

ENVIRONMENTAL ALERT

LOUISIANA SUPREME COURT CLARIFIES MINERAL LESSEE'S SURFACE RESTORATION OBLIGATIONS IN *SCHOOL BOARD VS. CASTEX ENERGY*

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Executive Summary: In *Terrebonne Parish School Board vs. Castex Energy, et al.*, the Louisiana Supreme Court has held that a mineral lessee has no implied obligation to backfill oilfield access canals when the oil company's lease granted an express right to dredge canals and where there is no evidence that the oil company lessees exceeded the rights granted to them under the lease or acted unreasonably or negligently in dredging the canals. Article 122 of the Louisiana Mineral Code only imposes a duty to restore the surface to its original condition where there is evidence of unreasonable or excessive use of the surface of leased premises.

In what can be considered good news for the oil and gas industry in Louisiana, on January 19, 2005, the Louisiana Supreme Court issued its decision in the matter of *Terrebonne Parish School Board v. Castex Energy, et al.*¹ In this case, the state's high court considered the issue of whether Article 122 of the Louisiana Mineral Code, which obligates a mineral lessee to act as a reasonably prudent operator, compels the lessee to restore the surface of the leased land to its pre-lease condition when lease terms do not expressly require restoration and when there is no evidence that the lessee excessively or unreasonably exercised its rights under a mineral lease.

The plaintiff landowner/lessor claimed that oilfield access canals dredged by defendants altered the hydrology of the marsh and adversely affected its ecology by removing marsh terrain, creating soil banks, and impairing the ebb and flow of tidal waters. The dredging of the canals resulted in a loss of 27.74 acres of marsh land. The mineral lease at issue expressly granted the lessee, and its assigns, the right to dredge

¹ *Terrebonne Parish School Board v. Castex Energy Inc., Sampson Hydrocarbons Company, Bois D'Arc Corporation, Fina Oil & Chemical Company and Sampson Resources*, 04-C-0968 (La. 1/19/05).

canals but was silent with respect to the lessee's surface restoration obligation at the end of the lease.

At trial, Castex, the last lease operator, and the other lessees submitted uncontested evidence that they had complied with all regulations of the Louisiana Commissioner of Conservation governing plugging and abandonment of oil and gas wells, closing of oil field pits, and clearing the area around abandoned wells. Testimony was also presented that it was not the custom and practice in the oil and gas industry to backfill canals at the cessation of a lease. The plaintiff's expert also conceded that backfilling canals was "more the exception than the rule" at the conclusion of lease operations.

Following trial, the district court entered judgment in favor of the School Board. The district court found that the defendant mineral lessees were solidarily liable to the School Board under the lease for restoration of the School Board's property "to a condition as near as practicable to its pre-leased condition." The court ordered the defendants to deposit \$1.1 million plus judicial interest into the registry of the court to be used to restore the property. The court also appointed a Special Master to "oversee the design, permitting, execution and disbursement of funds for said marsh restoration plan." The Special Master was ordered to devise a plan for filling the canals that would (1) preserve and make use of the current spoil banks and include water control structures as necessary, (2) include the plugging of the canals with earthen and/or stone material, if feasible, (3) result in filling the canals with a suitable material to result in the resolution of the displaced marsh to a condition as near as practicable to the property's pre-lease condition, and (4) be completed within two years of the date the defendants were to deposit the funds into the registry of the court. The court further ordered that any unused portion of the \$1.1 million would be returned to defendants.

On appeal, the First Circuit Court of Appeal affirmed the trial court's finding of an implied restoration obligation but vacated that portion of the trial court's remedy that required a deposit of \$1.1 million and the appointment of a Special Master to oversee the remediation. Instead, the Appellate Court majority held that the obligation under Article 122 of the Mineral Code was an obligation to specifically perform restoration without regard to the cost.

Notably, the First Circuit rejected the defendants' argument, based on the 1958 decision of *Rohner v. Austral Oil Exploration Company*,² that before imposing a duty to restore the surface, the court was required to find that the lessees were either negligent in their exercise of rights under lease, had used surface property outside the scope of the lease, or had otherwise acted unreasonably. The intermediate court further found that *Rohner* did not address the broad issue of whether the Mineral Code imposes an implied duty to restore the surface in the absence of an express duty under the lease. Rather, *Rohner* only considered the narrow issue of whether a lessee who had actually undertaken restoration of the surface but had failed to perform satisfactorily was liable to the lessor for damage.

² *Rohner v. Austral Oil Exploration Co.*, 104 So2d 253 (La. App. 1st Cir. 1958)

Judge McDonald dissented from the majority's conclusion that Article 122 imposed a duty to restore absent an express lease provision or any showing that the defendants negligently or excessively used the surface, or that it was customary for a reasonably prudent operator to backfill canals. Judge McDonald reasoned that *Rohner* represented a correct statement of the law and that the subsequent enactment of the Louisiana Mineral Code did not change the law. Judge McDonald further reasoned the Civil Code Articles 2719 and 2720 do not obligate a lessee to remedy damage to leased property from ordinary wear and tear. Judge McDonald further reasoned that Civil Code Article 2721, not mentioned by the majority, clarified that a lessee is only liable "for the injuries and losses sustained through his own fault." Imposing a restoration obligation, where none was specified in the lease contract, would alter the terms of the contract that were bargained for by the parties and would provide for something not contemplated by either party.

Finally, the dissent disagreed with the remedy selected by the trial court. The dissenting judge would have merely plugged the ends of the canals and allowed nature to regenerate the marsh. This process, would have more closely replicated the original condition of the property at a lower cost even though such restoration would have taken longer to accomplish.

The defendant lessees sought review of the lower courts' decisions by the Louisiana Supreme Court. Defendants argued that the lower courts erred in holding that Mineral Code Article 122 obligated a mineral lessee to restore the surface to its pre-lease condition absent proof that the lessee executed his rights unreasonably or negligently. In the alternative, the defendants argued that should the high court find that such a duty exists (1) breach of that duty must be measured by reference to what a reasonably prudent operator would do; (2) any such implied duty to restore the surface is limited by the land's fair market value; (3) the trial court should have chosen defendant's restoration plan, and (4) any duty to restore is subject to a one-year prescriptive period which had passed.

The Louisiana Supreme Court did not reach defendants' alternative arguments. In a 4-3 decision the Court held that "although the temptation may be to thrust a great part of the solution to the problem of coastal restoration upon the oil and gas companies and other private parties, rather than the state and federal governments currently faced with underwriting the expenses of restoration, we decline to do so out of respect for the terms of the mineral lease to which these parties have agreed. Thus, we reverse the courts below and find that, where the mineral lease expressly grants the lessee the right to alter the surface in the manner it did, and is silent regarding restoration, Article 122 [of the Mineral Code] only imposes a duty to restore the surface to its original condition where there is evidence of unreasonable or excessive use."

The majority opinion, written by Chief Justice Calogero, noted that the express language of Article 122 of the Mineral Code does not impose an express duty on a mineral lessee to restore the surface of the leased premises. Instead, the provisions of

Article 122 impose two obligations: (1) to perform the obligation in good faith; and (2) to develop and operate the leased premises as a reasonably prudent operator for the mutual benefit of lessee and lessor. This article “simply adapts the general, ‘good administrator’ standard of La. Civ. Code Art. 2710, applicable to all leases, to the specific context of a mineral lease.”

Despite the language in the comment to Mineral Code Article 122, the Supreme Court held that “[o]ur review of the jurisprudence bearing on this issue, as well as the general civil code articles dealing with lease, does not, however, persuade us that Article 122 imposes an implied duty to restore the surface absent proof that the lessee unreasonably or excessively exercised his rights under the mineral lease.”

The Supreme Court noted that it had not squarely addressed the issue of whether, and under what circumstances Mineral Code Article 122 imposed an implied duty to restore the surface to its original condition. Other cases where the high court has awarded damages for a mineral lessee’s failure to restore the surface have turned on the finding that the terms of the parties’ lease expressly imposed this obligation. Citing *Magnolia Coal Terminal v. Phillips Oil*,³ the Supreme Court noted that the mineral lease at issue in that case provided that “[l]essee shall pay for all damages caused by lessee’s operations, including damage to ... soil and other property....” In *Magnolia Coal*, the court observed that this lease language “impose[d] on express obligation [to restore the surface] which is a matter of contract not within the purview of the mineral code.” In *Corbello v. Iowa Production*,⁴ an express lease provision also existed which obligated the lessee upon termination of the lease, to “reasonably restore the premises as nearly as possible to this present condition.” The *Corbello* case emphasized that the lease terms constituted the law between the parties. In addition, the Supreme Court in *Castex* distinguished both *Magnolia Coal* and *Corbello* as cases which involved allegations that defendants had acted negligently or unreasonably.

Analyzing several intermediate appellate decisions addressing the existence and scope of any implied duty to restore the surface, the Supreme Court in *Castex* agreed with defendants that *Rohner* properly articulated the rule concerning the scope of any implied duty to restore the surface. The rule articulated by *Rohner* was as follows:

Unless provided for in the lease, the lessee is not responsible for damages which are inflicted without negligence upon the lessor’s property in the course of necessary drilling operations. Moreover, when the damaging of the lessor’s property by the mineral lessee is not negligent, per se, the lessor must prove that the injury was caused by unreasonable or negligent operation of the lease.

³ *Magnolia Coal Terminal v. Phillips Oil*, 576 So.2d 475 (La. 1991)

⁴ *Corbello v. Iowa Production*, 850 So.2d 686 (La. 2003)

The Supreme Court specifically found “unpersuasive” the lower courts’ attempt to distinguish *Rohner* as concerning only the limited circumstance where a lessee has undertaken restoration but not performed it satisfactorily.

The Supreme Court further noted that other intermediate appellate decisions such as *Ashby v. IMC Exploration Company*,⁵ *Edwards v. Jeems Bayou*,⁶ *Broussard v. Waterbury*,⁷ and *Smith v. Schuster*,⁸ similarly limit the scope of a lessee’s duty to restore the surface to those circumstances where a mineral lessee has exercised his rights under the lease unreasonably.

The Supreme Court further held that Civil Code Articles 2719 and 2720 do not impose a strict obligation to return leased property in an unchanged condition. Rather, both articles allow for deterioration of the leased premises because of “wear and tear.” In determining what constitutes “wear and tear” in a particular case, the specific rights granted in the lease should be considered as the lessor may be considered to have given his consent to the “wear and tear” normally involved in exercising the rights granted. The Supreme Court held that the School Board’s express grant of the right to dredge canals constituted consent to or approval of the changes incidental to dredging.

Associate Justices Weimer, Knoll and Kimball dissented in *Castex*. Justice Weimer wrote that because the lease is silent regarding restoration, the law governing restoration at the conclusion of a lease applies. Article 122 of the Mineral Code does not expressly address the obligation of the lessee as it relates to surface restoration. Therefore, since the mineral code is silent regarding the mineral lessee’s obligation to restore the surface, the Civil Code applies. In Justice Weimer’s view, the applicable provisions of the Civil Code are Article 2719 and 2720 which provide that in absence of an inventory having been made at the beginning of a lease, the lessee is obligated to return the leased thing to his lessor in the same condition in which it was received, ordinary wear and tear excepted. Justice Weimer writes, and the other two dissenting Justices, Knoll and Kimball agree, that the dredging of multiple canals through marshland is not ordinary wear and tear but a major alteration of the premises. Under this circumstance the lessee should have an obligation to restore the surface of the lease.

Justice Weimer agrees that the parties to a mineral lease have the freedom to contract regarding what is required relative to surface restoration. For this reason he states that the terms of the lease are important and that in this case the lease clearly authorized the dredging of canals. However, in Justice Weimer’s view, the right to dredge and use a canal is separate from the obligation to restore once the use has been completed. Should the lessee wish to avoid the obligation imposed by the Civil Code to restore the premises, the Lessee should include such a clause in the lease.

⁵ *Ashby v. IMC Exploration Company*, 496 So.2d 1334 (La. App. 3d Cir. 1986)

⁶ *Edwards v. Jeems Bayou Production Co.*, 507 So.2d 11 (La. App. 2d Cir. 1987)

⁷ *Broussard v. Waterbury*, 346 So.2d 1342 (La. App. 3d Cir. 1977)

⁸ *Smith v. Schuster*, 66 So.2d 430 (La. App. 2d Cir. 1953)

Justice Weimer also believes that the majority misreads the intermediate appellate decisions of *Broussard*, *Smith* and *Edwards* and that the lessee's obligation to return the leased premises in the same condition as when received, ordinary wear and tear excepted, is not a new concept in the law.

Justice Weimer further argues that Civil Code Article 2721, which provides that a lessee is only liable for damages occasioned by his fault, has no application. This article, he states, addresses the situation of an unrelated third party causing damage to the leased premises. In such a situation, the lessee would not be responsible for the unrelated third party's actions.

Although Justice Weimer believes that an obligation to restore the canals should have been found, he agrees with Judge McDonald's view of what remedy should be selected. No monetary award should be made. The canals should be plugged at the ends and nature should be allowed to restore a flotant marsh over an extended period of time. In Justice Weimer's view, the dredging of the canals at the time the lease was conferred was a prudent use of the property. It would not be unreasonable for a lessor to wait as long as fifty years for nature to restore the marsh in light of the fact that both the lessor and lessee derived benefits from the canals for an extended period of time.

The *Castex* decision clarifies some, but not all, of the obligations of a mineral lessee with respect to surface restoration. The decision reaffirms that where a mineral lease expressly authorizes and grants the lessee the right to alter the surface of the leased premises but the lease is silent regarding restoration, Article 122 of the Louisiana Mineral Code only imposes a duty to restore the surface to its original condition where there is evidence of unreasonable or excessive use.

The decision does not address those situations in which there is an express restoration provision contained in a lease nor does the decision specifically address a situation where a mineral lease is silent with respect to the authority to construct facilities that are nevertheless necessary for mineral operations to take place and where the mineral lessee constructs those facilities under an implied, as opposed to express, right. In the former situation, where there is an express restoration provision, the court is likely to follow its prior *Corbello* and *Magnolia Coal* decisions and uphold the express obligations. In the later situation, the focus of the case will likely be on whether the specific activity or facility was reasonably necessary to accomplish the underlying purpose for which the mineral lease was granted and whether the conduct of the lessee constituted unreasonable or excessive use of the premises.

Castex should not be read as a decision absolving a mineral lessee of all liability associated with oilfield canals or wetlands damage. There may be situations where the canals have excessively widened over time and exceed the rights granted by the lessee or where the canals have caused foreseeable damage to adjacent property. It is likely that future cases will continue to develop this area of the law.