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**Pitfalls to be Avoided in Drafting: Selected Issues
Under Texas Law and Louisiana Law**

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In the spirit of cross-Sabine harmony, this paper consists of two-parts, one principally dedicated to Texas law and the other to Louisiana law. Part One, which primarily concerns Texas law, consists of: (1) a brief discussion of general rules and guidelines for effective contract drafting; (2) a discussion of certain liability issues that may arise after the assignment of an oil and gas interest, with drafting tips for addressing these issues; and (3) a discussion of force majeure, with drafting tips for use in preparing and reviewing force majeure provisions. Part Two, which primarily concerns Louisiana law, consists of: (1) an overview of Louisiana mineral interests; (2) a discussion of issues relating to the assumption and release of personal obligations in mineral conveyances, with drafting tips provided; and (3) selected property description issues, including a discussion of wellbore assignments, which has a Texas overlay, with drafting tips provided. Although it is somewhat peripatetic, this paper will hopefully be of benefit to practitioners who, in drafting or reviewing agreements, are confronted with the issues discussed.

PART ONE

I. General Considerations for Contract Drafting.

A. The Basic Elements of an Effective Contract.

The most basic goal in drafting a contract is to produce a document that is easily understandable to both lawyers and non-lawyers. Since today's courts increasingly resolve contract disputes by relying solely on the words found within the four-corners of a contract, it is of paramount importance that parties precisely draft the instruments that set forth their contractual rights and obligations. Doing so requires the effective incorporation of at least four elements into every contract:

- A correct, accurate articulation of the deal being memorialized;
- A complete statement of all possibilities and contingencies;
- An exactness that avoids vague statements and ambiguity; and
- An ability to withstand adversarial review.¹

While not necessarily its most important attribute, a contract's ability to withstand adversarial review is critical and serves as a useful reference point for all contract drafting. This is because it is virtually inevitable that at some point after its execution, someone will review a contract to determine if a breach has occurred or if more favorable terms than those in place may be obtained. Bearing in mind the inevitability of adversarial review will thus serve a contract drafter well.

¹ GEORGE W. KUNEY, *THE ELEMENTS OF CONTRACT DRAFTING 5* (West Law School, 2003).

B. Selected Drafting Tips.

Use plain English and write for an ordinary reader. One of the most repeated adages in legal writing instruction is that briefs and contracts should feature plain English and be devoid of legalese. As Bryan Garner notes, commentators have been urging the application of plain English to legal documents for nearly 200 years.² One might conclude that the repeated plea for plain English demonstrates that excising legalese from a lawyer's written work product is an exercise in futility. Garner, however, urges that the repeated calls for plain English in legal writing serve as a reminder to the draftsman against lapsing into obtuse, overly technical legal jargon.

Do not use "and/or." The phrase "and/or" is at once conjunctive and disjunctive. It therefore lends itself to ambiguity and should be avoided. Careful examination of a sentence where "and/or" is being considered will almost always provide guidance as to whether use of the conjunctive or disjunctive is warranted.

Be wary of the word "shall." Used properly, "shall" creates a duty that attaches to a given individual. Courts, however, have frequently held that "shall" can mean (1) must, (2) may, (3) will, and (4) is. To avoid potential ambiguity, avoid using the word "shall" unless a duty is being created.

Be consistent. Consistency of form and style is essential to a well-drafted contract. As noted, adversarial review of a contract is a practical certainty. Lack of consistency in a contract will simply provide fodder for an adversarial reader, allowing them to argue that the inconsistencies in a contract are indicative of the parties' intent to give differing meanings to otherwise like rights or obligations.

Effect/Affect. "Effect" as a noun means "result" or "appearance." As a verb it means "to bring about" or "to accomplish." "Affect" is a verb meaning "to influence" or "to simulate."

² BRYAN A. GARNER, LEGAL WRITING IN PLAIN ENGLISH 90 (The University of Chicago Press, 2001).

For amounts, use numerals, not words. Frequently, numbers in legal documents are both spelled out and represented as numerals. The use of numerals and words to denote amounts originated as a means of guarding against forgery. When both are used, however, the risk of an unintentional discrepancy increases. Therefore, unless strong concerns about the risk of forgery are present, it is advisable to use only numerals to denote amounts.

The foregoing, of course, represents only a small number of general drafting tips and guidelines. For further suggestions and rules to use in drafting legal documents, *see* BRYAN A. GARNER, *LEGAL WRITING IN PLAIN ENGLISH* (2001), GEORGE W. KUNEY, *THE ELEMENTS OF CONTRACT DRAFTING* (2003), and J. Lanier Yeates, *Best Practice in Contract Drafting*, *ADVANCED CONTRACT RISK MANAGEMENT IN UPSTREAM OIL AND GAS AMERICAS* (2006).

II. Drafting Issues to Consider with Respect to Select Liability Issues that may arise after an Assignment under Texas Law.

A. Overview of the Issue.

As practitioners and persons in the energy industry know, it is common for a lease or an interest in a lease to be assigned.³ Typically, leases are assigned, either in whole or in party, through a farmout, a purchase agreement, or an area-of mutual-interest clause.⁴ As a lease conveys a fee simple determinable in oil and

³ A lessee may freely assign his rights in an oil and gas lease unless the lease contains an express prohibition against assignment. *Heffington v. Hellums*, 212 S.W.2d 245, 248 (Tex. Civ. App. 1948). Courts generally hold that any restriction on assignment in a lease must be reasonable; absolute restrictions against assignment are disfavored. *See* William A. Burford & George A. Snell, III, *Basic Conveyancing Rules for Mineral Deeds and Assignment of Oil and Gas Leases*, STATE BAR OF TEX. (2011).

⁴ERNEST E. SMITH & JACQUELINE LANG WEAVER, 3 *TEXAS LAW OF OIL AND GAS* § 16.5(A), at 23 (2d ed. 1998 & Supp. 2011). For a general discussion of assignments of oil and gas leases, *see* Burford & Snell, III, *supra* note 3.

gas, any assignment of the lessee's interest or an overriding royalty must comply with the statute of frauds.⁵

Frequently, the assignor of an oil and gas lease has entered agreements related to the lease. Most commonly, an assignor is party to a joint operating agreement.⁶ Additionally, an assignment may reference farmout agreements, preferential rights, gas-purchase agreements, or area of mutual interest obligations.⁷ When a lease is assigned, the assignor's interest is often conveyed "subject to" these agreements.⁸ In such situations, questions may arise regarding the liability of the assignor and assignee under the agreements made "subject to" the assignment. This section of the paper examines how these questions are answered under Texas law and provides drafting tips to address situations that may arise with

⁵ Smith & Weaver, *supra* note 4 at 23-24. Texas law provides that a landowner owns the minerals beneath his land in fee simple and may sever the minerals from the surface through a grant of the minerals or a reservation of them in a conveyance of the property. *Texas Co. v. Daugherty*, 176 S.W. 717, 719 (Tex. 1915) (holding that landowner owns oil, gas, and other minerals beneath his land in fee simple). When a severance occurs, two distinct estates are created, the surface estate and the mineral estate. *Humphreys-Mexia Co. v. Gammon*, 254 S.W. 296, 302 (Tex. 1923). Both of these estates possess all of the attributes of an estate in land. Thus, subsurface minerals, apart from the surface estate, are subject to absolute ownership in fee simple, thereby providing the owner of a mineral estate with fundamental rights akin to those that attach to the ownership of a surface estate, for example, the right to sell or convey all or a portion of the owner's interest in the mineral estate. ERNEST E. SMITH & JACQUELINE LANG WEAVER, 1 TEXAS LAW OF OIL AND GAS § 2.1(A)(1), at 5 (2d ed. 1998 & Supp. 2011). Ownership of a mineral estate carries with it five essential attributes, consisting of the right to: (1) develop; (2) lease; (3) receive bonus payments; (4) receive delay rentals; and (5) receive royalty payments. *French v. Chevron U.S.A., Inc.*, 896 S.W.2d 795, 797 (Tex. 1995). Each of these attributes may be separately conveyed or reserved by a landowner and each is a real property interest that may be owned independently or in any combination with the others. *See id.* Landowners rarely possess the resources necessary to develop a mineral fee by themselves; therefore, it is common for landowners to transfer to an oil and gas company the right to develop the mineral fee. SMITH & WEAVER, *supra* note 5, § 2.1(A)(1), at 10. Transfer of the right to develop occurs through the execution of an oil and gas lease, entered by a landowner pursuant to his right to lease. *Id.*

⁶ Dick Watt, *Privity of Contract and Estate in Oil & Gas Law*, ENERGY LAW INSTITUTE FOR ATTORNEYS AND LANDMEN 1-2 (2007).

⁷ *Id.*

⁸ *Id.*

respect to the liability of an assignor or assignee under an assignment made “subject to,” or otherwise referring to, agreements relating to an assigned oil and gas lease.⁹

B. Privity of Contract, Privity of Estate, and Covenants Running with the Land.

Although courts do not apply them in an entirely uniform manner, as noted by several commentators,¹⁰ the concepts of privity of contract, privity of estate, and covenants running with land are central to understanding the liabilities arising from agreements made subject to the assignment of an oil and gas lease.

Fundamentally, privity of contract pertains to the contractual relationship between the parties to a contract.¹¹ Privity of contract comes into being when two parties enter a contract.¹² As an

⁹ When an assignment occurs, issues may also arise regarding responsibility for performance of the obligations imposed by the lease itself. Generally, an assignee of an oil and gas lease is bound to perform the duties and obligations imposed under the lease being assigned and those contained in the assignment. The duties and obligations transferred to an assignee include any express or implied covenants of the lease that run with the land. It is accepted that an ultimate assignee of a lease is responsible for carrying out express covenants that run with the land, leases, however, are frequently assigned multiple times; therefore, questions may arise as to whether an initial or intermediate assignee is also liable for the performance of a covenant. For a general discussion of these issues, see SMITH & WEAVER, *supra* note 4, §§ 16(B)(5)(1)-16(C).

¹⁰ See, e.g., Watt, *supra* note 6, at 5; Michel E. Curry, *Operations Not Covered or Inadequately Covered by the Joint Operating Agreement and Other Problem Areas II*, AM. ASS'N OF PETROLEUM LANDMEN 14-15 (2009). One source of inconsistency in application of the concepts arises from the use by some courts of landlord-tenant law in assessing the liability of an assignor and assignee of an oil and gas lease. Pursuant to established landlord-tenant law, the assignee of a lease (the tenant) remains liable to the landlord under the terms of the lease even after he assigns the lease to a third party. An oil and gas lease in Texas, however, is not akin to a typical residential or commercial property lease in that an oil and gas lease creates a determinable fee. When an oil and gas lease is assigned, a fee is conveyed; as such, pursuant to the real property law of covenants running with fees, liability of an initial assignee for a covenant in a subsequently assigned oil and gas lease should end upon reassignment. SMITH & WEAVER, *supra* note 4, § 16(B)(5)(1).

¹¹ Amco Trust, Inc. v. Naylor, 317 S.W.2d 47, 50 (Tex. 1958).

¹² See *id.*

elementary example, when A enters a contract with B, whereby A agrees to buy natural gas from B, and B agrees to sell natural gas to A, A and B are in privity of contract. Regardless of any subsequent assignment, A and B will remain in privity of contract. As a consequence of being in privity of contract with B, if A assigns the contract to C, A, as the assignor, will nevertheless remain primarily liable to B under contract, the general principle of law being that one who is in privity of contract with another will remain liable for the performance of its obligations under the contract, even after the contract is assigned. For its part, C, as the assignee of A, will acquire A's rights under the contract between A and B; however, C will not acquire A's duties under the contract between A and B unless C expressly agrees to perform those duties.

While privity of contract is generally unique to the original parties to a contract,¹³ privity of estate can arise between an original lessor of real property¹⁴ and an assignee of a lessee's entire interest in the lease.¹⁵ "An assignment creating privity of estate occurs when a lessee executes an instrument conveying his entire estate and interest under a lease to a subsequent lessee so that the original lessee retains no reversionary interest under the lease whatsoever."¹⁶ Thus, for privity of estate to exist, there must be "a

¹³ An assignment wherein the assignee expressly assumes all of the assignor's rights and duties under a contract may result in privity of contract being created between the assignee and the lessor. *See* 718 Assocs., Ltd. v. Sunwest N.O.P., Inc., 1 S.W.3d 355, 361 (Tex. App. 1999).

¹⁴ *See* Wayne Harwell Properties v. Pan Am. Logistics Ctr., Inc., 945 S.W.2d 216, 218 (Tex. App. 1997) (stating that privity of estate involves interests in real property).

¹⁵ *Tawes v. Barnes*, 340 S.W.3d 419, 429 (Tex. 2011).

¹⁶ *Id.* As stated in *Tawes*, a lessee must convey his *entire* interest, with no possibility of reversion, to create privity of estate between an assignee and lessor. *Tawes* thus raises the possibility that the conveyance of a portion of a lease will not create privity of estate between a lessor and assignee, even when the assignor retains no reversionary interest in the portion of the lease assigned. *Id.*

mutual or successive relationship to the same rights of property.”¹⁷ For example, if A, as lessor, executes an oil and gas lease with B, as lessee, A and B are in privity of estate. If B subsequently assigns its interest in the lease to C, and retains no reversionary interest, C will be in privity of estate with A, while privity of estate between A and B will no longer exist.

Intertwined with privity of estate is the concept of covenants running with the land. Specifically, privity of estate dictates that when he acquires a real property interest, an assignee is liable for the performance of all covenants running with the land.¹⁸ A covenant runs with the land when (1) there is privity of estate between the parties, (2) the covenant touches and concerns the land,¹⁹ (3) the covenant relates to a thing in existence or specifically binds the parties and their assigns, (4) the parties intended the covenant to run with the land, and (5) the successor to the covenant has notice of its existence.²⁰ Thus, referring back to the simple example in the preceding paragraph, because it is in privity of estate with A after the assignment from B, C will be obligated to perform any covenant running with the land that pertains to the leases assigned to it by B. In general terms, C will not be liable for the breach of any covenant running with the land that occurs prior to the assignment, but, C is liable for any covenant running with land that is breached after it takes its interest from B.²¹

¹⁷ *Westland Oil Dev. Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903, 910-11 (Tex. 1982).

¹⁸ *See Amco Trust, Inc. v. Naylor*, 317 S.W.2d 47, 50 (Tex. 1958).. Covenants that do not run with the land are considered personal covenants. An assignee is not obligated to perform personal covenants unless he expressly assumes them. *See Jones v. Cooper Indus., Inc.*, 938 S.W.2d 118, 122-23 (Tex. App. 1996).

¹⁹ Although whether a covenant “touches and concerns” the land can be somewhat elusive, the Texas Supreme Court has noted that where a covenantor’s legal interest as owner is rendered less valuable by the promise or where the covenantee’s legal interest as owner is rendered more valuable by the promise, the benefit or burden in question touches and concerns the land. *See Westland Oil*, 637 S.W.2d at 911.

²⁰ *Inwood N. Homeowners’ Ass’n v. Harris*, 736 S.W.2d 632, 635 (Tex. 1987). The express and implied covenants contained in an oil and gas lease are covenants running the land. 55A TEX. JUR. 3d *Oil & Gas* § 514 (2011).

²¹ *Lone Star Gas Co., a Div. of Enserch Corp. v. Mexio Oil & Gas, Inc.*, 833

To summarize:

- The parties to a contract are in privity of contract, and, generally, will remain in privity of contract even if one party assigns its interest in the contract. Flowing from this proposition of law, an assignor will remain primarily liable on the contract even after an assignment. Conversely, an assignee will be bound to perform only those duties under the primary contract that it expressly assumes.
- Parties are in privity of estate when they have “a mutual or successive relationship to the same right in property.” When a lessee assigns its entire interest in the property to an assignee, and retains no reversionary interest, the assignee will be in privity of estate with the lessor and privity of estate between the lessor and the lessee/assignor will be destroyed. If an assignee is in privity of estate with the lessor, the assignee is obligated to perform any covenants running with the land with respect to the transferred property interest. An assignee is not, however, liable for breaches of covenants that occurred before privity of estate existed between the assignee and the lessor.

With the foregoing principles as backdrop, we can now examine select cases determining how liabilities arising from agreements made “subject to” an assignment of an interest in an oil and gas lease may befall the parties after the assignment is made, and, can propose select drafting tips for addressing these issues.

C. *Seagull Energy E & P, Inc. v. Eland Energy, Inc.: A Seller’s Continuing Liability for Operating Expenses after the Assignment of Its Interest in a Lease.*

1. Facts and Holding of the Case.

In *Seagull Energy E & P Inc. v. Eland Energy, Inc.*, the Texas Supreme Court held that the sale of an oil and gas working interest subject to an operating agreement did not relieve the seller of

S.W.2d 199, 202 (Tex. App. 1992) (holding that privity of estate is the essence of covenants running with the land and therefore “the assignee is not liable for breaches that took place before him.”).

further obligations to the operator under the terms of the operating agreement.²²

Under the facts of the case, Seagull Energy E & P, Inc. was the lessee and operator of two offshore oil and gas leases.²³ Eland Energy, Inc. purchased a working interest in the leases, and thus became an intermediate assignee. Each of the interests purchased by Eland were subject to identical operating agreements; as recited in the opinion, Eland assumed certain rights and responsibilities under these two operating agreements. In pertinent part, the operating agreements provided that Eland and the other lessees were to share the cost of operations in proportion to their respective interests.²⁴

Approximately two years after acquiring them, Eland sold its interests in the leases to Nor-Tex Gas Corporation, also assigning to Nor-Tex its rights and obligations under the operating agreements. Subsequently, Nor-Tex failed to pay Seagull for Nor-Tex's proportionate share of operating costs, specifically, plugging and abandonment costs; Seagull attempted to recover these costs from Eland, but Eland refused to pay on the basis that it no longer owned an interest in the leases. Thereafter, Seagull brought suit against Eland and Nor-Tex for breach of the operating agreements.²⁵

At trial, Seagull obtained a summary judgment concluding that Nor-Tex breached the operating agreement by failing to pay its proportionate share of operating expenses and that Eland remained liable for those unpaid expenses. The trial court awarded Seagull \$268,418.90 in damages, finding that Eland and Nor-Tex were jointly and severally liable.²⁶

Eland appealed the trial court's judgment and the court of appeals reversed, concluding that Eland had no continuing liability under

²² 207 S.W.3d 342 (Tex. 2006).

²³ *Id.* at 344.

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

the operating agreements following its assignment to Nor-Tex because the operating agreements did not expressly provide that Eland's obligations would continue after assignment. Furthermore, the court of appeals noted that the operating agreements conditioned the obligation to pay a proportionate share of operating expenses on ownership of an interest in the leases. Thus, because it did not own any interest in the leases after the assignment, Eland could not be liable for subsequently incurred operating expenses.²⁷

On appeal to the Texas Supreme Court, Seagull argued that basic contract law provided that an assignor's obligations under a contract would continue after assignment unless the contract expressly provided otherwise or the assignor obtained an express release. According to Seagull, since the operating agreements were silent on the subject of whether Eland's obligations ended upon assignment, and Seagull had not released Eland, general contract law dictated that Eland remained liable for Nor-Tex's unpaid share of operating expenses.²⁸

The Texas Supreme Court agreed with Seagull, finding that none of the provisions in the operating agreement dealt "specifically with the present circumstances" and that the operating agreements "simply [did] not explain the consequences of an assignment of a working interest to a third party."²⁹ Due to this lack of clear language providing that one would only be liable for operating expenses so long as it owned an interest in the leases, the Court applied the principle of contract law that "a party cannot escape its obligations under a contract merely by assigning the contract to a third party."³⁰ According to the Court, "[b]ecause the operating agreement did not expressly provide that Eland's obligations under the operating agreement should terminate upon assignment and Seagull did not expressly release Eland following the assignment

²⁷ *Id.* at 345.

²⁸ *Id.*

²⁹ *Id.* at 346.

³⁰ *Id.* at 346-47.

of its working interest,” Eland remained obligated to pay Seagull for the operating costs incurred after the assignment to Nor-Tex.³¹

Although never expressly mentioning it, and at one point meandering into a discussion more akin to covenants running with the land,³² the Texas Supreme Court’s holding in *Seagull* is largely derived from the principle flowing from privity of contract that a party cannot escape its contractual obligations simply by assigning a contract to a third party.³³ Rather, as a general rule, the assignor of a contract will remain liable for performance of its contractual obligations even after the contract is assigned. As noted, *Seagull* provides two mechanisms for an assignor to avoid continued liability under an assigned contract: (1) express language in the contract absolving the assignor of performance of its contractual obligations after assignment; or (2) an express release obtained by the assignor from its counterparty to the primary contract.³⁴ As it can generally not be expected that an operator will agree to a release, it is important that any party to an operating agreement who anticipates the prospect of assignment includes within the agreement express language relieving it of the responsibility of performing its obligations upon assignment. Suggested language for accomplishing this in onshore operations is included in the following section.

2. Drafting Tips.

Many commentators have noted that certain aspects of *Seagull* suggest that its holding is more limited than it may at first appear. For instance, David Patton has observed that, although not stated in the opinion, the Texas Supreme Court may have been motivated by equitable considerations, namely, that a lessee should not be able to hold a property while it is profitable, and then, at the end of the property’s economic life, transfer its interest in the property to an

³¹ Nor-Tex was not a party to the appeal and had filed bankruptcy. The holding in the case, however, is consistent with Eland and Nor-Tex being joint and severally liable, as was found by the trial court.

³² *Seagull Energy*, 207 S.W.3d at 347.

³³ David Patton, *Bad Moon Rising—The Continuing Liability of an Assignee after Assignment*, 53 ROCKY MTN. MIN. L. INST. 31 (2007).

³⁴ *Seagull Energy*, 207 S.W.3d at 345.

insolvent entity, thereby avoiding its share plugging and abandonment costs.³⁵

Furthermore, Smith and Weaver have noted that *Seagull* concerned an offshore operating agreement and that it remains unsettled as to whether a Texas court would find that the AAPL's 1989 Model Form onshore operating agreement relieves a party for post-assignment costs.³⁶ As noted by Smith and Weaver, article VIII.D of the 1989 Model Form provides, in pertinent part, that "[n]o assignment or other disposition of interest by a party shall relieve such party of obligations *previously incurred* by such party hereunder with respect to the interests transferred"³⁷ According to Smith and Weaver, this language may support "a negative inference that an assignment would relieve the assignor of obligations subsequently incurred with respect to the interest transferred."³⁸ But, it remains unclear whether a court would hold that the negative inference supplied by article VIII.D suffices to meet the test for avoiding continuing liability that is set forth in *Seagull*.³⁹ Notably, the 1989 Model Form, like other onshore operating agreement promulgated by the AAPL, does not contain express language of release.⁴⁰

As the 1989 Model Form cannot be conclusively said to eliminate the risk of continuing liability posed by *Seagull*, the best course for practitioners is to include in any new operating agreement or related agreement express language providing for release upon assignment. To accomplish this when using the 1989 Model Form, David Patton has suggested the following language:

Subject to compliance with the requirements of Article VIII.D and Article VIII.F, any assignment, conveyance, or other transfer of an

³⁵ Patton, *supra* note 33.

³⁶ SMITH & WEAVER, *supra* note 4 § 17.3(C)(3).

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

oil and gas lease or oil and gas interest that is subject to this operating agreement shall relieve the transferor from liability for the cost and expense of operations attributable to the transferred interest which are conducted after the effective date of such assignment, conveyance or other transfer (the “Effective Date”), including, without limitation, all liabilities, responsibilities, duties and obligations relating to plugging and abandonment of wells after the transfer effective date; provided however, that, the transferor shall remain liable for and shall cause to be paid its proportionate part of the cost and expense of all operations for which it was obligated to pay and were commenced prior to the transfer effective date, except costs and expenses arising out of or directly related to a specific operation in which the transferor elected (or was deemed to have elected) not to participate pursuant to Article VI. From and after the transfer effective date, the transferee, and not the transferor, shall be deemed to be a party to this operating agreement.

Use of the foregoing should of course be modified as needed on a case-by-case basis.

D. *Lone Star Gas Co. v. Mexia Oil & Gas, Inc.*: Lease Assignments Made “Subject To” Agreements that are Not Assumed by the Assignee.

1. Facts and Holding of Case.

In *Seagull*, the court notes that when it sold Nor-Tex its interests in the leases, Eland also assigned to Nor-Tex its “rights and obligations under the operating agreements.” Although the significance of this is not explored in the Supreme Court’s opinion, likely due to the fact that Nor-Tex was not a party to the appeal, the case of *Lone Star Gas Co. v. Mexia Oil and Gas, Inc.* illustrates the principle that an assignee who acquires lease and royalty interests “subject to” an existing claim of a third person is not liable for that claim unless the assignee expressly or impliedly assumes the outstanding obligation.⁴¹

⁴¹ 833 S.W.2d 199 (Tex. App. 1992).

In the case, Lone Star entered a gas-purchase agreement with Reita Production, Inc. in October 1981 whereby Lone Star agreed to buy, and Reita agreed to sell, natural gas produced from a well in Jack County, Texas.⁴² The well was located on a tract for which the company Quadco was the assignee of the oil and gas lease.⁴³ Reita was the operator of the well.

The terms of the gas-purchase agreement between Lone Star and Reita called for Reita to pay the state severance taxes on delivered gas; Lone Star would then fully reimburse Reita for payment of the severance taxes, with Reita agreeing to indemnify and hold Lone Star harmless with respect to the tax payments.⁴⁴

In November 1982, Mexia Oil & Gas, Inc. notified Lone Star that it had purchased all of Reita and Quadco's interest, and that it had taken over as operator of the well. Mexia forwarded to Lone Star, among other documents, a copy of the assignment from Quadco to Mexia of Quadco's lease interests and overriding royalty interests. The assignment provided that it was made "subject to" the gas-purchase agreement between Reita and Lone Star.⁴⁵

In 1985, the Texas Comptroller Office notified Lone Star that the taxes due on production for the months of January through March 1982 were unpaid. Lone Star had reimbursed Reita \$20,431 for Reita's presumed payment of these taxes, as called for under the original terms of the gas-purchase agreement; but, Reita had failed to pay the taxes.⁴⁶

After paying the outstanding taxes, Lone Star requested payment from Mexia. When Mexia refused Lone Star's request, Lone Star brought suit against Reita and Mexia. Lone Star based

⁴² *Id.* at 200.

⁴³ *Id.* at 200 n.1.

⁴⁴ *Id.* at 200.

⁴⁵ *Id.* at 201.

⁴⁶ *Id.* at 200. At Reita's request, Reita and Lone Star agreed to a division order providing that Lone Star would pay the taxes directly and then deduct the tax payments from its production payments to Reita. The tax arrangement set forth in this division order did not go into effect until April 1982 and thus did not implicate the taxes for which Lone Star sought reimbursement. *Id.*

its claim against Mexia on the contention that Mexia, as successor under the gas-purchase agreement, had as a matter of law assumed Reita's contractual obligation to indemnify Lone Star for the taxes.⁴⁷ In support of this contention, Lone Star advanced four arguments.

First, Lone Star contended that Mexia had expressly assumed the indemnity obligation by virtue of the assignment from Quadco to Mexia being made "subject to" the gas-purchase agreement. The court rejected this argument, stating that "[t]he acceptance of an assignment 'subject to' a specified claim of a third person is not an implied promise by the assignee to pay that claim. There must be express promissory words or words of 'assumption' on the part of the assignee."⁴⁸

Second, Lone Star claimed that Mexia, independent of the assignment, had expressly assumed the obligation by virtue of a division order entered between Lone Star and Mexia after the assignment. The court, too, rejected this argument, noting that the division order called for Lone Star to pay the taxes on production itself, deducting the amount of taxes paid from the production payment to Mexia. Thus, as the division order did not contemplate Mexia reimbursing Lone Star for the payment of any future taxes, the court concluded that the division order could not constitute an express assumption by Mexia to reimburse Lone Star for Reita's prior unpaid taxes.⁴⁹

Third, Lone Star asserted that Mexia impliedly assumed the gas-purchase agreement's indemnification clause because the clause was a covenant running with the land. The court rejected this argument on the ground that one cannot incur liability for a

⁴⁷ *Id.* at 201

⁴⁸ In holding that making an assignment "subject to" a prior agreement did not amount to an implied assumption of any of the assignor's obligations under that prior agreement, the court was likely recognizing the well understood principle that inclusion of a "subject to" clause in the assignment of an oil and gas lease serves the purpose of protecting the assignor against a future breach of warranty claim by the assignee. See *Averyt v. Grande, Inc.*, 717 S.W.2d 891, 894 (Tex. 1996).

⁴⁹ *Lone Star Gas Co.*, 833 S.W.2d at 202.

covenant running with the land absent privity of estate.⁵⁰ Thus, because the breach at issue, Reita's failure to pay taxes, occurred prior to the assignment, Mexia could not be obligated to reimburse Lone Star for the taxes, even assuming that the contractual indemnity provision was a covenant running with the land.⁵¹

Finally, Lone Star contended that the court should find that Mexia impliedly assumed the obligation by holding on equitable grounds that the benefits Mexia received under the gas-purchase agreement were so entwined with the agreement's burdens that Mexia would be unjustly enriched if it was not required to assume the obligation to reimburse Lone Star for the taxes. While recognizing that such implied assumptions on equitable grounds were possible, the court rejected this argument because Lone Star had "reimbursed" Reita for the unpaid taxes, not Mexia. Mexia thus received no benefit from Lone Star and was not unjustly enriched.⁵²

2. Drafting Tips.

Lone Star Gas illustrates that if a party assigning an interest in a lease wants its assignee to bear the responsibility of performing an obligation stemming from an agreement made "subject to" the assignment and accruing prior to the assignment, that party should include language in the assignment that expressly binds the assignee with respect to the obligation.⁵³ Simply making

⁵⁰ *Id.* Presumably, a party could assume an obligation for a covenant running with the land that accrued prior to its acquiring an interest in the land, much like a party can assume a contractual obligation.

⁵¹ *Id.*

⁵² *Id.* at 202-03. As an example of an implied assumption based on equitable grounds, the court referred to *Kirby Lumber Co. v. R.L. Lumber Co.* In that case, a buyer agreed to pay Kirby for timber it cut from Kirby's land. The buyer assigned the contract and its assignee proceeded to cut and remove timber from Kirby's land, but refused to pay for it, claiming that it had not assumed any obligation to do so. The court in *Kirby* found that contrary to its claims, the assignee had, on equitable grounds, impliedly assumed the obligation to pay for the timber. *Kirby Lumber Co. v. R.L. Lumber Co.*, 279 S.W. 546 (Tex. Civ. App. 1926).

⁵³ This applies whether the obligation in question is in the nature of an expressly stated contractual obligation or a covenant running with the land. As noted by the court in *Lone Star Gas*, with respect to a covenant running with the land, an

an assignment “subject to” an existing obligation or agreement will not suffice—the assignment must include express promissory words or words of assumption on the part of the assignee indicating that it is assuming the obligation.⁵⁴ It is thus advised that any obligation the parties to an assignment intend for the assignee to assume be expressly and unambiguously identified in the assignment’s substantive provisions, with further detail being provided in an attached and incorporated exhibit, if warranted.

In drafting an assignment so that an assignee expressly assumes an obligation of its assignor, one must also consider the fact that an assignee’s assumption of an obligation does not necessarily relieve the assignor of liability for the obligation. For instance, assume that Mexia did expressly assume Reita’s obligation to pay the severance taxes sought by Lone Star. This assumption by Mexia would not relieve Reita of its own obligation to Lone Star for the taxes. Indeed, Reita would likely remain liable to Lone Star under privity of contract, and, assuming the contractual indemnity obligation was a covenant running with the land, privity of estate, since the obligation accrued prior to assignment. In view of this, when the parties to an assignment intend for an antecedent obligation to be assumed by the assignee, a provision in the assignment should be included whereby the assignee agrees to defend and indemnify the assignor in the event the assignor incurs any damages caused by the assignee’s failure to perform the assumed obligation.

E. *Westland Oil Dev. Corp. v. Gulf Oil Corp.*: Privity of Estate and Area of Mutual Interest Clauses.

1. Facts and Holding of Case.

Westland Oil illustrates how an assignee can be liable for an obligation that is “subject to” an assignment when an assignee is in

assignee cannot be liable for a breach that occurs prior to assignment due to the lack of privity of estate. Therefore, for such liability to attach to an assignee, it would presumably be necessary for the assignee to assume the obligation. *See Lone Star Gas, Co.*, 833 S.W.2d at 202.

⁵⁴ *Id.* at 201.

privity of estate with the party to whom the obligation is owed and the obligation is a covenant running with the land.⁵⁵ In such cases, no express assumption of the obligation is necessary (although, as noted, it must arise after the assignment creating privity of estate occurs).

Under the facts of *Westland Oil*, Mobil Oil Corporation owned oil and gas leases in 29 sections of the Rojo Caballos Field in Pecos County, Texas. With respect to three of these sections 19, 23, and 24, Mobil entered a farmout agreement with Westland Oil Development Company providing that if it complied with its drilling obligations under the farmout, Westland would receive an assignment from Mobil of one-half of Mobil's interest in sections 19, 23, and 24.⁵⁶

Thereafter, by a November 15, 1966 letter agreement (the "Letter Agreement"), Chambers & Kennedy took over Westland's obligations under its farmout agreement with Mobil. Among other things, the Letter Agreement assigned to Westland an overriding royalty and working interest in any acreage earned from Mobil under the farmout. In addition, the Letter Agreement included an area of mutual interest clause ("AMI") providing that if any parties to the Letter Agreement or their assigns acquired "any additional leasehold interests affecting any of the lands covered by said farmout agreement . . . such shall be subject to the terms and provisions of this agreement."⁵⁷

Chambers & Kennedy⁵⁸ successfully performed the drilling obligations required by the farmout agreement and earned the acreage. Thereafter, on March 7, 1968, Mobil conveyed to Chambers & Kennedy one-half of its leasehold interests in the farmout block, including sections 19, 23, and 24. The assignment

⁵⁵ 637 S.W.2d 903 (Tex. 1982).

⁵⁶ *Id.* at 905.

⁵⁷ *Id.* An AMI is a "statement that all the parties [to the AMI] have a mutual interest in a certain geographic area and provides that if any one of them obtains an oil and gas interest in this area, the other parties have a right to participate in the interest." Smith & Weaver, *supra* note 4 at § 16.4(A).

⁵⁸ There were other investors in the well; Chambers & Kennedy is referred to exclusively for the sake of convenience. *Westland Oil*, 637 S.W.2d at 905.

from Mobil to Chambers & Kennedy provided that as to all lands and depths assigned, with one exception, it was made subject to the provisions of a March 1, 1968 operating agreement (the “Operating Agreement”).⁵⁹

The Operating Agreement provided, in pertinent part, that (1) in the event of a conflict between it and certain prior agreements, including the Letter Agreement, the prior agreements controlled, and (2) the interests of the parties to the Operating Agreement were subject to the farmout agreement between Mobil and Westland and the March 7, 1968 assignment from Mobil to Chambers & Kennedy.⁶⁰

Subsequently, in April 1972, Mobil entered a farmout agreement with Bernard Hanson. That farmout agreement provided, in pertinent part, that if Hanson commenced and completed a producing well on section 25 of the Rojo Caballos Field, Mobil would assign to Hanson certain leasehold rights in various sections in the field, including sections 19, 23, and 24, the same three sections involved in the Mobil-Westland farmout. The farmout agreement between Mobil and Hanson stated that the lands and leases covering sections 19, 23, and 24 were covered by the Operating Agreement, and that any interest earned by Hanson would be subject to the Operating Agreement.⁶¹

Hanson assigned his farmout agreement with Mobil to Gulf Oil Corporation and Superior Oil Company. Hanson also entered similar farmout agreements with Chambers & Kennedy covering part of their interests in sections 19, 23, and 24, and, for the most part, referred to the Operating Agreement. Hanson also assigned these farmout agreements to Gulf and Superior.⁶²

In March 1973, Gulf and Superior completed a well that was a large gas producer, thereby earning the acreage under the various farmout agreements assigned to them by Hanson. On May 22,

⁵⁹ *Id.* at 905-06.

⁶⁰ *Id.* at 906.

⁶¹ *Id.* at 906-07.

⁶² *Id.* at 907.

1973, Mobil assigned to Gulf and Superior their earned leasehold estates, including those in sections 19, 23, and 24. This assignment was also made subject to the Operating Agreement.⁶³

When it learned of Mobil's May 22, 1973 assignments to Gulf and Superior, Westland brought suit seeking a declaratory judgment that the Letter Agreement, and thus its AMI clause, was valid, entitling Westland to an overriding royalty and working interest in the leasehold estate acquired by Gulf and Superior in sections 19, 23, and 24. The Texas Supreme Court, with certain exceptions not relevant here, agreed with Westland, holding that the AMI obligation was a covenant running with the land that Westland could enforce against Gulf and Superior.⁶⁴

In its holding, the court noted that the requisite elements of an enforceable covenant running with the land were all present. First, it found that Gulf and Superior were on constructive notice of the AMI obligation because the March 7, 1968 assignment was recorded and made "subject to" the Operating Agreement, which in turn was effectively "subject to" the Letter Agreement containing the AMI obligation. Therefore, Gulf and Superior, who the court found had a duty to make investigation of the Operating Agreement, could not defeat liability for a covenant running with the land by virtue of being innocent purchasers.⁶⁵ Second, the court found that as to sections 19, 23, and 24, Westland was in privity of estate with Gulf and Superior because the parties had a "mutual or successive relationship to the same rights of property."⁶⁶ Third, the AMI obligations expressly applied to assigns, a fact that is indicative, although not dispositive, of an intent for an obligation to be a covenant running with the land.⁶⁷ Finally, the court concluded that the AMI obligation touched and

⁶³ *Id.*

⁶⁴ *Id.* at 910-11.

⁶⁵ *Id.* at 907-09.

⁶⁶ *Id.* at 910-11.

⁶⁷ See *Montfort v. Trek Res., Inc.*, 198 S.W.3d 344, 355 (Tex. App. 2006). In *Grimes v. Walsh & Watts, Inc.*, the El Paso Court of Appeals held that an AMI that is not expressly binding on successors and assigns is a personal covenant and thus not binding on successors in interest. 649 S.W.2d 724 (Tex. App. 1983).

concerned the land because it affected the nature and value of the conveyed leasehold estates.

2. Drafting Tips.

Westland Oil is illustrative of how privity of estate and covenants running with the land can bind assignees. *Westland Oil* thus suggests that when drafting agreements practitioners should be sensitive to potential liability issues that may arise through privity of estate and covenants running with land. Drafting tips to consider with respect to these issues include, but are certainly not limited to, the following:

- As noted, making an agreement binding on “successors and assigns” generally indicates that the parties to the agreement do not intend for its obligations to be merely personal, but rather, to be binding on successors in interest. Such language is thus consistent, although not dispositive, of the parties’ intent for an agreement’s obligations to run with the land.⁶⁸
- When the parties are particularly desirous that an agreement’s obligations run with the land, it may be prudent to include language expressly stating this. For instance, “The terms, covenants, and conditions stated herein shall be binding upon and inure to the benefit of the parties to this agreement and their respective heirs, assigns, successors, and permitted assigns, and the terms, covenants, and conditions stated herein are covenants running with the land.” Note, however, that merely stating that obligations are intended to be covenants running with the land will not necessarily make it so; for instance, if an obligation plainly does not touch and concern the land, it is doubtful that a court will consider it a covenant running with the land regardless of the parties’ expressed intent.⁶⁹
- On a related note, as the original parties’ intent is a factor in determining whether an obligation is a covenant running with the land, when parties do not desire that an obligation run with the land, they should consider including a

⁶⁸ See *Montfort*, 198 S.W.3d at 355.

⁶⁹ See *id.*

statement to this effect in their agreement. Here, it is important to emphasize the importance of being consistent throughout an agreement. For instance, stating that a particular obligation is not intended by the parties to run with the land may allow for an inference that other obligations are intended to run with the land. This illustrates the general rule that one must always anticipate when drafting an agreement that it will at some point in time be read in an adversarial context.

- Note that in 2011, the Texas Supreme Court, in *Tawes v. Barnes*, held that a provision in a joint operating agreement requiring consenting working interest owners to pay lessors the share of royalties due from non-consenting working interest owners did not create privity of estate between the consenting owners and the lessor.⁷⁰ The Court based its holding on the fact that the provision in question provided that the non-consenting owners' working interest in the well would revert back to them after a period of time, thereby destroying privity of estate. Furthermore, the court noted that joint operating agreements "are used for the primary purpose of allocating costs and revenues from production amongst the parties to the agreement, not to permanently transfer ownership interests in pooled oil and gas leases."⁷¹ The court went on to note that the operating agreement in question, an AAPL 1982 Model Form, specifically stated that "[n]othing contained in this [contract] shall be deemed an assignment or cross-assignment of interests covered hereby."⁷² Parties not using a form operating agreement containing a disclaimer of assignment should add such a provision in order to provide themselves with maximum protection against a claim by a lessor that an operating agreement creates privity of estate.

⁷⁰ 340 S.W.3d 419.

⁷¹ *Id.* at 429.

⁷² *Id.*

III. Drafting Considerations and Force Majeure Provisions.

A. Overview of the Issue.

In the last seven years, oil and gas operations in the Gulf of Mexico and surrounding areas have experienced Hurricanes Katrina, Rita, and Ike, as well as the Macondo blowout and resulting six-month moratorium on deepwater drilling operations. These events greatly impaired the ability of many parties in the energy industry to perform their contractual obligations and resulted in several parties invoking the force majeure provisions in their contracts as a means of excusing performance. As the potential for similar disrupting events remains omnipresent, it is vital that participants in the energy industry ensure that their contracts—be they oil and gas leases, drilling contracts, exploration agreements, natural gas supply contracts, or any other industry agreement—contain robust, enforceable force majeure provisions. This section of the paper provides an overview of the law of force majeure, and, situated against that backdrop, offers various tips to incorporate into one’s drafting and review of force majeure provisions.

B. General Principles of the Law of Force Majeure that are Important to Understand When Drafting or Reviewing a Force Majeure Provision.

Force majeure⁷³ generally refers to an event or occurrence that is beyond the reasonable control of the party affected, and, despite its exercise of due diligence, the affected party is unable to prevent.⁷⁴ Thus, force majeure has often been “likened to impossibility, [and] historically embodied the notion that parties could be relieved of performing their contractual duties when performance was prevented by causes beyond their control.”⁷⁵

⁷³ Literally translated, force majeure means “greater force.”

⁷⁴ See J. Lanier Yeates, *The Force Majeure Provision: Faux Stipulation?*, UNIV. OF TEX. OIL & GAS MINERAL LAW INST. (2006).

⁷⁵ Sun Operating Ltd. P’Ship v. Holt, 984 S.W.2d 277, 282-83 (Tex. App. 1998)

At common law, if an event purporting to excuse performance was not unforeseeable and the affected party did not use reasonable efforts to overcome the event, force majeure could not be successfully invoked.⁷⁶ This outcome likely derives from the fact that the common law origins of force majeure are rooted in the doctrines of impossibility of performance and commercial impracticability.⁷⁷ The well established trend, however, is that today's courts will apply a force majeure provision in strict conformity with the terms of the contract in which it appears. "In other words, when the parties have themselves defined the contours of force majeure in their agreement, those contours dictate the application, effect and scope of force majeure."⁷⁸ Accordingly, in Texas, when an event that gives rise to force majeure is stipulated in the party's agreement, the party seeking to invoke force majeure need not show that the event in question was "unforeseeable."⁷⁹ Similarly, absent express contractual language to the contrary, a Texas court will not require that a party seeking to invoke force majeure use reasonable efforts to overcome the disrupting event.⁸⁰

In sum, when a Texas court is confronted with a claim that performance was excused by force majeure, it will seek to resolve the claim by reference to the parties' contract.⁸¹ If the contract's force majeure provision is unambiguous, the court will construe its

citing 6A CORBIN, CORBIN ON CONTRACTS § 1324 (1962).

⁷⁶ *See id.*

⁷⁷ *See Yeates, supra* note 74.

⁷⁸ *Sun Operating*, 984 S.W.2d at 284.

⁷⁹ *See, e.g., Eastern Airlines v. McDonnell Douglas Corp.*, 523 F.2d 957, 992 (5th Cir. 1976) (holding that when event giving rise to force majeure is specified in contract, party invoking force majeure need not show that event was unforeseeable); *Kodiak Drilling P' Ship v. Delhi Gas Pipeline Corp.*, 736 S.W.2d 715, 721 (Tex. App. 1987) (same).

⁸⁰ *See PPG Industries v. Shell Oil Co.*, 727 F. Supp. 285, 286 (E.D. La. 1989) (applying Texas Law), *aff'd*, 919 F.2d 17 (5th Cir. 1990); *Sun Operating*, 984 S.W.2d at 283-84.

⁸¹ *Sun Operating*, 984 S.W.2d at 282-83.

meaning as a matter of law by according the provision's words their plain, grammatical meaning.⁸² In view of this controlling emphasis on the plain written terms of a force majeure provision as it appears in the parties' contract, it is of paramount importance that practitioners exercise great care in defining the contours of a force majeure clause. Tips for doing so are provided below.

C. Tips for Drafting and Reviewing Force Majeure Provisions

One of the first steps in preparing a force majeure provision is determining the events that the parties wish to constitute force majeure. Events that should be considered include, but are not limited to, the following:⁸³

- Acts of God,⁸⁴ actions of the elements, weather delays, and natural disasters;
- The loss or destruction of the subject matter of the contract;
- Riots, strikes, lockouts, work stoppages, and other labor disputes;⁸⁵
- Accidents;
- War, national emergency, and civil unrest;
- Delays caused by a party to the contract or a third party;
- Power outages;
- The death, incapacity, or illness of a party;
- Laws, acts, rules, regulations, and orders of government agencies or officers;

⁸² *See id.*

⁸³ Caution should be taken to ensure that no event within the control of a party to the contract can serve as the basis for force majeure.

⁸⁴ "Act of God" is not a term with a universally accepted meaning; therefore, the term should be defined within the four-corners of the contract at issue. Generally, the term is defined to mean an occurrence that directly and exclusively results from the occurrence of natural causes that could not have been prevented by the exercise of foresight or caution.

⁸⁵ One should consider including language in a force majeure provision providing that a party is not relieved of performance as a result of its own work stoppages or labor disputes.

- Delays in necessary administrative acts of government agencies, e.g. the failure to issue a permit; and
- Disruptions in transportation.

After determining what events will serve as the potential basis for force majeure, it is critical to specify what reasonable efforts, if any, a party must take to overcome the event. As noted, a Texas court will not require the exercise of reasonable efforts to overcome a disrupting event unless such efforts are expressly required in the contract. Furthermore, many form contracts do not provide much, if any, guidance regarding the reasonable efforts required to overcome the events giving rise to force majeure.⁸⁶ Consequently, considerable thought should be given to the issue of what reasonable efforts are to be required of a party seeking to invoke force majeure.

Also of great importance when drafting a force majeure provision is carefully setting forth what the consequences of a force majeure event will be on the parties' obligations under the contract. Most fundamentally, it must be determined if an event of force majeure will entirely excuse a party's performance or will only allow for a delay in performance until the condition giving rise to force majeure abates. If the latter option is desired, terms must be included in the contract with respect to how long performance can be excused and how any costs associated with time delays are to be calculated. A contract's force majeure provision should also set forth how notice of a force majeure event and its consequences is to be communicated between the parties and when any response to this notice is due.

⁸⁶ See, e.g., *Virginia Power Energy Mktg., Inc. v. Apache Corp.*, 297 S.W.3d 397, 404 (Tex. App. 2009) (declining plaintiff's request to interpret "reasonable efforts" clause to require gas supplier to deliver gas to location other than that expressly agreed upon by parties when clause was not defined in parties' agreement).

PART TWO

IV. Overview of Louisiana Mineral Interests.

The term “minerals rights” is defined in Article 16 of the Louisiana Mineral Code⁸⁷ to include three basic interests: the mineral servitude, the mineral royalty and the mineral lease.⁸⁸ Mineral rights are real rights and are subject either to prescription of non-use for ten years or to special rules of law governing the term of their existence.⁸⁹ A landowner may convey, reserve or lease his exclusive minerals rights.⁹⁰ All mineral rights are alienable and heritable.⁹¹

Under Louisiana’s theory of non-ownership-in-place of minerals, ownership of land in Louisiana excludes ownership of oil, gas and other minerals naturally occurring in liquid or gaseous form.⁹² Although a landowner does not actually own oil, gas and other fugitive minerals underlying the surface of his property, he has the exclusive right to explore and develop his property for the production of such minerals and to reduce them to possession and ownership.⁹³

A. Mineral Servitude.

The mineral servitude doctrine is perhaps the most unusual feature of Louisiana mineral law when compared to other states. When the

⁸⁷ References to the Mineral Code herein are to the Louisiana Mineral Code codified at La. Rev. Stat. Ann. § 31:1 *et seq.* (2012). Mineral Code articles correspond to the same numbers under Title 31 of the Louisiana Revised Statutes.

⁸⁸ LA. REV. STAT. ANN. § 31:16 (2012) (“This enumeration does not exclude the creation of other mineral rights by a landowner.”).

⁸⁹ *Id.*

⁹⁰ LA. REV. STAT. ANN. § 31:15 (2012).

⁹¹ LA. REV. STAT. ANN. § 31:16.

⁹² *See* LA. REV. STAT. ANN. § 31:5 (2012).

⁹³ LA. REV. STAT. ANN. § 31:6 (2012).

exclusive right to explore and develop minerals is separated from fee title, either by sale to a third party or by sale of land with a reservation of the right in the vendor, a mineral servitude is created.

The Louisiana Mineral Code defines a mineral servitude as, “the right of enjoyment of land belonging to another for the purpose of exploring for and producing minerals and reducing them to possession and ownership.”⁹⁴ The mineral servitude is an incorporeal immovable that may be bought and sold like any other immovable property and is thus, subject to the same rules of registry. The mineral servitude is subject to the prescription of nonuse for ten years.⁹⁵

The Louisiana law of mineral servitudes is codified in Articles 21-79 of the Mineral Code which provides detailed rules regarding: (1) who may create the mineral servitude (Articles 24 - 26); (2) termination of the mineral servitude (Article 27); (3) prescription of the mineral servitude (Articles 28-61); (4) indivisibility of the mineral servitude (Article 62-71); and (5) contracts and transactions affecting the mineral servitude (Articles 72-79).⁹⁶

B. Mineral Royalty.

In addition to mineral servitudes, Louisiana law recognizes the mineral royalty as a right in minerals that may be created by the landowner or a mineral servitude owner.⁹⁷ Generally, a mineral interest owner reserves a royalty in an oil and gas lease. A royalty may also be created in a deed transferring land or by the assignment of all or part of the lessee’s working interest. “‘Royalty,’ as used in connection with mineral leases, means any interest in production, or its value, from or attributable to land

⁹⁴ LA. REV. STAT. ANN. § 31:21 (2012).

⁹⁵ LA. REV. STAT. ANN. § 31:27 (2012).

⁹⁶ See generally John M. McCollam, *A Primer for the Practice of Mineral Law Under the New Louisiana Mineral Code*, 50 TUL. L. REV. 729, 739-760 (1976).

⁹⁷ See LA. REV. STAT. ANN. §§ 31:80-81 (2012).

subject to a mineral lease, that is deliverable or payable to the lessor or others entitled to share therein.”⁹⁸ Such interests in production or its value are royalties, whether created by the lease or by separate instrument, if they comprise a part of the negotiated agreement resulting in execution of the lease.⁹⁹

A mineral royalty differs from a mineral servitude because the mineral royalty owner only receives a passive interest in production; he has no right to conduct operations to explore for or produce minerals.¹⁰⁰ Unless expressly qualified by the parties, a royalty is a right to share in gross production free of drilling and production costs.¹⁰¹ The mineral royalty, like the mineral servitude, is subject to the prescription of nonuse for ten years.¹⁰²

The Louisiana law of mineral royalties is codified in Articles 80-105 of the Mineral Code which provides detailed rules regarding (1) who may create the mineral royalty (Articles 82-84); (2) termination of the mineral royalty (Article 85); (3) prescription of the mineral royalty (Articles 86-100); (4) indivisibility of the mineral royalty (Articles 101-102); and (5) contracts and transactions affecting the mineral royalty (Articles 103-105).¹⁰³

1. Overriding Royalty.

Typically, the term overriding royalty is used to describe a mineral royalty carved out of the working interest created by an oil and gas lease. “An overriding royalty is an interest severed out of the working interest or lessee’s share of the oil, free of the expenses of development, operation and production. Its duration is limited to the life of the lease from which it was created.”¹⁰⁴ Under Louisiana

⁹⁸ LA. REV. STAT. ANN. § 31:213 (2012).

⁹⁹ *Id.*

¹⁰⁰ LA. REV. STAT. ANN. § 31:81.

¹⁰¹ LA. REV. STAT. ANN. § 31:80.

¹⁰² LA. REV. STAT. ANN. § 31:85 (2012).

¹⁰³ *See generally* McCollam, *supra* note 96 at 761-767.

¹⁰⁴ Pinnacle Operating Co. v. ETTCO Enterprises, Inc., 914 So.2d 1144 (La. App. 2 Cir. 2005) (citing WILLIAMS & MEYERS, OIL AND GAS LAW § 418 (1991)). The term “working interest” is defined *infra*, n. 113.

law, an overriding royalty interest is necessarily dependent upon the continued existence of the lease and is not subject to the prescription of non-use for that reason.¹⁰⁵

C. Mineral Lease.

A mineral lease is the instrument by which a leasehold or working interest is created in minerals.¹⁰⁶ The Mineral Code defines a mineral lease as a “contract by which the lessee is granted the right to explore for and produce minerals. A single lease may be created on two or more noncontiguous tracts of land, and operations on the land burdened by the lease or land unitized therewith sufficient to maintain the lease according to its terms will continue it in force as to the entirety of the land burdened.”¹⁰⁷ The lessee’s interest in a mineral lease may be assigned or subleased in whole or in part.¹⁰⁸ The assignment of a lease is a sale of a real right.¹⁰⁹ The mineral lease, although not subject to the prescription of nonuse, cannot be continued for longer than ten years without drilling, mining operations, or production.¹¹⁰

The Louisiana law of mineral leases is codified in Articles 114-148 of the Mineral Code which provides detailed rules regarding (1) who may create the mineral lease (Articles 116-119); (2) obligations of the mineral lessor (Articles 119-121); (3) obligations of the mineral lessee (Articles 122-125); (4) transactions affecting the mineral lessee’s interest (Articles 126-132); (5) termination and

¹⁰⁵ LA. REV. STAT. ANN. § 31:126 (2012).

¹⁰⁶ PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS MANUAL OF OIL AND GAS TERMS 545 (LexisNexis, 13th ed. 2006).

¹⁰⁷ LA. REV. STAT. ANN. § 31:114 (2012).

¹⁰⁸ LA. REV. STAT. ANN. § 31:127 (2012). *See also id.* § 31:128, comments and cases cited thereunder, for discussion regarding distinction between an assignment (and partial assignment) and a sublease of a mineral lease. *See also* Patrick S. Ottinger, *What’s in a Name? Assignments and Subleases of Mineral Leases Under Louisiana Law*, 58 ANN. INST. ON MIN. LAW (2011).

¹⁰⁹ *Berwick Mud Co. v. Stansbury*, 205 So. 2d 147, 149 (La. App. 3 Cir. 1967).

¹¹⁰ LA. REV. STAT. ANN. § 31:115 (2012).

remedies under the mineral lease (Article 133-143); (6) leases involving outstanding mineral rights (Article 144-145); and (7) the lessor's privilege (Article 146-148).¹¹¹

1. Working Interest and Leasehold Interest.

The term "leasehold interest" means the rights that a grantee or lessee has under an oil and gas lease.¹¹² The term "working interest" is generally viewed as synonymous with the extent of a lessee's "leasehold interest" in a tract of land or subsurface geological strata thereunder.¹¹³ Both terms typically refer to an "operating interest"¹¹⁴ under an oil and gas lease, which gives the holder of the interest the exclusive right to exploit the minerals on the leased premises and the burden to pay the costs of developing and operating the leased premises.¹¹⁵ Working interests and leasehold interests are wholly (and partially) assignable and heritable.

V. Assumption and Release of Personal Obligations in Mineral Conveyances.

A. General Principles – Louisiana Law.

Instruments transferring minerals typically define how the rights and obligations of the parties, including liabilities under contracts affecting the minerals, will be shared post-transfer. The following section outlines Louisiana's basic rules for the transfer and assumption of personal rights and obligations in mineral

¹¹¹ See generally, McCollam, *supra* note 96, at 782-835.

¹¹² MARTIN & KRAMER, *supra* note 106, at 550.

¹¹³ See Pinnacle Operating Co. v. ETTCO Enterprises, Inc., 914 So.2d 1144, 1146 (La. App. 2 Cir. 2005).

¹¹⁴ See MARTIN & KRAMER, *supra* note 106, at 708. An operating interest is basically a mineral interest minus the royalty interest(s) – i.e. the interest burdened with the cost of developing and operating the subject property. *Id.*

¹¹⁵ *Id.* at 1158.

conveyances. Both the Civil Code and the Mineral Code authorize this type of transaction.

1. Civil Code.

Louisiana law recognizes two basic kinds of obligations: real and personal obligations. The Louisiana Civil Code does not define a personal obligation. It defines a real obligation as “a duty correlative to a real right.”¹¹⁶ Real rights confer direct and immediate authority over a thing. Real rights are distinguished from personal (obligatory) rights that merely confer authority over the person of a certain debtor who has assumed the obligation to allow the enjoyment of a thing by his creditor.¹¹⁷ In contrast to a real right which defines the relation of man to things, a personal right “refers merely to any obligation one owes to another which may be declared only against the obligor.”¹¹⁸

Real obligations are transferred subject to significantly different rules than personal obligations. Real obligations attaching to an immovable “run with the land” and thus, they are:

transferred to the universal or particular successor who acquires the ... immovable thing to which the obligation is attached, without a special provision to that effect.

But a particular successor is not personally bound, unless he assumes the personal obligations of his transferor with respect to the thing, and he may liberate himself of the real obligation by abandoning the thing.¹¹⁹

¹¹⁶ LA. CIV. CODE ANN. art. 1763 (2012); *see also* Hawthorne Oil & Gas Corp. v. Continental Oil Co., 368 So.2d 726 (La. App. 3 Cir. 1979) (using “real obligation” to refer to those obligations incurred as a result of ownership or possession of a thing burdened by a real right),.

¹¹⁷ *See* 5 A.N. Yiannopoulos, LOUISIANA CIVIL LAW TREATISE, The Law of Obligations §§ 3.1-3.1 (2nd ed. 2001).

¹¹⁸ *Joslyn Mfg. Co. v. Koppers Co.*, 40 F.3d 750, 756 (5th Cir. 1994) (citing 4 Yiannopoulos, Louisiana Civil Law Treatise Property § 203, at 370).

¹¹⁹ LA. CIV. CODE ANN. art. 1764 (2012).

Whereas personal obligations are subject to the general law on assumption of obligations which provides:

An obligor and a third person may agree to an assumption by the latter of an obligation of the former. To be enforceable by the obligee against the third person, the agreement must be made in writing. The obligee's consent to the agreement does not effect a release of the obligor. The unreleased obligor remains solidarily bound with the third person.¹²⁰

A person who, by agreement with the obligor, assumes the obligation of the latter is bound only to the extent of his assumption. The assuming obligor may raise any defense based on the contract by which the assumption was made.¹²¹

Thus, the most important distinction is that personal obligations, unlike real obligations, can only be transferred and assumed by third persons by virtue of an express writing.

Under these articles, once a third person agrees in writing to assume an obligor's personal obligation, the obligee may demand performance directly from the assuming third person.¹²² Thus, the obligee is made a third party beneficiary of that assumption agreement.¹²³ Likewise, when the assumption is by agreement between the obligee and the assuming obligor, it is the original obligor who is made a third party beneficiary of that agreement, since it gives him the benefit of having his obligation performed by another.¹²⁴ Such a *stipulation pour autrui* gives the third party the right to enforce that contractual provision by directly suing the party that has assumed the obligation.¹²⁵

¹²⁰ LA. CIV. CODE ANN. art. 1821 (2012).

¹²¹ LA. CIV. CODE ANN. art. 1822 (2012).

¹²² *See id.* and comment (b) thereto.

¹²³ Louisiana Civil Code article 1978 provides that “[a] contracting party may stipulate a benefit for a third person called the third party beneficiary.” LA. CIV. CODE ANN. art. 1978 (2012).

¹²⁴ *See* LA. CIV. CODE ANN. art. 1823 (2012).

¹²⁵ *See* LA. CIV. CODE ANN. arts. 1978 and 1821 (comment (a)).

The intent of the contracting parties to stipulate a benefit in favor of a third party is never presumed; it must be made manifestly clear.¹²⁶ Similarly, the fact that a provision in a contract confers an incidental benefit on a third party does not constitute a *stipulation pour autrui*.¹²⁷ Rather, that advantage must actually form the consideration for the contract.¹²⁸

Likewise, to establish contractual intent for one party to a contract to assume obligations benefiting a nonparty obligee of the other party, the contract must “clearly contemplate(s) the benefit to the third person as its condition or consideration.”¹²⁹ The intent to assume the obligation must be clearly expressed on the face of the documents.¹³⁰ While “explicit reference to the individual, assumed obligation” is not necessary, the clear intent to benefit the third party must be “apparent from the face of the document.”¹³¹

As stated, to be enforceable by the obligee against the third person, the assumption agreement between the latter and the obligor must be made in writing.¹³² Note, however, that an assumption agreement can be valid and enforceable between the *obligor* and the third person even without a writing, unless a writing is required by some other rule, as when their agreement involves immovable property.¹³³

¹²⁶ See *Homer Nat'l Bank v. Tri-District Dev. Corp.*, 534 So.2d 154, 156 (La. App. 3 Cir. 1988).

¹²⁷ See *New Orleans Pub. Serv., Inc. v. United Gas Pipe Line Co.*, 732 F.2d 452, 467 (5th Cir. 1984).

¹²⁸ See *id.*

¹²⁹ *Davis Oil Co. v. TS, Inc.*, 145 F.3d 305, 311 (5th Cir. 1998).

¹³⁰ *Pinnacle Operating Co. v. ETTCO Enterprises, Inc.*, 914 So.2d 1144, 1149 (La. App. 2 Cir. 2005).

¹³¹ *Id.*

¹³² See *id.* at 1149; *Eastman Kodak Co. v. Latter & Blum, Inc.*, 578 So.2d 1004, 1006 (La. App. 4 Cir. 1991).

¹³³ LA. CIV. CODE ANN. art. 2440 (2012); *cf.*, *U-Serve Petroleum and Investments, Inc. v. C. Cambre*, 486 So. 2d 821, 825 (La. App. 1 Cir. 1986).

Where a third person agrees to assume the obligor's obligation, both the third person and the obligor become solidarily bound to the obligee.¹³⁴ In other words, the original debtor is not released from his original debt, and the assumption of obligation does not effect a novation by substitution of a new obligor.¹³⁵ This is because the original obligation is not extinguished by the assumption. Thus, as a general rule, a party who transfers, by assignment or otherwise, its contractual rights and duties to a third party remains liable unless expressly and affirmatively released by the other party to the contract.¹³⁶ This is true even if the obligee to whom the debt is owed consents to the assumption.¹³⁷ Furthermore, even if a party is released from its contractual obligations, it will not be discharged from its statutory obligations.¹³⁸

Moreover, without an effective release, the original debtor and the "assuming" debtor remain *solidarily* liable for the assumed debt.¹³⁹ An obligation is solidary for the obligors when each obligor is liable for the whole performance. A performance rendered by one of the solidary obligors discharges the obligation, and consequently, relieves the others of liability toward the obligee.¹⁴⁰

2. Mineral Code.

The Mineral Code provides special rules for the transfer of mineral leases. As explained, a mineral lease is a real right.¹⁴¹ Thus, when

¹³⁴ LA. CIV. CODE ANN. art. 1821 (revision comment (b)).

¹³⁵ LA. CIV. CODE ANN. art. 1821 (revision comment (d)). *See* LA. CIV. CODE ANN. arts. 1879-1887 for novation principles.

¹³⁶ *See, e.g.,* Chieftain Inter. (U.S.), Inc. v. Southeast Offshore, Inc., 553 F. 3d 817, 819 (5th Cir. 2008); Joslyn Mfg. Co. v. Koppers Co., 40 F.3d 750, 758-759 (5th Cir. 1994).

¹³⁷ LA. CIV. CODE ANN. art. 1821 (2012).

¹³⁸ *See, e.g.,* LA. ADMIN. CODE § 43:137 and 30 C.F.R. §§ 250.1700-250.1754 (2012).

¹³⁹ *See* LA. CIV. CODE ANN. art. 1821 (revision comments (c) and (f)); *Chieftain*, 553 F. 3d at 819.

¹⁴⁰ LA. CIV. CODE ANN. art. 1794 (2012).

¹⁴¹ *See* LA. REV. STAT. ANN. § 31:16 (2012).

a mineral lease is assigned or sublet, an assignee or sublessee “stands in the shoes” of his assignor with respect to the lease and with respect to the lessor. Louisiana Mineral Code article 128 provides “to the extent of the interest acquired, an assignee or sublessee acquires the rights and powers of the lessee and becomes responsible directly to the original lessor for performance of the lessee’s obligations.”¹⁴² Also relevant is Louisiana Mineral Code article 129 which provides “an assignor or sublessor is not relieved of his obligations or liabilities under a mineral lease unless the lessor has discharged him expressly and in writing.”¹⁴³

Importantly, Articles 128 and 129 provide lessors certain rights to demand performance; they do not expressly purport to affect the relationship between assignors-sublessors and assignees-sublessees. In at least one case, however, a court interpreted Article 128 to impose privity of contract between a lessee-sublessor and a sublessee once removed, which would seem to expand the definition of an “original lessor” to include a lessee-sublessor.¹⁴⁴

The Codal assumption principles set above also apply to the transfer of a mineral lease (and other mineral interests regulated by the Mineral Code, including royalties and overriding royalties). In the event of conflict between the provisions of the Mineral Code and those of the Civil Code, the provisions of the Mineral Code will prevail.¹⁴⁵

¹⁴² LA. REV. STAT. ANN. § 31:128 (2012).

¹⁴³ LA. REV. STAT. ANN. § 31:129 (2012).

¹⁴⁴ See *Robinson v. North Am. Royalties, Inc.*, 463 So. 2d 1384 (La. App. 3 Cir. 1986) (holding that Article 128 allows a lessee-sublessor to enforce obligations created in its sublease against a sublessee once removed); *but see*, *Chevron U.S.A., Inc. v. Traillour Oil Co.*, 987 F. 2d 1138, 1158 (5th Cir. 1993) (applying Louisiana law) (refusing to extend privity under the article for lessee-assignors and assignees once removed or “between all successors in interest to an oil and gas lease”).

¹⁴⁵ See LA. REV. STAT. ANN. § 31:2 (2012).

B. Selected Louisiana Case Law Involving Assumption and Release of Personal Obligations in Mineral Lease Conveyances.

In Louisiana, an obligation contained in a mineral conveyance is thus, either a real obligation (for example, an obligation to the lessor to pay royalties under a mineral lease) or a personal obligation (for example, an obligation to pay costs under an operating agreement affecting a mineral lease).¹⁴⁶ Assumption and release of the latter type of obligation is addressed in the following selected case law.

1. *Transworld Drilling Co. v. Texas General Petroleum Co.*, 524 So. 2d 215 (La. App. 4 Cir. 1988).

In *Transworld*, the court held that where an assignment is made “subject to” an operating agreement, it is a question of fact as to whether an assignee assumes his assignor’s liabilities for lease operating expenses that were incurred before filing for bankruptcy protection.

As part of its bankruptcy proceeding, defendant TGP transferred its interest in various mineral leases to Marmid. TGP’s creditors, seeking to enforce certain rights and obligations under an operating agreement with TGP, sued Marmid on the theory that Marmid, as TGP’s assignee, assumed the obligations arising out of the parties’ operating agreement.¹⁴⁷ The relevant assignment contained a section which provided that Marmid would be liable for various assets and liabilities of TGP. It stated as follows:

¹⁴⁶ As an additional example, compare the obligation of a lessee to plug and abandon wells under a mineral lease which transfers automatically to each successor who acquires an interest in the lease with the personal obligation of an assignee to an assignor to perform these obligations does not. *See infra* notes 161-67 and accompanying text.

¹⁴⁷ *Transworld Drilling Co. v. Texas General Petroleum Co.*, 524 So.2d 215, 216-17 (La. App. 4 Cir. 1988).

This assignment is made expressly subject to the following:

1. Except as the same may be limited by the Agreed Order of July 18, 1984, the terms, provisions, conditions and obligations of:

...

C. any operating agreements in force relating to any of the properties and interests described in Exhibit "A";¹⁴⁸

Marmid argued that it did not expressly assume or consent to perform TGP's obligations and pointed out that the assignment was silent regarding any operational responsibilities. It also argued, citing Louisiana Civil Code article 1847, that extrinsic evidence is inadmissible to establish a promise to pay the debt of another, and thus, only the language contained within the four corners of the agreement was relevant.¹⁴⁹ The court, focusing on the "subject to" language quoted above, concluded that a genuine issue of fact remained as to whether Marmid intended to assume TGP's obligations arising out of the operating agreement and whether it intended to pay the amounts owed to those partners.

Because the assignment is silent as to the definition of the type of TGP operational agreements included, the instrument is ambiguous as to the intent of the parties' assumptions of liability. The evidence may establish that Marmid assumed the primary obligations of TGP, rather than merely the collateral agreement of suretyship. If so, parol evidence is admissible.¹⁵⁰

¹⁴⁸ *Id.* at 216.

¹⁴⁹ *Id.* at 217. Louisiana Civil Code article 1847 provides: "[p]arol evidence is inadmissible to establish either a promise to pay the debt of a third person or a promise to pay a debt extinguished by prescription."

Note that an assumption of obligation differs from a promise to pay the debt of a third person. In the former, a promise is made by a third person to the obligor, while in the latter a promise is made by a third person to the obligee. It appears that *Transworld* presents an assumption issue (not a promise to pay problem) since Marmid contracted with TGP (the obligor), not the other working interest owners (the obligees).

¹⁵⁰ *Id.* at 218 (citations omitted).

It is unclear as to whether the operating agreement here was recorded, although it is unlikely.¹⁵¹

2. *Avatar Exploration, Inc. v. Chevron, U.S.A., Inc.*, 933 F. 2d 314 (5th Cir. 1991).

In *Avatar*, the federal Fifth Circuit (applying Louisiana law) held that an assignee who took a lease “subject to” an overriding royalty was not obligated by the deed’s extension and renewal clause¹⁵² to pay the overriding royalty on a top lease acquired by the assignee.

The following facts are relevant in this case: Avatar obtained a mineral lease (the “Avatar Lease”) and assigned overriding royalty interests in that lease to several individuals. The overriding royalty assignments contained the following extension and renewal clause:

In the event [Assignor] secures an extension, correction or renewal of any lease subject hereto prior to the termination of such lease or within one year there-after, or if [Assignor] secures a new lease covering any or all lands described in the leases subject hereto prior to the termination of such leases or within one (1) year thereafter, then the overriding royalty interest reserved [assigned] herein shall attach to and burden such extension, renewal or new lease, and [Assignor], if requested to do so by [Assignees] shall

¹⁵¹ *Id.* In Louisiana, when an operating agreement (or declaration of operating agreement) is filed for registry in the conveyance records of the parish or parishes where the lands affected by the mineral rights are located, it is binding upon third persons. See LA. REV. STAT. ANN. §§ 31:216-217 (2012). Note, however, that no court has decided the extent to which third persons are bound by the contents of the unrecorded provisions where only a declaration has been filed.

¹⁵² An extension and renewal clause is a common contractual provision for the protection of an overriding royalty owner. This clause, also called an “anti-washout provision”, generally provides that the override shall apply to and burden future extensions or renewals of the lease. Its purpose is to prevent a washout or elimination of an override by the surrender of the lease and subsequent reacquisition of a lease free of the burdened interest. See *Avatar Exploration, Inc. v. Chevron, U.S.A., Inc.*, 933 F. 2d 314, 319 (5th Cir. 1991) (applying Louisiana law); *Otter Oil Co. v. Exxon Co., U.S.A.*, 834 F. 2d 531 (5th Cir. 1987).

execute a recordable instrument evidencing the existence and effectiveness of the overriding royalty.¹⁵³

Avatar later assigned the Avatar Lease to Gulf (now Chevron). The lease assignment included a provision making the assignment “subject to the terms and provisions contained in that certain assignment of Overriding Royalty Interest...between Avatar... and [the overriding royalty owners].”¹⁵⁴

In the last month of the Avatar Lease’s primary term, a third party, Murexco, acquired an option for a mineral lease effective on the date of expiration of the Avatar Lease (the “top lease”). Later that month, still during the Avatar Lease’s primary term, Gulf made an agreement with Murexco that Murexco would exercise its option and then assign that top lease to Gulf if Gulf agreed not to commence operations under the Avatar Lease. Gulf did not commence operations and let the Avatar Lease expire later that month. Murexco exercised its option and assigned the top lease to Gulf. Gulf later refused to execute recordable instruments acknowledging that the overrides burdened that top lease.¹⁵⁵ The overriding royalty owners then instituted suit against Gulf/Chevron.

After reviewing the general purpose of extension and renewal clauses, the court first found that extension and renewal clauses “are for the purpose of extending the overriding royalty interest to new leases obtained on the same property by the same lessee.”¹⁵⁶ Second, with respect to the specific instruments in the case, the court found that the overriding royalty assignments, to which Gulf was not a party, “addressed only the relationship between Avatar and [the over-riding royalty owners].”¹⁵⁷ It explained that these overriding royalty assignments “did not contemplate extending the renewal and extension clause to assignees of Avatar such as Gulf”,

¹⁵³ *Avatar*, 933 F. 2d at 318.

¹⁵⁴ *Id.* at 319.

¹⁵⁵ *Id.* at 316.

¹⁵⁶ *Id.* at 319.

¹⁵⁷ *Id.*

and thus the overriding royalty owners had to show that Gulf expressly assumed Avatar's obligations thereunder.¹⁵⁸

On this second point, the court also found the "subject to" language of the lease assignment from Avatar to Gulf unavailing.¹⁵⁹

the language of the assignment from Avatar to Gulf did not make Gulf responsible for Avatar's covenants in the Royalty Assignments. The "subject to" language of the assignment is critical. It did nothing more than put Gulf on notice of an existing burden on the lease it received from Avatar. It did not graft the renewal and extension clause and accompanying duties into the assignment from Avatar to Gulf.¹⁶⁰

Thus, the court concluded that the overriding royalty interests had terminated with the expiration of the Avatar Lease, and that neither the extension and renewal clause nor the "subject to" language attached those interests to the top lease or obligated Gulf to recognize them as burdens on the toplease.

3. *Chevron U.S.A., Inc. v. Traillour Oil Co., 987 F. 2d 1138 (5th Cir. 1993).*

In *Chevron U.S.A., Inc. v. Traillour Oil Co.*, the federal Fifth Circuit (applying Louisiana law) held that remote assignees were not liable to the original lessee for plug and abandonment

¹⁵⁸ *Id.* at 319.

¹⁵⁹ The district court also explained that: "this language creates no new obligations on any party, however; it merely puts Gulf on notice of an existing burden on the Property that conditions the leasehold interest it is receiving through the assignment. Gulf would be obligated to pay any royalties due from production only because, after agreeing to the Gulf Assignment, it is the holder of all the rights and interests of the Avatar Lease. There is nothing in the "subject to" language that would transfer the extension and renewal provisions' obligations, specifically put therein upon Avatar, to Gulf." *Id.* at 5-6.

¹⁶⁰ *Id.* at 319; *see also* *Grace-Cajun Oil Co. No. 3 v. FDIC*, 882 F. 2d 1008 (5th Cir. 1989) (one who acquires "subject to" incurs no personal liability but "acquires property interest burdened with the obligation") (citing *H.E.P. Dev. Corp. v. Mouton*, 256 So. 2d 744 (La. App. 1 Cir. 1971)).

obligations because the assignees did not expressly assume those personal obligations in their assignments.

In this case, Gulf (now Chevron) assigned a mineral lease along with its producing wells. The assignees (Traillour and Marsh) agreed in the assignment to be responsible for plugging and abandoning the wells. An unrecorded agreement between Gulf and the assignees provided for Traillour and Marsh to present a letter of credit for two million dollars to secure their plugging and abandonment obligations. The assignees also made a side agreement with a third party (Rocky Mountain) to raise the purchase money for the lease assignment and the money for the letter of credit.¹⁶¹

After several transactions in which Traillour and Marsh divested themselves of their interests to a group of investors (the “investors”), but before the work to plug and abandon had begun, the letter of credit expired. Chevron brought suit against Traillour and the investors to obtain a replacement letter of credit and to declare the plug and abandon obligations of the parties.¹⁶² Although this case was decided on multiple grounds, the relevant part deals with Chevron’s claims that 1) as successors’ in interest to Traillour, the investors were obligated to supply an additional letter of credit and 2) that, under their subleases with Traillour *et al*, the investors were also bound to indemnify Chevron for plug and abandonment liability.

First, the court held that the investors who had succeeded in interest to Traillour were not liable for a letter of credit because Traillour’s agreement was never recorded. It also explained that performance under the agreement constituted a personal obligation rather than a real obligation burdening the lease; thus, to be bound the investors would have had to expressly assumed the obligation, which they did not do.¹⁶³

¹⁶¹ 987 F. 2d 1138, 1142- 43 (5th Cir. 1993).

¹⁶² *Id.* at 1143- 44.

¹⁶³ *Id.* at 1149.

Second, the court declined to read into the investors' subleases with Traillor an express assumption of Traillor's personal indemnity obligation to Chevron. In support of its argument, Chevron relied on two paragraphs in the investors' subleases. The first provided that each investor would

assume all obligations and perform all duties resulting from the ownership of the Subject Interest conveyed hereby or imposed by any governmental authority asserting jurisdiction over the lands covered by the lease.¹⁶⁴

The second provided that

each investor (i) agreed to "comply with all of the express and implied covenants and conditions of [the Bayou Couba lease]" and (ii) obligated himself "to comply and conduct his operations hereunder in accordance with all rules and regulations of the Commissioner of Conservation."¹⁶⁵

After citing to Article 1821, the court determined that neither provision resulted in an assumption of Traillor's obligations to Chevron by the investors; rather they meant that the investors were assuming "only the real obligations running with the Bayou Couba lease, obligations running in favor of the original lessor."¹⁶⁶ Thus,

¹⁶⁴ *Id.* at 1159.

¹⁶⁵ *Id.*

¹⁶⁶ *Id.* Compare language in *Joslyn* (involving a surface lease):

the undersigned [Joslyn] agrees to carry out and perform, as well as *to be bound by* all the terms and provisions of said Industry Track Agreement of January 16, 1936, and said Lease Agreements of June 11, 1942 and November 11, 1949, *all of which are incorporated herein by reference with the same like effect as if copied herein in full.*

Joslyn, 40 F. 3d at 758 (emphasis added) (provision held to clearly express the assignee's intent to assume all obligations referenced in the lease and the track agreement, including those accruing before the effective date of the assignment).

it refused to burden the investors with Traillor's obligation to indemnify Chevron for plug and abandonment liability.

Importantly, the court made a point to distinguish the investors' subleases with the assumption provision in the original assignment from Chevron to Traillour, Marsh and Rocky Mountain. The original assignment provided that "Traillour *et al* shall comply with all of the express and implied covenants and conditions of the lease described in Exhibit 'A' and shall assume all of Gulf's obligations under said lease."¹⁶⁷ The comparison suggests that had similar language been used in the investors' subleases, the investors might have had to indemnify Chevron.

4. *Davis Oil Co. v. TS, Inc., 145 F. 3d 305 (5th Cir. 1998)*

Like *Chevron*, *Davis* involved the question of whether a remote successor to the original lessee contractually assumed his seller's indemnity obligation for plug and abandonment costs. In contrast to *Chevron*, however, the federal Fifth Circuit (applying Louisiana law) in *Davis* found that the successor had, in fact, assumed his assignor's indemnity obligation.

In *Davis*, a former operator of a state oil and gas lease (Davis) instituted suit to recover cleanup costs from a subsequent operator's successor in interest after the state required Davis to pay cleanup costs upon lease termination. Davis, as the original lessee, had transferred its interest in the lease to HPC, Inc. ("HPC") in 1981. At the same time, the parties also executed a separate unrecorded agreement obligating HPC to plug and abandon the wells and to restore the surface of the lease property.¹⁶⁸ HPC, after

¹⁶⁷ *Chevron*, 987 F.2d at 1159 n. 16 (emphasis in opinion).

¹⁶⁸ *Davis Oil Co. v. TS, Inc.*, 145 F.3d 305, 307 (5th Cir. 1998). The relevant clause provided in part:

Section 2.14 Assumption of Certain Obligations. Subject to the other provisions hereof, Buyer [HPC] agrees to assume and will pay, perform and discharge all obligations of Seller [Davis Oil] relating to the Properties to the extent such obligations (a) are attributable to the Properties, and (b) attributable to any time or period of time after the Effective Time, and (c) arise out of legally binding obligations to which

operating the lease for a period of time, assigned a portion of the lease to another party, which in turn transferred that portion to the defendant, TS/Home.¹⁶⁹

Citing to language contained in the Sale Agreement between HPC and TS/Home (quoted below in paragraph (3), Davis argued that TS/Home had assumed HPC's obligation for site cleanup costs under the unrecorded indemnification agreement between HPC and Davis. The Fifth Circuit agreed, relying on the general structure of the transaction between HPC and TS/Home and the following three agreements:

(1) the 1986 Option Agreement giving HPC's parent the right to convey HPC's "Oil and Gas Assets and Liabilities" to TS/Home, which adopts the phrase "Oil and Gas Assets and Liabilities" as it was defined in a related agreement:

[T]hose assets and liabilities of HW-GW [HPC parent] and its subsidiaries (excluding any Consolidated Indebtedness but including, without limitation, assets and liabilities of HPC Inc.) *habitually designated as part of the oil and gas division of such corporations*, which assets and liabilities as at August 31, 1985 were those set forth in Schedule D annexed hereto.¹⁷⁰

(2) the 1988 Memorandum of Understanding acknowledging that the option was being exercised and setting forth which liabilities were part of the Oil and Gas Assets and Liabilities. The Memorandum of Understanding provided in part that:

Without limiting the provisions of the [Option] Agreement ... the following liabilities shall be part of the Oil and Gas Assets and Liabilities:

the Properties are shown to be subject in the documents pursuant to which conveyances are made to Buyer hereunder, and (d) which are not the subjects of Title Defects or breaches of any representation or warranty of Seller hereunder. *Id.* at 307 n.2.

¹⁶⁹ *Id.* at 307-08.

¹⁷⁰ *Id.* at 314 (emphasis in opinion). There is no indication in the opinion as to what assets and liabilities Schedule D provided for.

(i) except as contemplated herein all obligations and liabilities of HPC and its subsidiaries at Closing, whether or not contingent, that have arisen in the ordinary course of the oil and gas business of HPC or any of its subsidiaries *carried on with the Oil and Gas Assets and Liabilities*;

(iv) except as contemplated herein, all liabilities and obligations accruing or falling due after closing, whether or not contingent, in relation to the oil and gas business theretofore conducted by HPC or any of its subsidiaries *carried on with the Oil and Gas Assets and Liabilities*.¹⁷¹

(3) the 1988 Sale Agreement providing in part that:

Assignee [TS/Home] hereby assumes, subject to the Option Agreement and Memorandum of Understanding, the following obligations and liabilities:

*2. All obligations and liabilities of Assignor at the Effective Date that have arisen in the ordinary course of its business;*¹⁷²

The Sale Agreement also contained the following exclusion:

*Except to the extent expressly assumed or required to be assumed pursuant to this Assignment, the Option Agreement or the Memorandum of Understanding, the liabilities assumed by Assignee hereunder shall not include, and Assignee and Assignee shall not assume or in any way be liable or responsible for (a) any liability or obligation of any kind incurred by or on behalf of Assignor after the Effective Date (b) any liability or obligation which may in the future be asserted against Assignee arising out of, resulting from or in connection with, Assignor's operation of its business....*¹⁷³

¹⁷¹ *Id.* at 315 (emphasis in opinion).

¹⁷² *Id.* at 313 (emphasis in opinion).

¹⁷³ *Id.* at 313. (emphasis in opinion). Note that the district court originally

TS/Home maintained that the indemnification provision that Davis sued upon was a personal obligation contained in a contract between HPC and Davis. Thus, TS/Home argued that the obligation had to be expressly (and not merely implicitly) assumed in the Sale Agreement – which it was not.

The Fifth Circuit, in finding that TS/Home was responsible for HPC’s plug and abandonment liability, concluded that TS/Home and HPC had intended to confer a “continuous and contemplated” benefit to HPC’s creditors.¹⁷⁴ Thus, even though TS/Home did not explicitly assume the cleanup obligations in the agreements, the court inferred an intended benefit from the facts and the language of the assumption agreements. The court, citing to but distinguishing *Chevron*, reasoned that explicit reference to the particular obligation is not required under Louisiana law; rather it must be apparent “from the face” of the agreement by which the assumption is made that it “clearly contemplates the benefit to the third person as its condition or consideration” – which benefit existed here.¹⁷⁵

With respect to exactly what liabilities TS/Home had assumed, the court found that under the Sale Agreement, TS/Home acquired all obligations which “arose in the ordinary course of business” which would include cleanup costs.¹⁷⁶ The court also held that TS/Home had assumed the subject liability for all assets that had been at time “habitually designated” as part of HPC’s oil and gas business.¹⁷⁷

Some commentators have questioned the *Davis* decision for inferring an intention to provide a benefit to Davis in the absence of express language stating as much.

rejected Davis’ claim, finding this exclusion determinative. *See Davis Oil Co. v. TS, Inc.*, 962 F. Supp. 872, 889-90 (E.D. La. 1/21/1997).

¹⁷⁴ *Davis*, 145 F. 3d at 313.

¹⁷⁵ *Id.* The dissent disagreed explaining that the boilerplate language used in the document fell “short of showing that the benefit to a specific third party [Davis] was contemplated as part of the [TS/Home and HPC] transaction’s condition or consideration.” *Id.* at 320.

¹⁷⁶ *Id.* at 316-17

¹⁷⁷ *Id.*

The majority's determination that the parties intended to make TS directly liable to HPC's obligees for the assumed obligations may be correct, but it certainly was not apparent from the face of the documents. There was no language in the documents to that effect. Moreover, the court's conclusion that its interpretation made "more sense" seems to be at odds with its statement that the third party benefit must be apparent from the face of the document. In fact, the court simply inferred the necessary intent based upon the inferences it drew from the "larger components of the deal."¹⁷⁸

The result here may to some degree be explained by the "labyrinth of contracts" presented by this case.¹⁷⁹

5. *Pinnacle Operating Co. v. ETTCO Enterprises, Inc.* 40, 367 (La. App. 2 Cir. 10/26/05), 914 So. 2d 1144.

In this case, a Louisiana appellate court held that where an unrecorded farmout is not expressly identified in an assignment, an assignee is not bound by the obligations in that farmout agreement, even if the assignee was aware of the particular provisions in it.

The relevant facts of *Pinnacle* are: in 1979, fewer than all the lessees in a lease covering certain acreage in Sabine Parish farmed out particular depths to White & Ellis (the "1979 Farmout"). A well was completed, but assignments that were required to be made under the 1979 Farmout were never executed or recorded. White & Ellis transferred its (unrecorded) interest to ETTCO in May 2000, at which time the 1979 Farmout and the ETTCO conveyance were first recorded in the appropriate records. Previously, however, the original farmers in the 1979 Farmout had already assigned their rights in the leases to one of the co-lessees (Everett) who had not originally signed the 1979 Farmout. Everett, in February 2000, had transferred his entire leasehold interest to Pinnacle.¹⁸⁰

¹⁷⁸ Guy E. Wall and C. Peck Hayne, Jr., *Fifth Circuit Symposium: Oil & Gas*, 44 LOYOLA L. REV. 519, 529 (1998).

¹⁷⁹ *Davis*, 145 F. 3d at 311.

¹⁸⁰ *Pinnacle*, 914 So.2d at 1146-47.

ETTCO was acting as operator of several wells on the subject lease when Pinnacle applied for a drilling permit - which it was promptly denied. Pinnacle then filed suit against ETTCO. ETTCO in turn filed a third party demand against Everett arguing that pursuant to his assignments with the original farmers, Everett had assumed the obligations under the 1979 Farmout. Some of Everett's assignments from the original farmers provided:

[A]ll of Assignors' right title and interest in and to the well bores and all equipment and appurtenances ..., as well as any interest which Assignors might own in any of the leases covering the above sections.

Assignee assumes, from effective date of this assignment, any and all liabilities associated therewith, including, but not limited to, restoration of surface and plugging and abandonment in accordance with the rules as provided by the Louisiana Department of Conservation.¹⁸¹

Other assignments contained the following language:

Assignee agrees to protect, defend, indemnify and hold assignor and its employees free and harmless from and against any and all costs, expenses, claims, demands and causes of action of every kind and character arising out of, incident to, or in connection with the above-described leases ... regardless of whether the liability therefor is based on some alleged act or omission of Assignor, or Assignee, or some other party.¹⁸²

ETTCO argued that in these assignments, Everett had assumed all the original farmers' liabilities "associated with" or "incident to" or "in connection with" the leases, including the obligation in the 1979 Farmout to make assignments to ETTCO.¹⁸³

¹⁸¹ *Id.* at 1148.

¹⁸² *Id.*

¹⁸³ *Id.*

After distinguishing *Davis*, the court ultimately rejected ETTCO's arguments and concluded Everett had not, with this language, assumed the original farmers' obligations under the unrecorded farmout agreement. Rather, the court reasoned that these provisions indicated "only that Everett is obligated to comply with the terms and provisions of the oil and gas leases related to the assigned leasehold interests after the effective date of the assignments" and that Everett was obligated "to protect the assignor from any claim or cause of action arising from operations conducted *by Everett* with respect to the assigned leasehold interests after the effective date of the assignments."¹⁸⁴

The court additionally considered whether Everett was obligated under language making the assignments "subject to the terms and conditions of certain agreements even though they are not described in the assignment or they are not recorded."¹⁸⁵ The court concluded that because the 1979 Farmout was neither described nor identified anywhere in the assignments, Everett was not "subject to" any obligations contained in the unrecorded agreement.¹⁸⁶

It further rejected ETTCO's argument that the obligations contained in the 1979 Farmout were enforceable on their own as unrecorded real rights. Instead, the court held that the obligations in the 1979 Farmout were personal obligations of the original farmers, which Everett did not personally assume.¹⁸⁷ In dictum, the court noted, however, that the farmers *could have made* Everett subject to the unrecorded 1979 Farmout if the parties had "expressly identified" that agreement in the assignments.¹⁸⁸

¹⁸⁴ *Id.* at 1149 (emphasis added).

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* at 1149-50.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.* at 1150. Compare the following cases which have held that reference to an unrecorded document in a recorded document is ineffective and thus non-binding on third parties. *Judice-Henry-May Agency, Inc. v. Franklin*, 376 So. 2d 991 (La. App. 1 Cir. 1979) ("Jurisprudence to the effect that unrecorded acts will have no legal effect on a third person, even where the third person has actual knowledge of the unrecorded acts, is of long-standing."); *Sklar Producing Co., Inc. v. Rushing*, 262 So. 2d 115 (La. App. 2 Cir. 1972) ("This letter agreement, even though referred to in the record instrument, is not itself

6. *Chieftain International (US), Inc. v. Southeast Offshore Inc.*, 553 F.3d 817 (5th Cir. 2008).

In this case, the federal Fifth Circuit (applying Louisiana law) held that where an assignee assumes all of his assignor's obligations under a lease and an operating agreement, both the assignor and assignee remain solidarily liable to a working interest owner for costs owed under an operating agreement.

Here, the operator (Chieftain) of oil and gas leases covering federal lease tracts located advanced operation costs and billed the other working-interest owners for their proportionate share of expenses under the applicable operating agreement. After several years of operations, one of the co-owners (Southeast) ceased paying the operator's invoices. Southeast later assigned its working interests to a wholly-owned subsidiary, South Pass Properties, Inc., who also failed to pay Chieftain's invoices.¹⁸⁹

Chieftain filed suit against both Southeast and South Pass for the invoice amounts. Southeast argued that it had no liability, relying in part on a clause in the operating agreement providing that "[t]he parties expressly agree that no party hereto shall be responsible for the obligations of any other party, each party being severally responsible only for its obligations arising hereunder and liable only for its share of the costs and expenses incurred hereunder."¹⁹⁰ Chieftain responded that neither the above quoted provision nor the assignment from Southeast to South Pass released Southeast from its obligations under the operating agreement. The district

recorded and insofar as third parties...are concerned has no effect on Rushing's ownership." Consider, however, a new registry provision of the Civil Code, article 3343, which expressly excludes from the definition of third person a "person who by contract assumes an obligation." LA. CIV. CODE ANN. art. 3343 (2012).

¹⁸⁹ *Chieftain Inter. (U.S.), Inc. v. Southeast Offshore, Inc.*, 553 F. 3d 817, 818 (5th Cir. 2008).

¹⁹⁰ *Id.* at 819.

court agreed with Chieftain, granting a partial summary judgment in its favor.¹⁹¹

The Fifth Circuit affirmed. It explained that pursuant to Article 1821, an assignor and assignee have solidary liability for the assignor's contractual obligations to a third party unless the third party releases the assignor. The court further concluded that the provision of the operating agreement quoted above did not constitute a release, and therefore, did not relieve Southeast of liability.¹⁹²

7. *Nippon Oil Exploration U.S.A. Limited v. Murphy Exploration & Production Company – USA*, 2011 WL 1193005 (E.D. La 3/25/2011) and 2011 WL 2456358 (E.D. La. 6/15/2011).

These two unpublished federal district court cases involve apportionment of decommissioning costs under a federal oil and gas lease. Here, the assignor (Murphy) was found to have retained all lease obligations, including decommissioning costs accruing before the effective date of its assignment.

Murphy and Pennzoil were original co-owners in an oil and gas lease covering federal lease tracts located in the Gulf of Mexico; they were also parties to a 1974 operating agreement covering the subject lease. After refusing to participate in a “lease saving operation”, Murphy assigned all of its right, title and interest in the lease to Pennzoil, pursuant to terms in the operating agreement which provided in part:

a nonparticipating party as to such well shall assign to the participating parties all of its right, title and interest in and to such Joint Lease or such portion thereof, *but such assignor shall not be relieved of any accrued obligations as to such Joint **Lease** or such portion thereof prior to such **assignment***.¹⁹³

The resulting assignment from Murphy into Pennzoil provided that

¹⁹¹ *Id.* at 818.

¹⁹² *Id.* at 820.

¹⁹³ *Nippon*, 2011 WL 1193005 at 1 (E.D. La 3/25/2011) (emphasis in opinion).

From and after the effective date of this Assignment, Assignee shall be liable for and shall assume all obligations and perform all duties *both of which result after the effective date and that result from the ownership of the rights conveyed hereby or imposed by any governmental authority* asserting jurisdiction over the assigned acreage.¹⁹⁴

Nippon later acquired a 50% interest in the subject lease from Pennzoil and became the operator. Following hurricane damage, Nippon and the other co-owners decided to abandon the wells and platform on the lease and sought Murphy's share of costs for the operation. Murphy refused and Nippon filed suit, contending that pursuant to its assignment with Pennzoil, Murphy had assumed decommissioning obligations for the lease.¹⁹⁵

In its first opinion, the court held that under the clear and unambiguous language in the operating agreement and the assignment, Murphy retained all obligations accruing before the effective date of the assignment, whether resulting from ownership or government regulations.¹⁹⁶

In the second opinion, the court first explained that Murphy's obligation to pay its proportionate share of decommissioning costs accrued when it became a lessee and participated in drilling activities.¹⁹⁷ For this reason, the assignment did not limit Murphy's liability for decommissioning expenses to wells and platforms that existed at the time of the assignment. The court, however, refused to make Murphy liable for decommissioning costs caused

¹⁹⁴ *Id.* at 1 (emphasis in opinion).

¹⁹⁵ *Id.* at 2. This case involved the apportionment of liability between the parties and did not implicate their obligations to the Minerals Management Service ("MMS") - now divided into two federal agencies and known as the Bureau of Ocean Energy Management, Regulation and Enforcement and the Bureau of Safety and Environmental Enforcement. The court correctly recognized that the MMS "regulations do not preclude agreement between the parties which allocate those obligations between themselves." *Nippon*, 2011 WL 2456358 at 4.

¹⁹⁶ *Nippon*, 2011 WL 1193005 at 4.

¹⁹⁷ See 30 C.F.R. § 250.2701 as quoted and explained in *Nippon*, 2011 WL 2456358 at 4.

exclusively by storm damage occurring after the effective date of the assignment.¹⁹⁸

Nowhere in the opinion is the assignment from Pennzoil to Nippon mentioned, but presumably it would not have changed the outcome here. The fact that this case involved a federal lease subject to special decommissioning regulations and obligations was clearly significant.

C. Drafting Tips Gleaned from Selected Case Law.

- If assumption is desired, the transferee should *expressly* assume the obligation of his transferor –using the word “assume” if practical.
- To be safe, the parties can even expressly state whether an assumption is personal and/or intended to permit direct action by the transferor’s obligee against the transferee or its successors and assigns.
- Language making an agreement “subject to” other documents typically will be insufficient to create a personal obligation under Louisiana law; again, express assumption is prudent.
- Merely listing or identifying an unrecorded document in a conveyance typically will not, of itself, bind the transferee personally to the obligations contained in it.
- If a transfer is made “subject to” an agreement, clearly identify the agreements that are binding on the transferee including as much detail as practical regarding the obligations contained in those agreements.
- Remember that under La. Rev. Stat. Ann. § 31:216, recordation of an operating agreement (or declaration thereof under La. Rev. Stat. Ann. § 31:217) binds third persons.
- Define within the document *when* liability will shift from transferor to transferee.
- Avoid relying on other agreements - including the use of definitions contained in further agreements – to define the scope of the assumed obligation.
- Remember consent from the obligee (e.g. the lessor) does not effectuate a release of the original obligor.

¹⁹⁸ *Nippon*, 2011 WL 2456358 at 5.

- Both the transferee and the transferor will remain solidarily liable after transfer, unless the transferor is expressly and affirmatively released by the obligor.
- When an operating agreement is involved, a transferor seeking to limit post-assignment liability should consider also obtaining releases from the operator and other non-operators named in the operating agreement.
- Consider “advance novation” clauses in your leases in which the lessor expressly agrees to “relieve the lessee from prospective contractual liability when the lease is assigned a third party” or one where the limiting post-assignment liability for breaches of the lease exclusively to the *owners* of the leases.¹⁹⁹
- Do your due diligence with respect to your business partners before you get into the deal!

VI. Selected Property Description Issues.

Typically, an assignment conveys a specific interest in property. Obviously, it is very important for the drafter to describe the property to be conveyed clearly and unambiguously. While this paper does not purport to address all potential property description issues, the following are selected pitfalls to be avoided.

A. Wellbore Assignments.

A wellbore, sometimes called a borehole, is defined as the hole in the ground created by the process of drilling or boring a well.²⁰⁰ Sometimes assignors desire, for various operational and economic reasons, to limit the assignee’s interest to rights “in the wellbore” of a specifically defined well or wells.²⁰¹ In contrast to traditional lease assignments, which typically contain an exhibit describing

¹⁹⁹ See *Patton*, *supra* note 33 at 31-16 (citing DAVID E. PIERCE, *Oil and Gas Law Update*, 58th ANNUAL OIL & GAS INST. (Ctr. for Am. & Int’l L. 2007)).

²⁰⁰ *Petro Pro, Ltd. v. Upland Resources, Inc.*, 279 S.W.3d 743, 751 (S.W.3d 2007) (citing 8 Patrick H. Martin & Bruce M. Kramer, WILLIAMS & MEYERS OIL AND GAS LAW, MANUAL OF TERMS, 107, 1207 (9th ed. 1998)).

²⁰¹ See generally Kurt M. Peterson, *Wellbores: Shedding Light on a Transactional Black Hole*, 48 ROCKY MTN. MIN. L. INST. (1989) for a detailed article on the scope of wellbore assignments.

the leases assigned, wellbore assignments may or may not identify any leases being assigned.

While making “wellbore assignments” to transfer existing oil and gas production (and in some cases future interests in oil and gas production) has become a common practice in the industry, it is still unclear as to what mineral rights are actually transferred in such assignments. To date, no Louisiana court has answered this question, but there is confusion, under both Louisiana’s theory of non-ownership of minerals and under Texas’ ownership-in-place theory of mineral rights, as to what rights to drill and produce the “wellbore” an assignee actually receives with this type of assignment.

In 2007, a Texas appellate court had opportunity to construe an assignment limited to the wellbore of a particular well.²⁰² The wellbore assignment in *Petro Pro, Ltd. v. Upland Resources, Inc* conveyed the following:

All of Seller’s right, title and interest in and to the oil and gas leases described in Exhibit “A” attached hereto and made a part hereof (“Subject Leases”) insofar and only insofar as said leases cover rights in the wellbore of the King “F” No. 2 Well.²⁰³

The parties had varying interpretations regarding the nature and extent of the estate conveyed, but all agreed that the above-quoted language “unambiguously assign[ed] leasehold rights in the King ‘F’ No. 2 Wellbore.”²⁰⁴

²⁰² *Petro Pro*, 279 S.W.3d at 743.

²⁰³ *Id.* at 746. There is no indication in the opinion as to how the leases were described on Exhibit “A”.

²⁰⁴ *Id.* at 750. It was important that the parties agreed that the assignment conveyed *some leasehold rights*; perhaps the result could have been different if the assignment only described the wellbore and did not reference the leasehold, or if the parties had not agreed that the assignment transferred a determinable fee interest or perhaps, if Louisiana law had applied. As explained, under Louisiana’s theory of non-ownership-in-place of minerals, a transferee merely receives the right to explore for minerals underlying the lands conveyed, but there is no separate mineral estate conveyed – in the land, wellbore or otherwise. Accordingly, it is difficult to

The assignee (Petro Pro) argued that it owned the exclusive right to produce oil and gas interests from the unit associated with the King “F” No. 2 Well, or at least in all areas that could “reasonably be reached and produced” through the wellbore.²⁰⁵ The owners of the remaining lease interests in the unit (Upland) argued that Petro Pro’s rights were restricted to the horizon that was open in the King ‘F’ No. 2 wellbore on the date of the assignment, without the right to deepen the well to other zones or horizons.²⁰⁶ The intervenor royalty owners contended that Petro Pro had the right to produce from any depth “limited [to] the horizontal extent of Petro’s rights to forty acres surrounding the King “F” No. 2 wellbore.”²⁰⁷

The court concluded that the assignment conveyed part of the leasehold estate created by the underlying oil and gas leases, subject to vertical and horizontal limitations. Emphasizing that the assignment was completely devoid of language limiting Petro Pro’s leasehold interest to certain depths, the vertical limit of the assignments was to be defined “by the depth of the wellbore as assigned.”²⁰⁸ Also, because the assignment neither expressly nor impliedly conveyed leasehold rights in any horizontal surface acreage, Petro Pro’s leasehold interest could only extend horizontally to the area of the hole identified as the King “F” No. 2 Well and such surface area adjacent thereto reasonably necessary to operate the well.²⁰⁹ The court rejected arguments of the royalty owner intervenors to interpret the wellbore assignment as creating

conceptualize of how a wellbore assignment (especially one that does not purport to also transfer a part of the leasehold interest) could give the owner of the “wellbore” the right to drill and produce therefrom.

²⁰⁵ *Id.* at 747.

²⁰⁶ *Id.*

²⁰⁷ *Id.*

²⁰⁸ *Id.* at 750-51.

²⁰⁹ *Id.* at 751. Arguably though, the court nevertheless read language into the assignment that was not there – i.e., that surface area sufficient to drill and produce the well was implicitly included in the wellbore assignment.

exclusive rights in a 40 acre spacing unit around the assigned wellbore.²¹⁰

Consistent with these geographic limitations, the court ultimately determined that Petro Pro has a right to drill and produce from any formation that might be reached by the existing wellbore, but has no right to deepen or sidetrack the wellbore.²¹¹ The remaining leasehold interest owners, however, retained the exclusive right to drill and produce minerals from the leased premises - excepting the King “F” No. 2 wellbore – subject to the rule of capture.²¹²

No further interpretation of the parties rights and obligations were determined in this case, leaving various questions regarding the scope of a wellbore assignment unanswered.

1. Drafting Wellbore Assignments.

As noted above, wellbore assignments are often ambiguous and thus, may result in litigation as to what actually was assigned. A well-drafted wellbore assignment should include as much information as possible about what is intended to be conveyed and with what accessory rights. Some drafting suggestions are made below:

- Wellbore assignments should include a leasehold interest or working interest.
- Wellbore assignments should include any rights to be acquired in the spacing unit.
- When describing an existing well to transferred or excluded, describe both the wellbore and a certain amount of acreage

²¹⁰ *Id.* There was no discussion in the opinion as to exactly how Petro Pro was to obtain a drilling permit to perforate uphole without owning any significant oil and gas leasehold interest around the wellbore.

²¹¹ “A wellbore assignment is the narrowest form of oil and gas assignment.” *Id.* at 751 (citing Lawrence P. Terrell, *Limited Assignments—Who Gets What?*, 35 ROCKY MTN. MIN. L. INST. 17, § 17.02 (1989)).

²¹² *Petro Pro*, 279 S.W.3d at 752. The rule of capture provides that a landowner or his lessee has the absolute right to produce oil and gas from a well located on his land or lease even though such production caused drainage of oil and gas from adjoining properties. *See id.* at 752-53; LA. REV. STAT. ANN. §§ 31:8 (2012) and 14 (2012).

surrounding the wellbore (if only for regulatory purposes). The acreage included may be the drilling or spacing unit that has been approved by the applicable state department. If there is not a state approved drilling or spacing unit, the parties may describe the acreage as a square around the well – making that acreage sufficient to satisfy any regulatory spacing requirements.

- If surface area for future facilities, such as tanks, flow lines and treatment equipment is desired, the assignment should describe that property.
- Wellbore assignments should include whether they are limited to certain depths and/or formations. The drafter, for example, should consider whether:
 - the assignee has the right to deepen the well;
 - the assignee has the right to plug back to produce from a shallower zone than the one producing at the effective date of the assignment;
 - horizontal drilling from the existing wellbore is permitted;
 - a substitute well may be drilled if the existing well ceases to produce; and
 - the wellbore owner has any right to prohibit the owner of the remaining leasehold interest from drilling and producing any additional wells.
- Because a dearth of caselaw interpreting this type of assignment exists, it is important that wellbore assignments be drafted so that the parties clearly set forth their intent.
- Be cautious of certain AAPL Model Form JOAs which contain special rules for wellbore assignments:
 - The maintenance of uniform interest provision in the 1956, 1977, 1982 and 1989 JOA forms prohibit wellbore assignments and depth restricted assignments without consent.
 - Under the Loss or Failure of Title (typically Article IV.B) provision in the 1989 AAPL Model Form, the ownership of only a wellbore lease may not give a party an interest in the contract area.²¹³

²¹³ See Andrew B. Derman & Isabel Amadeo, *The 1989 AAPL Model Form Operating Agreement – Why Are You Not Using It?*, 2 ROCKY MTN. MIN. L. INST. 16, § 3 (2008).

B. Express Mineral Right Reservation Necessary.

Where the transferor intends to except certain mineral rights, special attention should be paid when using the common phrase “all right, title and interest” in a deed’s granting clause.

Under Louisiana law, a conveyance of land carries with it all incidents of ownership, including mineral rights, except such rights as may be expressly reserved.²¹⁴ Thus, recently, in *Sheridan v. Cassel*, the Louisiana Third Circuit held that when a vendor sells “all rights” to 80 acres to a purchaser, all oil, gas, and other minerals under the 80- acre tract are conveyed, including the minerals the vendor had previously reserved in a 3.27-acre tract located within that 80 acre tract.²¹⁵ The court explained that because the sale agreement did not include any express reservation of mineral rights, the minerals rights were transferred. Likewise, the deed from the same vendor selling all of his “right, title, claim and interest, real and personal, in and to” the purchaser’s estate (including the 80 acres which he presumably inherited), included the oil, gas, and other minerals under the 3.27-acre tract. A quit claim deed executed on the same day expressly excluding the 3.27-acre tract was unavailing to the court, and the purchaser’s predecessor in interest was held to be the owner of all minerals under the 80 acre tract.²¹⁶

C. Coordination of Granting Clause, Description and Exhibit.

Drafters need also be mindful that a property description in the body of the conveyance should be consistent with any exhibits purporting to further define or limit the property.

For example, a typical assignment may recite that Assignor transfers to Assignee “all of Assignor’s right, title and interest in and to the Oil, Gas and Mineral Leases, lands and interests therein,

²¹⁴ See *Texaco, Inc. v. Newton & Rosa Smith Charitable Trust*, 471 So.2d 877, 882 (La. App. 2d Cir. 1985).

²¹⁵ 70 So.3d 89 (La. App. 3d Cir. 2011).

²¹⁶ *Id.* at 93.

described in Exhibit ‘A’ attached hereto and made a part hereof...” Exhibit A then might identify the relevant leases – generally, by effective date and recordation information – but limit the various leases to certain acreage or specific units –i.e. the transferred lease includes lease than all acreage than the original lease. In this example, a party could conceivably argue that a conflict exists between the broad granting clause language and limiting exhibit language.

In *Sunwest Operating Co., LLC v. Classic Oil & Gas, Inc.*, the federal Fifth Circuit (applying Texas law) held that an assignment which limited the interest conveyed to units described in Exhibit A did not effectively convey the assignor’s interest in those portions of the leases covering properties outside the unit even where the granting clause assigned “all right, title and interest of Assignor in and to the Properties.”²¹⁷ There the applicable assignment language provided:

RECITALS

1. Assignor owns an interest in the oil and gas leases described on Exhibit “A” attached hereto and made a part hereof (the “Leases”) which pertain to the Lands described on Exhibit A (the “Lands”).

...

The Leases, Lands, Equipment, Contracts, Production and Data are all collectively referred to as the “Properties.”

6. Assignor agrees to assign all right, title and interest of Assignor in and to the Properties to Assignee in order to vest Assignee with title in and to the Properties.

CONVEYANCE

... Assignor does hereby GRANT, BARGAIN, SELL, TRANSFER, ASSIGN and CONVEY to Assignee, all of Assignor’s right, title and interest, including any and all overriding

²¹⁷ 2005 WL 1939685, 143 Fed. Appx. 614 (5th Cir. 2005).

royalty interest, in and to the Properties, to have and to hold unto Assignee, its successors and assigns, forever.²¹⁸

Exhibit A was attached to the relevant assignment. The exhibit was organized with respect to the seller's interest in several oil and gas units and listed interests in leases falling within the different units. The interest in the relevant lease was described as follows:

Beckville

Panola County, Texas

VELMA DANIELS GAS UNIT NO. 1, 2, 3, 4, 5, 6

Seller's interest in and to acreage allocated to the Velma Daniels Gas Unit No. 1, more particularly described as 641.76 acres, more or less, out of the Thomas M. Scott Survey, A-594, and the Joseph Spencer Survey, A-590, Panola County, Texas, more particularly described in Gas Unit Designation for the Velma Daniels No. 1, a counterpart of which is recorded in Volume 655, Page 13 of the Deed Records of Panola County, Texas as amended and supplemented:²¹⁹

A list of leases followed in the Exhibit including an accurate description of the relevant lease which included its original gross acreage.²²⁰

The plaintiff argued that the assignment included all acreage in the leases while the defendants argued that the assignment was limited to that acreage covered by the described unit. The court held that the above quoted language was unambiguous and could only be interpreted to exclude acreage outside of the unit as described in Exhibit A. It explained that all of the broad language in the assignment was limited by the property description on Exhibit A to the assignment which, by omission, excluded properties outside the unit.

The description of the Velma Daniels Gas Unit describes the interest conveyed as "Seller's interest in and to acreage allocated

²¹⁸ *Id.* at 617.

²¹⁹ *Id.*

²²⁰ *Id.*

to” the unit (emphasis added). We see no other interpretation of this language except that it was meant to convey the Properties within the unit and, by omission, exclude the Properties outside the unit.²²¹

Accordingly, the assignment of “all of Assignor’s right, title and interest in and to the Properties” simply means that the assignor conveyed all of its interest in the Tompkins lease as limited by the description on Exhibit A to that area within the Velma Daniels Gas Unit. The phrase cannot alter what constitutes “Properties” to include the Excluded Acreage.²²²

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²²¹ *Id.* at 618.

²²² *Id.*