C. v. Tauren Exploration, Inc.*, No. 2017-C-1518 (La. 6/27/18), the Louisiana Supreme Court held (1) that a mineral lessee's mortgagee is not liable to a mineral lessor for damages under the Mineral Code for breach of the mineral lease and (2) that the maximum allowable damages under Mineral Code article 140 for underpayment of royalties is double (not treble) the amount of damages owed.

The facts in the case are complicated, but here are some critical ones. In 2004, Gloria's Ranch granted to Tauren Exploration a mineral lease covering lands in five sections in Caddo Parish; the lease had a three-year primary term. During the primary term, Tauren assigned an undivided 49% interest in the lease to Cubic Energy, which then granted to Wells Fargo Energy Capital, Inc. a mortgage in its leasehold rights and security interest in its share of related production. Wells at or above the Cotton Valley Formation (the "Shallow Depths") were successfully drilled in three sections. After the primary term, the entirety of each of the two remaining sections was unitized in the deeper Haynesville Shale formation, and a successful well located within each such unit but off the Gloria's Ranch lease was completed for each such deep unit. Thereafter, Tauren sold to EXCO USA Asset, Inc. 51% of its leasehold rights with respect to the depths below the Shallow Depths (the "Deep Rights"). Thereafter, Gloria's Ranch sent a letter to Tauren, Cubic, EXCO and Wells Fargo for information whether the lease was still producing in paying quantities. Dissatisfied with the response, Gloria's Ranch then sent a letter demanding a recordable release of the lease; when no such release was forthcoming, it filed suit alleging that the lease had expired for not producing in paying and seeking damages from this failure to release; it also sought damages for unpaid royalties from one of the sections. Gloria's Ranch settled with EXCO and, after a bench trial, obtained a favorable judgment. Significantly, the trial court held Wells Fargo solidarily liable with Cubic and, for unpaid royalties of around $240,000, awarded three times that amount pursuant to Mineral Code article 140. The second circuit affirmed.

The Louisiana Supreme Court reversed on both issues. It squarely rejected the position of the lower courts and Gloria's Ranch that, in light of the "bundle of rights" and control Wells Fargo held under its mortgage, it should be considered a "former owner" under Mineral Code article 207 and a "lessee" under Mineral Code article 140 and thus solidarily liable with its mortgagor. The Court explained that Wells Fargo's rights were merely "incidental to mortgage and credit agreement[s]" and did not "r[i]se to the level of ownership of a mineral lease." The Court further reasoned that nowhere in the Mineral Code does ownership of a lessee's interest transfer via a theory of control of rights, but rather only though assignment or sublease. This ruling in favor of Wells Fargo is sensible; a ruling otherwise would have jeopardized oil and gas financing throughout Louisiana—and perhaps more broadly nationwide.

The Court also addressed the long-simmering question over the maximum allowable damages under Article 140 of the Mineral Code. The article provides:

> If the lessee fails to pay royalties due or fails to inform the lessor of a reasonable cause for failure to pay in response to the required notice, ***the court***

> ***may award as damages double the amount of royalties due***, interest on that sum from the date due, and a reasonable attorney's fee regardless of the cause for the original failure to pay royalties. The court may also dissolve the lease in its discretion.

Since its enactment over forty years ago, the industry and courts alike have grappled with the question whether Article 140 permits a total maximum recovery of just twice the royalties due or instead permits up to twice the royalties due ***plus*** the actual royalties due (for a total of three times the royalties due).

Finding the text of article 140 clear, the Court easily held that courts may only award "a maximum of two times the amount of unpaid royalties, not three times." The Court explained that to permit treble recovery would assume that the unpaid royalties are something separate than the "damages" permitted under Article 140, which would ignore the common and "plain meaning of the word 'damages.'"

In a dissenting opinion, Justice Genovese suggested that this holding ignores Mineral Code article 139, which provides that, if a lessee pays the royalties due in response to a notice from the lessor, the court "may award as damages double the amount of royalties due ... provided the original failure to pay royalties was either fraudulent or willful and without reasonable grounds." Per Justice Genovese, it was illogical that the legislature would allow a lessor to collect no more than twice the royalties due when no royalties were paid, but could effectively allow a lessor to collect three times the royalties due when the actual royalties due were paid before suit was filed. Although the majority did not address his point, Justice Genovese failed to consider that the opportunity for a triple recovery under article 139 is permitted only in cases of fraud or willful misconduct by the lessee and that article 140 does not address these circumstances. Admittedly, the entire statutory scheme has some warts, but the majority's conclusion seems the more textually supported: courts should not, in the name of policy, add statutory language that the legislature, for whatever reason, did not include. And of course, the legislature is always free to amend the statute in the future.

The Court also raised, but ultimately left for another day, the issue whether the holder of leasehold rights for one portion of a lease (say, shallow rights) could be liable for breaches relating to other portions of the lease (say, deep rights). Tauren (which ultimately held only a 51% interest in the Shallow Depths) argued that the bulk of the damages relating to failure to provide a release of the Deep Rights and that the obligations relating these Deep Rights were divisible from the obligations relating to the Shallow Depths. But because Tauren was the original lessee as to all depths and also because the lease had stopped producing in paying quantities before Tauren sold its remaining Deep Rights to EXCO, the Court rejected Tauren's efforts to limit its liability and thus left for another day this important issue whether obligations to provide a release instrument can in some circumstances be considered divisible or not.

Regardless of how one may feel about the Court's resolution of these two central issues, it is always nice to have clarity within the law. The Louisiana Supreme Court's decision here resolves two important questions that have created consternation within the industry and complicated parties' analyses of their risks. Going forward, all players should have a better sense of the lay of the land. This third issue will have to await another day.