

Neither Fish nor Fowl: The Louisiana Law of Shut-in Gas Wells

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TABLE OF CONTENTS

I.	Introduction.....	44
	A. Rationale for the “Shut-in Clause”	44
	B. “Habendum Clause”	46
II.	The “Shut-in Clause”—in General	49
	A. Preface.....	49
	B. “Freedom of Contract”	50
	C. Contrast of “Shut-in Clauses” in Prevalent Commercial Printed Lease Forms.....	52
	1. Preface.....	52
	2. Under What Circumstances May Shut-in Payments be Made?	54
	3. At What Point in Time May Shut-in Payments be Made?	54
	4. An Example	55
	D. Mutual Benefit to Both Lessor and Lessee	58
III.	The “Shut-in Clause”—How it Operates	59
	A. Preface.....	59
	B. Requisite Level or Amount of Production Needed in Order to Invoke the “Shut-in Clause”	59
	C. Capability of Well to Produce as an Engineering Matter	60
	D. Burden to Demonstrate Productive Capacity of a Shut-in Well.....	62
	1. Jurisprudence	62
	2. State Mineral Leases	65
	E. Customary Lease Maintenance Options	66
	F. Lease Being Otherwise Maintained	71

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G. What is a Well Producing “Gas Only”?	72
H. What Constitutes a “Market” for Purposes of a “Shut-in Clause”?	73
I. Status of Lease While Shut-in Payments are Made	75
J. Characterization of the Shut-in Payment	77
K. Requirement for Notice and an Opportunity to Cure	83
L. Does the Existence of a “Shut-in Clause” Override Implied Duty to Market?	84
M. The “Shut-in Clause” as Affected by Unitization of the Leased Premises	86
IV. Shut-in Wells and the Mineral Servitude and Mineral Royalty	87
A. Preface	87
B. Effect of a Shut-in Well on Prescription of Nonuse Accruing Against a Mineral Servitude	88
1. Pre-Code Jurisprudence	88
2. Louisiana Mineral Code	88
3. Comment: Incongruity in Articles 30, 34 and 36	91
C. Effect of a Shut-in Well on Prescription of Nonuse Accruing Against a Mineral Royalty	92
1. Pre-Code Jurisprudence	92
2. Louisiana Mineral Code	94
3. Comment: Unit Must be Valid	95
V. Conclusion	96

I. INTRODUCTION

A. Rationale for the “Shut-in Clause”

The production of natural gas presents a multitude of unique issues and challenges that are generally not applicable to the production of oil. By its very nature, gas in its natural form cannot be stored and, when and as produced, must be immediately delivered to the market. The production of gas necessarily involves capital expenditures to install or construct pipelines and sometimes processing facilities. If gas production is established in remote or undeveloped areas, the laying of a pipeline might involve a great deal of permitting from governmental agencies or sophisticated

landowners. Moreover, a purchaser might not be willing to expend the significant sums involved in constructing a pipeline unless assured that adequate reserves are committed to the repayment of construction costs. If the gas is too “rich” or too “wet,” or does not meet the specifications of the pipeline, the gas may need to be processed, which would necessitate the arrangement of processing facilities.

In contrast, an oil well does not present similar issues or challenges. Being a liquid, oil is susceptible to storage in tanks. The sale of liquids does not typically involve the extensive facilities or infrastructure that are often required for the gathering, transportation, processing, or marketing of gas production.

These gas necessitated matters take time—and money—to resolve. While these issues are being resolved, the well otherwise capable of producing is not producing—it is “shut-in.”¹ How does the lessee maintain a mineral lease when the lessee has drilled a well that is not in fact producing, but that obviously will produce at some future date?

A well that is shut-in is, self-evidently, a well that is not producing, but it is also a well that—under the “standard form” of mineral lease² and the Louisiana Mineral Code—gives rise to certain consequences relative both to lease maintenance as well as to the perpetuation of a mineral servitude or mineral royalty, if such exist.

Concerning the maintenance of a mineral lease that covers lands on which a shut-in well is situated, the “standard form” of mineral lease usually permits, under certain circumstances and for a certain period of time, the lessee to continue the mineral lease by paying a shut-in payment—which may either be characterized as a “royalty” or a “rental.” Halfway between here and there, the shut-in well is “neither fish nor fowl.”³

This Article considers the myriad of issues and challenges that arise under Louisiana law in connection with the shut-in gas well and the tender of a shut-in payment, however characterized. If one

1. A “shut-in” well is one which is capable of producing gas, but which is not in fact producing gas, usually because of the lack of a market or marketing facilities.

2. Here, your author violates one of his principal beliefs, that the mere reference to a so-called “standard” mineral lease is misleading in view of Louisiana’s strong policy which supports the notion of “freedom of contract.” *See infra* Part II.B.

3. This expression appeared in slightly different form in John Heywood’s 1546 proverb collection (“Neither fish, nor flesh, nor good red herring”) and is thought to allude to food for monks (fish, because they abstained from meat), for the people (flesh, or meat), and for the poor (red herring, a very cheap fish).

had to conjure a song that captures the essence of a mineral lease on which exists a shut-in well, perhaps “Money for Nothing” by Dire Straits would come to mind. Although there have been several articles that have examined the “shut-in clause” under Louisiana law, the subject has not been reviewed in depth in a number of years.⁴

In considering these matters, it is appropriate to recognize the natural tension between the lessee and the lessor in a situation involving a shut-in well. The lessee has expended significant amounts of money to drill a well and to discover hydrocarbons, and now has to await the finalization of marketing arrangements and the construction of facilities before experiencing any positive cash flow. Correspondingly, the lessor—not averse to playing the “what have you done for me lately” card—only knows that “his well” is not producing and, if the lessee is not producing and is not drilling a well, how is “my lease” being maintained? What is in it for me?

B. “Habendum Clause”

Any consideration of these issues necessarily begins with the “habendum clause.” The “habendum clause” is the mineral lease provision that specifies the duration of the mineral lease, both during and after the primary term. A standard “habendum clause” might read as follows:

This lease shall be for a term of ___ years and ___ months from the date hereof (called “primary term”) and so long thereafter as oil, gas or some other mineral is being produced or drilling operations are conducted either on this land or on acreage pooled therewith, all as hereinafter provided for.

Sometimes called the “thereafter” clause, it states the general proposition that the mineral lease may be maintained in force and

4. Andrew L. Gates III, *Problems of Delay Rentals and Shut-in Payments*, 27 ANN. INST. ON MIN. LAW 110 (1980); D. Douglas Howard, *Problems of Interpreting and Applying Shut-In Clauses*, 11 ANN. INST. ON MIN. LAW 3 (1964); Leslie Moses, *Problems in Connection with Shut-in Gas Royalty Provisions in Oil and Gas Leases* (Part 1), 23 TUL. L. REV. 374 (1949); Leslie Moses, *Problems in Connection with Shut-in Gas Royalty Provisions in Oil and Gas Leases* (Part 2), 27 TUL. L. REV. 478 (1951); Leslie Moses, *Recent Problems in Connection with Shut-in Gas Royalty Provisions in Oil and Gas Leases*, 10 LOY. L. REV. 1 (1960); Gordon R. Crawford & William Shelby McKenzie, Comment, *Shut-in Gas Well Payment—Royalty or Rental*, 24 LA. L. REV. 384 (1964).

effect during the primary term and “thereafter” in the manner specified in the mineral lease.

The courts of Louisiana take a very strict view of the “habendum clause” of the mineral lease. For example, in the early case of *Smith v. Sun Oil Co., Inc.*,⁵ a lessor sued his lessee to declare the mineral lease to have terminated. Although not quoted in this decision, one finds from an earlier case⁶ involving the same parties and the same mineral lease that the “habendum clause” stipulated that the mineral lease was granted for a primary term of three years,

and so long thereafter as oil, gas or any other mineral is produced therefrom . . . or as long thereafter as lessee, in good faith, shall conduct drilling or mining operations thereon, with the right, if such operations result in production, to continue this lease as long as oil, gas or other mineral shall be produced.⁷

There existed on the land

two shallow gas wells, capable (perhaps) of producing from half a million to a million feet of gas per day. But [observed the court] the fact is that there is no market for said gas, that the only gas used from said wells was a few thousand feet which were used by the driller of said well.⁸

The court found that the mineral lease had lapsed by its own terms, saying:

We are of opinion that the lease has now ceased to produce either oil or gas in paying quantities. Where the output of a gas well either cannot be, or in fact is not, disposed of, the well cannot be said to be a paying proposition either for the owner of the land or for the owner of the well; and, where a well has ceased to be a paying proposition for any one concerned, it has clearly ceased to produce gas in paying quantities. We think the lease has expired by its very terms.⁹

Relying on *Smith*, the Louisiana Supreme Court in *Pace Lake Gas Co., Inc. v. United Carbon Co.*,¹⁰ stated that the “mere finding

5. 135 So. 15 (La. 1931).

6. *Smith v. Sun Oil Co.*, 116 So. 379 (La. 1928).

7. *Id.* at 379–80.

8. *Smith*, 135 So. at 15.

9. *Id.*

10. 148 So. 699 (La. 1933).

of gas in paying quantities is not a compliance with the contract of lease. Gas must be produced within the required time; that is, withdrawn and reduced to possession for use in commerce.”¹¹

This strict view of the “habendum clause” was continued in *Landry v. Flaitz*.¹² In that significant case, the plaintiff-lessor sought cancellation of a mineral lease for failure to produce oil during the primary term. The mineral lease was granted on March 29, 1957, for a primary term of three years. On January 25, 1960, the Hebert well was completed and shut-in on nearby property.

On March 28, 1960 (the day before the last day of the lease’s primary term), the Commissioner formed a unit containing 53.97 acres, of which 9.245 acres were from the plaintiff’s lands covered by defendant’s mineral lease. An allowable to produce the then unitized Hebert well was issued effective April 1, 1960,¹³ and a potential test was run on April 4, 1960. Production began on the same day. “From the foregoing recital of facts, it is clear that there was no production from the lease in controversy or from land pooled or unitized therewith within the primary term of the lease.”¹⁴ Judgment was granted in the trial court in favor of plaintiff-lessor. On appeal, the court of appeal reversed and rendered judgment for defendant-lessee. The supreme court reversed and reinstated the trial court’s judgment in favor of the plaintiff-lessor.

The court held that the mere fact that oil was *discovered* in the unit, in which part of plaintiff’s land was included, was not sufficient to maintain the mineral lease. Said the court:

Discovery of a well capable of producing minerals in paying quantities does not satisfy the requirement that oil, gas or some other mineral be *produced* under the habendum clause in order to continue the lease in full force and effect beyond the primary term. In the case of an oil well there must be actual production in progress at the time of the expiration of the primary term in order that the life of the lease may be continued beyond the primary term. This same rule applies whether the well is located on the leased

11. *Id.* at 701.

12. 157 So. 2d 892 (La. 1963).

13. The court noted that the “reason the allowable could be made effective April 1, 1960, although the required potential test was not made until April 4, 1960, is found in Statewide Order 29-B, which expressly permits retroactive effect not in excess of five days.” *Id.* at 894.

14. *Id.*

premises, or the leased premises are included in a unit formed under existing laws and regulations.¹⁵

Perhaps sympathetically, the court noted that it was

aware that in some jurisdictions “discovery” rather than “production” is sufficient to hold the lease beyond the primary term where the well was capable of production but had not in fact been produced However, such a result cannot obtain in this state in view of the language of the contested lease.¹⁶

The lessee claimed that the Commissioner’s Order (which would not provide an allowable until the unit was formed) was an obstacle or “force majeure” and, thus, extended the mineral lease. The court disagreed, noting that the lessee could have obtained an allowable on a temporary basis. Cancellation of the mineral lease was ordered.

The strict view of the “habendum clause” as articulated by Louisiana courts is to be contrasted with the view of other producing states. For example, in a case arising out of Oklahoma,¹⁷ the court held that “payment of shut-in royalty was not required to preserve a lease in the secondary term if the lessee engaged in diligent efforts to market production.”¹⁸

II. THE “SHUT-IN CLAUSE”—IN GENERAL

A. Preface

In order to ameliorate the harsh consequences experienced by the lessee in the cases noted above, the “shut-in clause” was born and soon became a part of the commercial printed lease form. Indeed, the *Flaitz* court’s recognition that “such a result cannot obtain in this state *in view of the language of the contested lease*” clearly invites a contractual fix to the court’s harsh result (from the lessee’s viewpoint).

15. *Id.* at 895 (emphasis added).

16. *Id.*

17. *Gard v. Kaiser*, 582 P.2d 1311 (Okla. 1978). The *Gard* court held that, under the facts, “the provisions of leases ‘as long thereafter as . . . gas . . . is produced’ do not require ‘marketing.’ [The court did] not construe language of the leases to operate to terminate a shut-in gas well during a period lessee is diligently seeking a market.” *Id.* at 1314.

18. HOWARD R. WILLIAMS & CHARLES J. MEYERS, *OIL AND GAS LAW* § 631 n.2 (3d ed. 2008).

The “shut-in clause” would provide relief to the lessee under the circumstances presented in *Landry v. Flaitz* and the earlier cases cited above. Thus, this contractual innovation specifies the circumstances under which the mineral lease might be maintained, in the absence of some other basis of maintenance, if a well is drilled and is capable of producing but is not in fact producing for a reason envisioned by the lease clause.

On more than one occasion, your author has heard the view expressed that the lessee can maintain leasehold rights when a well is shut-in, regardless of when that occurs or of the circumstances which necessitated the shutting-in of the well. Maybe. But maybe not. It depends on the language of the lease contract, which brings us to the general notion of “freedom of contract.”

B. “Freedom of Contract”

A “shut-in clause” is purely a “creature of contract.”¹⁹

“Freedom of contract” prevails in Louisiana in that “[u]nless expressly or impliedly prohibited from doing so, individuals may renounce or modify what is established in their favor by the provisions of [the Mineral] Code if the renunciation or modification does not affect the rights of others and is not contrary to the public good.”²⁰

Of course, this is not a concept unique to mineral leases. As a general proposition, “[p]arties are free to contract for any object that is lawful, possible, and determined or determinable.”²¹ This latitude is subject to the limitation that contracting parties “may not by their juridical acts derogate from laws enacted for the protection of the public interest” and that “any act in derogation of such laws is an absolute nullity.”²²

A mineral lease—above all other “mineral rights”²³—is the classic example of the exercise of “freedom of contract” enunciated in article 3 of the Louisiana Mineral Code. In this

19. Your author’s conversations with lawyers who studied mineral rights at LSU Law School under Professor Harriett “Ma” Daggett indicate that she would diligently instruct as to the mineral servitude and the mineral royalty, but, when it came to the mineral lease, would rather dismissively say, “the lease, it’s a contract—read it,” or words to that effect. While it might be that the mineral lease has since been elevated to a more prominent role, Professor Daggett’s view certainly says a great deal about this notion of “freedom of contract.”

20. LA. REV. STAT. ANN. § 31:3 (2000).

21. LA. CIV. CODE ANN. art. 1971 (2008).

22. LA. CIV. CODE ANN. art. 7 (2008).

23. “The basic mineral rights that may be created by a landowner are the mineral servitude, the mineral royalty, and the mineral lease.” LA. REV. STAT. ANN. § 31:7 (2000).

sense, there is no such thing as a “standard form” of mineral lease, although this has not prevented courts from making reference to a mineral lease under judicial consideration as being on a “standard form.”²⁴

The supremacy of the contract confectioned by the parties is enforced by the legislative recognition that the mineral lease is the “law between the parties.”²⁵ Or, as stated by one court, “the ‘shut-in clause’ was devised to benefit *both* lessor and lessee and that each such clause must be interpreted on an individual basis according to its own language.”²⁶

For this reason, one should be cautious about drawing universal conclusions from cases involving the interpretation of mineral leases; in many cases, the ruling may be unique to the peculiarities of the particular mineral lease involved.

While there is no “standard form” of mineral lease, there are certain commercially printed forms which are in prevalent use in Louisiana. These include the following, to-wit:

- (1) 14BR1, North Louisiana Form;
- (2) Bath 4A or 4B, South Louisiana Form—the so-called “lessor’s form,” as the nuances of its terms tend to favor the lessor;
- (3) Bath 6, South Louisiana Form—the so-called “lessee’s form,” as the nuances of its terms tend to favor the lessee.

The reference to the “Bath” form has reference to the M. L. Bath Co., Ltd., a printing company in Shreveport, which has been the industry leader in the publication and sale of the mineral lease forms most frequently utilized in Louisiana.

24. Such a reference has been made in several cases, including *Butler v. Bazemore*, 303 F.2d 188, 191 (5th Cir. 1962) (“Both leases were on an identical standard form (Bath’s Spec. 14-BR-1) in common use in north Louisiana.”), *Acadia Holiness Assoc. v. IMC Corp.*, 616 So. 2d 855 (La. App. 3d Cir.), *writ denied*, 620 So. 2d 842, 856 (La. 1993) (“In 5 of the 7 standard lease forms executed by the plaintiffs . . .”), *Brundage v. Bean Energy, Inc.*, 509 So. 2d 112, 113 (La. App. 1st Cir.), *writ denied*, 512 So. 2d 460 (La. 1987) (“The mineral lease is printed on a standard Bath-O-Gram Louisiana Revised Six (6) 76K—Pooling Form.”), *Mathews v. Goodrich Oil Co.*, 471 So. 2d 938, 939 (La. App. 2d Cir. 1985) (“The lease is contained on a standard printed form (Bath’s 14BRI-2A) . . .”), *Richard v. Tarpon Oil Co.*, 269 So. 2d 261 (La. App. 3d Cir. 1972), *writ denied*, 271 So. 2d 262, 262 (La. 1973) (“On March 11, 1969, Herbert Richard executed an oil, gas and mineral lease on a standard form . . .”), and *Fontenot v. Humble Oil & Refining Co.*, 210 So. 2d 340, 342 (La. App. 3d Cir. 1968) (“The lease is on a standard lease form commonly used in Southwest Louisiana.”).

25. LA. CIV. CODE ANN. art 1983 (2008).

26. *Nordan-Lawton Oil & Gas Corp. of Tex. v. Miller*, 272 F. Supp. 125, 133 (W.D. La. 1967).

C. Contrast of “Shut-in Clauses” in Prevalent Commercial Printed Lease Forms

1. Preface

Because the relief afforded to the lessee in the case of a shut-in well is purely contractual, it is important to carefully review the content of the clause.

As noted above, the 14BR1 is the prevalent commercial printed mineral lease form in use in North Louisiana. Paragraph 5 of that mineral lease form is the “shut-in clause” and it reads as follows:

If Lessee obtains production of mineral on said land or on land with which the lease premises or any portion thereof has been pooled, and if, during the life of this lease either before or after the expiration of the primary term, all such production is shut in by reason of force majeure or the lack either of a market at the well or wells or of an available pipeline outlet in the field, this lease shall not terminate but shall continue in effect during such shut-in period as though production were actually being obtained on the premises within the meaning of paragraph 2 hereof,²⁷ and, during the month of January of each year immediately succeeding any year in which a shut-in period occurred when all such production was so shut-in, Lessee shall pay or tender, by check or draft of Lessee, to the royalty owners or to the royalty owners’ credit in any depository bank named in this lease, as royalty, one-twelfth (1/12) of the amount of the delay rental provided for in paragraph 4 hereof for each full calendar month in the preceding calendar year that this lease was continued in force solely and exclusively by reason of the foregoing provisions of this paragraph. The owners of the royalty as of the date of such payment shall be entitled thereto in proportion to their ownership of the royalty. The provisions of this paragraph shall be recurring at all times during the life of this lease. Nothing in this paragraph contained shall abridge the right of Lessee to otherwise maintain this lease in force and effect under its other provisions, and for any part of a shut-in period that this lease is otherwise being maintained in force and effect no shut-in royalty shall be due.

The “shut-in clause” in the Bath 4A Form (Paragraph 6) reads as follows:

27. Paragraph 2 of the so-called “North Form” is the “habendum clause.”

Should Lessee by the drilling of any well located on the land or on property pooled therewith, discover gas or gaseous substances capable of producing in paying quantities but which Lessee is unable to produce (or which although previously produced, Lessee is unable to continue to produce) because of lack of market or marketing facilities or Governmental restrictions, then Lessee's rights may be maintained, in the absence of production or drilling operations, by commencing or resuming rental payments as hereinabove provided for in connection with the drilling of a non-producing well; and should such conditions occur or exist after the primary term Lessee's rights may be further extended by the commencement, resumption or continuance of such payments at the rate and in the manner herein fixed for rental payments during the primary term; provided, however, that in no event shall Lessee's rights be so extended by rental payments and without drilling operations or production of oil, gas or some other mineral for more than two consecutive years.

The "shut-in clause" in the Bath 6 Form (Paragraph 6) reads as follows:

In the event that any well on the land or on property pooled therewith (or with any part thereof), is capable of producing gas or gaseous substances in paying quantities but such minerals are not being produced, then Lessee's rights may be maintained, in the absence of production or drilling operations, by commencing or resuming rental payments as hereinabove provided for in connection with the abandonment of wells drilled. Should such conditions occur or exist at the end of or after the primary term, or within ninety (90) days prior to the expiration thereof, Lessee's rights may be extended beyond and after the primary term by the commencement, resumption or continuance of such payments at the rate and in the manner hereinabove provided for rental payments during the primary term, and for the purpose of computing and making such payments the expiration date of the primary term and each anniversary date thereof shall be considered as a fixed rental paying date; provided, however, that in no event shall Lessee's rights be so extended by rental payments and without drilling operations or production of oil, gas or some other mineral for more than five consecutive years.

2. *Under What Circumstances May Shut-in Payments be Made?*

Another common misconception is that the lessee may resort to the payment of shut-in rentals (under the so-called "South Forms"; the so-called "North Form" provides for shut-in *royalties*) at any time that a well is shut-in, and then regardless of the cause that precipitated the shut-in situation.

Under the Bath 4A Form, the lessee may maintain its leasehold rights by paying a shut-in rental *only* if the well is shut-in because of "lack of market" or "Governmental restrictions." This constitutes a predicate that, under such form of lease, must be met before resort may be had to the payment of shut-in rentals. Thus, under the Bath 4A Form, if a well ceases to produce purely because of mechanical problems unrelated to the "market," the "shut-in clause" is not implicated. Such a well cannot be said to be shut-in because of "lack of market."

In contrast, the Bath 6 Form does not articulate a predicate reason for the shut-in conditions that first must be met. Rather, shut-in conditions exist when gas is in fact "not being produced." Therefore, no showing of a precise cause or reason is necessary under the Bath 6 Form.

Shut-in conditions arise under the so-called "North Form" when the well is shut-in "by reason of force majeure or the lack either of a market at the well or wells or of an available pipeline outlet in the field."

In any event, the lessee who relies on the "shut-in clause" under a mineral lease which applies in a particular circumstance, such as "lack of market or marketing facilities," would be prudent to document those predicate circumstances in the event that a dispute arises at a later date as to the lessee's right to maintain the mineral lease by a shut-in payment.

3. *At What Point in Time May Shut-in Payments be Made?*

Under the Bath 4A Form (even if the predicate circumstances are presented) and under the Bath 6 Form (which contains no predicate), the issue is presented as to whether the lessee has the right, at a particular point in time, to resume shut-in rentals.

The so-called "North Form" seems to permit the lessee to resort to the "shut-in clause" at any time during the "life of this lease" by stating that the "provisions of [the 'shut-in clause'] shall be recurring at all times during the life of this lease."

If the situation arises during the primary term under the so-called "South Forms," the answer clearly is yes. As seen by

reference to the “shut-in clauses” quoted in Part II.C.1, it is provided that “[l]essee’s rights may be maintained, in the absence of production or drilling operations, by commencing or resuming rental payments as hereinabove provided for” in connection with “the drilling of a non-producing well”²⁸ and “the abandonment of wells drilled.”²⁹ The reference to the manner “as hereinabove provided for” has reference to the “dry hole clause”—Paragraph 4 of the so-called “South Form”—expressly allows resumption of rental payments if the circumstances arise during the primary term.

Paragraph 6 further provides that,

[s]hould such conditions occur or exist at the end of or after the primary term, or within ninety (90) days prior to the expiration thereof, Lessee’s rights may be extended beyond and after the primary term by the commencement, resumption or continuance of such payments at the rate and in the manner hereinabove provided for rental payments during the primary term, and for the purpose of computing and making such payments the expiration date of the primary term and each anniversary date thereof shall be considered as a fixed rental paying date.

There is a temporal limitation, however, in that, “in no event shall Lessee’s rights be so extended by rental payments and without drilling operations or production of oil, gas or some other mineral for more than five consecutive years.”

It is not uncommon, when dealing with these forms, to see the “five” changed to “three” or “two,” and also to see the word “consecutive” stricken. The use of the word “consecutive” would seem to allow the lessee to pay rentals for a period of time, not reaching “five [or three] consecutive years,” and then produce the well, and then again shut-in the well and resume payments for a period not reaching “five [or three] consecutive years,” and so on and so forth. By striking “consecutive,” the stated period of time constitutes a temporal limitation on the maximum period during which leasehold rights may be maintained by such payments.

4. An Example

An example under each of the Forms would facilitate an understanding of the workings of the “shut-in clause.” A mineral lease is granted on February 1, 2006, for a five year primary term. It covers and affects a 120-acre tract of land and stipulates delay

28. Bath 4A Form.

29. Bath 6 Form.

rentals based upon \$100.00 per acre. The lessee commences a well on the leased premises on October 1, 2006, and, on December 1, 2006, the well is completed as a well capable of producing gas in “paying quantities,” but is shut-in. The lessee consults you two days before Christmas (isn’t that always the case?) and asks for your advice as to how he might maintain his leasehold rights. What is your advice?

To start with a radical thought, one needs to know what the lease says. Let’s consider the factual scenario under the so-called “South Form” and then under the so-called “North Form.” It is necessary under the Bath 4A Form to ascertain the reason the well is shut-in, as mentioned above.³⁰ The lessee may maintain its leasehold rights by paying a shut-in rental *only* if the well is shut-in because of “lack of market” or “[g]overnmental restrictions.” Similarly, under the so-called “North Form,” it must be determined that “such production is shut in by reason of force majeure or the lack either of a market at the well or wells or of an available pipeline outlet in the field.” In other words, the reason does matter—the predicate must be met.

If your client is operating under the Bath 6 Form, there is no predicate reason for the shut-in conditions that must first be met. The mere fact that the well is shut-in is sufficient.

Having made that initial determination, one should note that no action is necessary under either lease if, by chance, the lease is being “otherwise maintained.”³¹ The facts do not disclose it, but you should inquire into the possibility that some portion of the leased premises is included in a unit for another well which is either producing or being drilled. If such were the case, you would then need to determine if the mineral lease contained a “Pugh clause.”³² If so (and, of course, depending upon what the “Pugh clause” provides), the other well might not serve to abate the need to make a shut-in payment.

Assuming that the mineral lease is not being “otherwise maintained,” the options available to the lessee include the drilling

30. See *supra* Part II.C.2.

31. See *infra* Part III.F.

32. LA. REV. STAT. ANN. § 31:114 (2000). As noted by then Judge Tate in *Fremaux v. Buie*, 212 So. 2d 148 (La. App. 3d Cir. 1968), a “Pugh” clause is named after its creator, the late Lawrence G. Pugh, Sr., a distinguished attorney of Crowley, Louisiana. Its purpose is to avoid the consequences of the holding of Louisiana mineral law, see *Hunter Co. v. Shell Oil Co.*, 31 So. 2d 10 (1947) . . . , that production from a unit including a portion of a leased tract will maintain the lease in force as to all the lands covered by the lease.

Id. at 149 n.1.

of another well or the payment of a “shut-in payment.” Under the so-called “North Form,” that payment is characterized as a royalty, while, under the so-called “South Forms,” it is classified as a rental.³³

Under the so-called “North Form,” a payment is due “during the month of January of each year immediately succeeding any year in which a shut-in period occurred when all such production was so shut-in.” Since it is due “during the month of January,” it would seemingly not be late if paid on or before the last day of the month, although prudence would suggest that the payment should be made as early as possible. The payment should be “one-twelfth (1/12) of the amount of the delay rental provided for in Paragraph 4 hereof for each full calendar month in the preceding calendar year that this lease was continued in force solely and exclusively by reason of” the provisions of Paragraph 5 of the so-called “North Form.”

Our hypothetical example indicates that the well was shut-in on December 1, 2006. Hence, the month of December 2006 is a “full calendar month in the preceding calendar year that this lease was continued in force solely and exclusively by reason of” the “shut-in clause.” In fact, it is the only such month. If the well were shut-in, say, on some subsequent date in December, the month of December would not constitute a “full calendar month,” and presumably no payment is due.

Thus, under our factual scenario, a payment of \$1,000.00 should be made “to the royalty owners” during the month of January 2007. This is calculated as follows: 1/12 times 120 acres times \$100.00 per acre times 1 month, or \$1,000.00.

Under both of the so-called “South Forms”—the Bath 4A Form and the Bath 6 Form—the shut-in well is treated, for lease maintenance purposes, as a “dry hole,” and resort must be had to Paragraph 4 of such forms. This allows the lessee to maintain leasehold rights by “commencing or resuming rental payments as hereinabove provided for in connection with the abandonment of wells drilled.”

In essence, unless the lessee elects to drill another well or perhaps (if permitted) re-work a well, Paragraph 4 requires the lessee to make a proportionate rental payment on or before ninety days from the date on which the well is shut-in.³⁴ From that ninetieth day, the lessee counts the number of days remaining in the lease year (running up to the next anniversary date) and then

33. See *infra* Part III.J.

34. See *Wehran v. Helis*, 152 So. 2d 220 (La. App. 4th Cir. 1963) (providing an explanation of the computation of a lease term).

forms a proportion (number of remaining days over 365) which is multiplied by the annual rental. In this example, the “on or before” date would be March 1, 2007, and there are 336 days remaining in the lease year until the next anniversary date of February 1, 2008.

Thus, under our factual scenario, a payment of \$11,046.58 should be made to the lessor on or before that ninetieth day, or on or before March 1, 2007. This is calculated as follows: 120 acres times \$100.00 per acre times 336/365, or \$11,046.58.

It should be noted that, had the well been drilled in 2007, or after the payment of the initial delay rental (for the entire year), no monies would be owing under either of the so-called “South Forms” since the circumstances arise in a year for which rental or other payment had already been made.³⁵ Since the lessee paid a rental in order to “delay” drilling operations, it would be unjust to punish the lessee who nevertheless conducted drilling operations.

D. Mutual Benefit to Both Lessor and Lessee

The “shut-in clause” is a “two-way street.” There is value to both the lessor and the lessee under the unique circumstances that are presented by a shut-in gas well (brought about at the risk of, and after significant expenditure of capital by, the lessee) that is capable of producing in “paying quantities” (which assures value to the lessor upon attainment of a market).

No one says it better than the courts. For example, in *Nordan-Lawton Oil & Gas Corp. v. Miller*,³⁶ Judge Griffin Bell recognizes this mutuality of interest in the following words, to-wit:

Shut-in or in lieu royalties were devised to benefit both the lessor and lessee from the standpoint of insuring exploration for and the production of minerals in paying quantities so that both parties will reap the expected benefits. A clause embracing such a provision is for the purpose of protecting the lessor where there are wells capable of producing in paying quantities but where no market can be found for such production. Under this type of clause the lessor or royalties owner is paid a stipulated sum while the production is shut-in. At the same time the lease is maintained instead of being cancelled for lack of production.³⁷

35. See ¶ 4, Bath 4A Form and Bath 6 Form (“[B]ut, if said ninety (90) days should expire during any year for which rentals have been paid, no further rental shall be due until the next fixed rental paying date.”).

36. 403 F.2d 946 (5th Cir. 1968).

37. *Id.* at 948.

III. THE “SHUT-IN CLAUSE”—HOW IT OPERATES

A. Preface

At the risk of redundancy, one must remember that the ability of a lessee to properly maintain his rights under a mineral lease is purely contractual. Therefore, one must necessarily examine the precise terms of the “shut-in clause” to ascertain its applicability and operation. There are, however, certain features that generally prevail in the area of “shut-in clauses.”

B. Requisite Level or Amount of Production Needed in Order to Invoke the “Shut-in Clause”

Under the “shut-in clauses” contained in the Bath 4A Form and the Bath 6 Form (the so-called “South Forms”), shut-in conditions arise whenever a well is drilled and is “capable of producing [gas or gaseous substances] in paying quantities.” While the 14BR1 (the so-called “North Form”) makes no reference to “paying quantities,” the courts of Louisiana will nevertheless imply such a requirement.³⁸

Since Louisiana law requires that, in connection with the maintenance of mineral leases by production under the usual “habendum clause,” such production must be in “paying quantities,”³⁹ it would be illogical that production in less than “paying quantities” would suffice to invoke the “shut-in clause.” Since production that is not in “paying quantities” is really no production at all for lease maintenance purposes,⁴⁰ the resolutive condition embodied in the “habendum clause” would become operative when production ceases to be in “paying quantities” (assuming, of course, that the lease is not being otherwise maintained).

This conclusion is reinforced by the recognition of the Louisiana Supreme Court in *Taylor v. Kimbell*⁴¹ that the lessee may only resort to the “shut-in clause” upon a showing that “the gas well drilled on the premises can be classed as a *producer in*

38. *Brown v. Sugar Creek Syndicate*, 197 So. 583, 593 (La. 1940) (interpreting the customary “habendum clause” providing that the lease is to last “for a period of five years and as long thereafter as oil or gas, or either of them, is produced” to mean “producing oil and gas in paying quantities”); *Caldwell v. Alton Oil Co.*, 108 So. 314 (La. 1926).

39. See Patrick S. Ottinger, *Production in “Paying Quantities”—A Fresh Look*, 65 LA. L. REV. 635 (2005).

40. *Caldwell*, 108 So. at 314.

41. 54 So. 2d 1 (La. 1951).

paying quantities and was shut in because of no market or demand for the gas.”⁴²

In *Pan American Petroleum Corp. v. O’Bier*,⁴³ the court was concerned with a well that was shut-in, not “for lack of market,” but that was, “in effect, abandoned because of failure of production.” At issue was whether the payment of shut-in royalties served to interrupt prescription accruing against a mineral servitude. The court rejected the contention that the payment and receipt of shut-in royalty payments “constituted such a use of the servitude rights as would prohibit the application of the principle of prescription.”⁴⁴ Clearly, the absence of a well capable of producing in “paying quantities” made the payment of shut-in royalties unavailable and ineffectual for any purpose.

The courts have indicated that the amount of the shut-in payment stipulated in the mineral lease is not a “floor” which determines the minimum amount which must be produced in order for the lease to be considered as producing in “paying quantities.” For example, in *Vance v. Hurley*,⁴⁵ the supreme court stated as follows:

The fact that the lessees have the right under the lease to cap any well drilled when there is a lack of demand or market and yet keep the lease in effect by paying \$2,000 per well per year, not, however, exceeding three years, does not mean, as contended by the plaintiffs, that the lease can be cancelled if a well produces in quantities that do not net the lessors royalties amounting to \$2,000 per well per year.⁴⁶

C. Capability of Well to Produce as an Engineering Matter

The notion that the “shut-in clause” is operative if there exists a well “capable of producing in paying quantities” requires that consideration be given to the meaning, in this context, of the word “capable.” The word “capable” gives rise to two distinctly different meanings in relation to a shut-in gas well.

The first connotation is whether the lessee has discovered reserves which, if produced and “reduced to possession,” would be of such a quantity as to meet the quantitative test of “paying

42. *Id.* at 2 (emphasis added).

43. 201 So. 2d 280 (La. App. 2d Cir. 1967).

44. *Id.* at 286.

45. 41 So. 2d 724 (La. 1949).

46. *Id.* at 727.

quantities.” That phase of the term “capable” is considered elsewhere.⁴⁷

The second meaning of the term “capable” concerns the physical capacity or ability of the well to actually produce the found minerals. Is the well sufficiently equipped to actually produce the minerals?

Case law in Texas holds that a well is capable of production if it is capable of producing in “paying quantities” without additional equipment or repairs.⁴⁸ That is, “capable of producing in paying quantities” means a well “that will produce in paying quantities if the well is turned ‘on’ and it begins flowing, without additional equipment or repair.”⁴⁹ As a converse proposition, “a well would not be capable of producing in paying quantities if the well switch were turned ‘on,’ and the well did not flow, because of mechanical problems or because the well needs rods, tubing, or pumping equipment.”⁵⁰

There is no Louisiana case that squarely addresses this precise issue, but a Louisiana court would hold similarly. For example, in *Eads Operating Co., Inc. v. Thompson*,⁵¹ a 1948 voluntary unit agreement was held to have terminated by its own terms where the agreement provided that the unit would continue in full force and effect as long as production is or can be produced in paying quantities.⁵² The unit was operated by the original operator until 1979, at which time the leases were released and all equipment was salvaged from the wells. Several months later, new leases were taken by Eads, a different operator.

Eads, the new operator, drilled a well on a “lease basis” but within the confines of the former unit, which produced for a period of time. After the costs of drilling and operating the new well were paid out, a royalty owner under a tract adjacent to the drill site contended that the 1948 unit was a Commissioner’s unit which had not been terminated by action of the Commissioner. Therefore, the royalty owner contended that the tract (which was unleased) was entitled to participate in production from the well on a unitized basis.

47. See *infra* Part III.D.

48. *Anadarko Petroleum Corp. v. Thompson*, 94 S.W.3d 550, 558 (Tex. 2002).

49. *Hydrocarbon Mgmt. v. Tracker Exploration*, 861 S.W.2d 427, 433–34 (Tex. App.—Amarillo 1993).

50. *Id.* at 434.

51. 646 So. 2d 948 (La. App. 1st Cir. 1994), *writ denied*, 652 So. 2d 1345 (La. 1995). In the interest of full disclosure, your author represented the operator in this suit.

52. *Id.* at 952.

The new operator filed a declaratory judgment against the Commissioner of Conservation and the adverse royalty claimants to determine the rights and obligations of the parties. The principal issue was whether the unit created in 1948 was a compulsory unit that was still in effect by reason of the fact that the Commissioner had taken no formal action to terminate it, or, as posited by the operator, was a conventional unit (albeit one that had been “blessed” by the Commissioner) that had terminated by its own terms despite the absence of further action by the Commissioner.

The court held that the order issued in 1948 could not have created a reservoir-wide unit since the Commissioner did not have the statutory authority to create such units until Act No. 441 of 1960, which enacted Louisiana Revised Statutes section 30:5C. Since the Commissioner did not have such authority in 1948, the unit was not a Commissioner’s unit which required the action of the Commissioner to be terminated. It terminated in accordance with the express terms of the contract.

The plaintiff’s well was held to be a “lease basis,” non-unitized well. Instructive here is the conclusion that, despite the fact that production was later obtained from the (voluntarily) unitized reservoir (indicative of a capacity to produce), the voluntary unit agreement was held to have terminated because the absence of the necessary “plumbing” meant that the wells were not *capable* of producing in “paying quantities.”

D. Burden to Demonstrate Productive Capacity of a Shut-in Well

1. Jurisprudence

As between the lessor and the lessee, who has the burden to prove that a well is shut-in and that the lessee has the right to make shut-in payments? This issue has been considered by the courts in a number of cases.

First is *Taylor v. Kimbell*,⁵³ wherein a mineral lease was granted for a five year primary term on June 22, 1944. The lessee drilled a well on a portion of the leased premises. The court noted that the well “is capable of producing gas in paying quantities, but is shut-in because of lack of market for the gas.”⁵⁴ After the period of time during which the mineral lease permitted the lessee to pay delay rentals, the lessee tendered a shut-in royalty payment of \$50 pursuant to the following clause in the mineral lease, to-wit:

53. 54 So. 2d 1 (La. 1951).

54. *Id.* at 2.

Where gas from a well producing gas only is not sold or used because of no market or demand therefor, lessee may pay as royalty \$50 per well, per year, payable quarterly, and upon such payment it will be considered that gas is being produced within the meaning of Article 2 of this contract.⁵⁵

The lessor refused the tender of this payment and sued to have the mineral lease declared terminated. The court framed the issue before it as follows:

Under the plain terms of the lease contract, the primary term having expired, all rights granted the lessee under the lease have terminated unless the record shows that the gas well drilled on the premises can be classed as a producer in paying quantities and was shut in because of no market or demand for the gas.⁵⁶

Considering the evidence, the court concluded that “it does not appear to us that the well is capable of producing in paying quantities.”⁵⁷ Since the well was determined to be incapable of producing in “paying quantities,” there was no right to invoke the shut-in provision of the mineral lease.

This issue was next considered in *Webb v. The Hardage Corp.*⁵⁸ In that case, three separate mineral leases were granted for a primary term of five years in May 1976. A well was drilled on each of the leased premises in April 1981, one month prior to the expiration of the primary terms of the mineral leases. The wells were cored, logs were run, casing was set, the wells were perforated, and the formation was fracked. The only surface testing performed by the lessee was to flare the gas for four or five hours. After flaring such gas, the wells were shut-in for lack of a market for the gas. Work on the wells was completed in June 1981. The initial potential test required by the Commissioner of Conservation was not performed. The lessee tendered shut-in royalty payments to the lessors, which were refused and returned. In March 1983, the lessee performed an initial potential test on one of the wells. The lessors filed suit to seek a declaration of the termination of the mineral leases and to enjoin the lessee from taking any further action on the property in question.⁵⁹

55. *Id.*

56. *Id.*

57. *Id.* at 3.

58. 471 So. 2d 889 (La. App. 2d Cir. 1985).

59. *Id.* at 890–891.

The mineral leases in question contained the following shut-in provision, to-wit:

If lessee obtains production of minerals on said land or on land with which the lease premises or any portion thereof has been pooled, and if, during the life of this lease either before or after the expiration of the primary term, all such production is shut in by reason of force majeure or the lack either of a market at the well or wells or of an available pipeline outlet in the field, this lease shall not terminate but shall continue in effect during such shut-in period as though production were actually being obtained on the premises within the meaning of Paragraph 2 hereof.⁶⁰

The issue presented was whether or not the lessee had timely demonstrated the existence of shut-in conditions. The court stated as follows:

Reading LSA-R.S. 31:124 [which defines ‘production in paying quantities’] in conjunction with the terms of the leases, the shutting-in of the gas wells on the three leased properties could only extend the leases beyond their primary terms if the wells were capable of producing in paying quantities.⁶¹

The court observed that the lessor generally, “has the burden of proving the propriety of cancellation of a mineral lease,”⁶² but held that “the situation encountered in this case presents an exception to that general rule.”⁶³ The court further stated:

A lessee cannot place the burden of proving the propriety of cancellation on the lessor by simply alleging that a well that has never been placed into actual production is capable of producing in paying quantities. Rather, the lessee must prove by a preponderance of the evidence that prior to the expiration of the primary term or the continuous drilling operations term a well was completed and surface tested to the extent that the well was at that time demonstratively capable of producing in paying quantities.⁶⁴

60. *Id.* at 891.

61. *Id.* at 892. *See* Taylor v. Kimbell, 219 La. 731, 54 So. 2d 1 (1951).

62. *Id.* (citing Frazier v. Justiss Mears Oil Co., 391 So. 2d 485 (La. App. 2d Cir. 1980)).

63. *Id.*

64. *Id.*

Ordinarily, proof sufficient to carry this burden is a finding of commercial productivity resulting from the performing of the initial potential test required by the Department of Conservation. While other kinds of evidence of production potential could also be considered, such as the results of logs and cores, the flaring of the wells for periods of time, and the history of the wells in the same zone in the field, the importance of actual testing of surface production is obvious and is the most direct indication of production capability.

The court then noted, by way of analogy, that the “importance of surface testing is illustrated by the provisions of LSA-R.S. 31:34 and 31:90 which address the testing of shut-in wells in the context of interrupting prescription on mineral servitudes and mineral royalties respectively.”⁶⁵ The initial potential test, according to the court, “must be conducted during the primary term or the continuous operations term in order to continue a lease in effect beyond the primary and the continuous operations terms. Without such surface testing, the status of the lease would ordinarily remain uncertain while the well is shut-in.”⁶⁶

A lessee should not be able to rely on the shut-in clause to hold a lease beyond its primary term where the well’s capacity to produce in paying quantities cannot be determined until further testing and procedures are carried out at some later date.

Because the lessee failed to carry its burden to demonstrate that its wells were shut-in and that the lessee had the right to make shut-in payments, the mineral leases were held to have lapsed.⁶⁷

2. *State Mineral Leases*

In the case of a State mineral lease,⁶⁸ there is an explicit contractual requirement for proof as to the eligibility of a well to be maintained by the payment of shut-in rentals. The current form of State lease⁶⁹ permits the lessee to maintain his rights in the event that “there is on the leased premises a well or wells capable of producing gas in paying quantities, *which fact has been duly verified and confirmed in accordance with Lessor’s requirements for proof thereof.*”

The State Mineral Board has adopted “Requirements for Verification of Commercial Productivity of Non-Producing

65. *Id.*

66. *Id.*

67. *Id.* at 893.

68. LA. REV. STAT. ANN. §§ 30:124–125 (2007).

69. Louisiana State Lease Form ¶ 6(d) (revised 2000).

Leases.”⁷⁰ In essence, this requires submittal to the State Mineral Board of the initial potential test, as required by the Louisiana Office of Conservation, and other described data. If, for any reason, such proof cannot be presented, the matter is addressed by the Board through its Legal and Title Controversy Committee process and is effectuated by an amendment to the lease.

E. Customary Lease Maintenance Options

In *Sohio Petroleum Co. v. V.S. & P.R.R.*,⁷¹ a gas well was drilled and “was capped immediately.” Among other bases to declare the lease to have terminated, the lessors contended that the mineral lease lapsed by reason of the failure of the lessee to pay a shut-in “well fee or royalty of \$500.00 a year.”

Article 3(c) of the lease comprised the “shut-in clause” providing as follows:

Where gas from a well producing gas only is not sold or used because of no market or demand therefor, lessee may pay as royalty \$50.00 per well, per year, payable quarterly, and upon such payment it will be considered that gas is being produced within the meaning of Article 2 of this contract.⁷²

The court rejected plaintiffs’ contention, saying, as follows:

Article 3 of the lease, relied on by the plaintiffs as an alternative ground for the cancellation of their leases, does not provide for the forfeiture of the lease in the event of the failure of the lessee to pay the shut-in well fee or royalty of \$50.00 a year. The payment of this royalty is not made a condition precedent for the continuation of the lease. Instead, the provision makes it optional with the lessee to make such payment if he wants it “to be considered that gas is being produced within the meaning of Article 2” of the contract, i.e., the primary term is to be continued so long as minerals are produced.⁷³

In *Davis v. Laster*,⁷⁴ plaintiff-lessor sought cancellation of a mineral lease. The lessee drilled a gas well on the leased premises,

70. The requirements are available on the web site of the Office of Mineral Resources. See La. Dept. of Natural Res., <http://dnr.louisiana.gov/min/forms.asp> (last visited July 18, 2008).

71. 62 So. 2d 615 (La. 1953).

72. Article 2 of the mineral lease is the “habendum clause.”

73. *Sohio Petroleum*, 62 So. 2d at 620.

74. 138 So. 2d 558 (La. 1962).

which was shown by open flow potential tests to be “capable of producing in paying quantities.”⁷⁵ The well, “having been completed and potential tests having been made, was shut in for lack of a market for the gas.”⁷⁶ Actual production did not begin until after the expiration of the ten year primary term of the mineral lease.

Although shut-in payments were provided for by the mineral lease, the lessee had erroneously paid delay rentals for a period of time when the well was shut-in. The lessee argued that the “shut-in clause” afforded an option to the lessee to pay *either* delay rentals *or* shut-in payments. The clause read as follows:

Where gas from a well producing gas only is not sold or used because of no market or demand therefor, lessee *may* pay as royalty \$50.00 per well, per year, payable quarterly, and upon such payment it will be considered that gas is being produced within the meaning of [the habendum clause] of this contract.⁷⁷

Focusing on the permissive word “may,”⁷⁸ the lessee urged that the “shut-in clause” “makes it optional with the lessee to make such payments *if* he wants it ‘to be considered that gas is being produced’ within the meaning of the habendum clause in the lease.”⁷⁹

The appellate court (reversing the trial court) held that the payment of delay rentals when shut-in payments were due resulted in the termination of the mineral lease.

The supreme court also rejected the lessee’s contention that it had the option to pay *either* delay rentals *or* shut-in payments, at his election.

No reason is apparent that would permit the interpretation that the language of the option granted by article 3(c) permits the payment of annual delay rentals after drilling operations have resulted in a shut-in well. This is true because rental payments under article 4 are designed only to grant the privilege of deferring commencement of drilling operations. Once, therefore, drilling operations have commenced, the lessees are relegated to

75. *Id.* at 559.

76. *Id.*

77. *Id.* at 561 (emphasis added).

78. Although referenced purely by way of analogy (as it pertains to the interpretation of statutes), Louisiana Revised Statutes section 1:3 instructs that the “word ‘shall’ is mandatory and the word ‘may’ is permissive.” LA. REV. STAT. ANN. § 1:3 (2003).

79. *Davis*, 138 So. 2d at 561 (emphasis added). The lessee relied upon *Sohio Petroleum Co. v. V.S. & P.R.R.*, 62 So. 2d 615 (La. 1953).

continuing drilling operations, paying shut-in royalties, or actual royalties to maintain the lease, or, where production *ceases*, resuming delay rentals as authorized by article 5.

The result, under the facts of this case, is that the option granted by “may” in article 3(c) is the option to pay shut-in royalties or resume drilling operations under the terms of the lease.⁸⁰

The lessee also attempted to rely on the “cessation of production clause” as a basis of authority to pay delay rentals. This was also rejected by the supreme court, which said that a “shut-in well is not dry, and, although not actually producing, it is unrealistic to say that production has ceased within the established meaning of these words. The very purpose of the shut-in well clause of oil and gas leases is to permit the lessees to maintain the lease as though it were producing.”⁸¹

Notwithstanding that shut-in payments were due, the lessor had accepted delay rental payments for nine years. The court found it equitable to consider that the mineral lease provisions had been modified by mutual consent, especially in view of the fact that the lessor suffered no loss (the delay payments were much more than the shut-in payments).⁸²

The court provided the following explanation of the essential purpose and objective of a “shut-in clause” as follows:

The plain language of the lease contract provides for its termination at the end of the primary term, unless it can be considered that oil, gas or other minerals are being produced from the leased premises or lands pooled therewith. The production required to maintain the lease must be either actual or constructive. It is not actual production here. Lessees, by paying the shut-in royalty prior to the expiration of the primary term, seek thereby to put constructive production into operation effective with the expiration of the primary term and thereby continue the life of their lease.⁸³

80. *Davis*, 138 So. 2d at 562–63.

81. *Id.* at 562.

82. *See* LA. CIV. CODE ANN. art. 2053 (2008) (“A doubtful provision must be interpreted in light of the . . . conduct of the parties before and after the formation of the contract, and of other contracts of a like nature between the same parties.”). One might quarrel with the court’s resort to this article as it only applies if there is a “doubtful provision” in the contract, yet the court had no difficulty in determining that the lessee “cannot pay delay rentals when royalties are required.” *Davis*, 138 So. 2d at 563.

83. *Id.* at 565.

The shut-in clause is specifically designed to enable the lessees to protect their investment in a shut-in well beyond the primary term. For, at the expiration of the primary term, they can no longer pay delay rentals to maintain the lease, and they cannot produce gas from the well they have discovered where no market is available. Therefore, if it were not for the shut-in clause, and the constructive production resulting from its application, the lease would be forfeited for expiration of its term at the end of the primary term.

In *Caldwell v. Humble Oil & Refining Co.*,⁸⁴ the defendant conducted drilling operations that were commenced during the primary term but which were unsuccessfully concluded after the expiration of the primary term. Prior to the abandonment of that well (but after the expiration of the primary term), the Office of Conservation issued an Order forming a unit that included a portion of the leased premises; the unit well was situated off of the leased premises and was a shut-in gas well. The lessee tendered shut-in payments that were refused by the lessors. The lessee released all of the mineral lease situated outside of that unit. The lessors sued to cancel the mineral lease as to that portion of the leased premises situated within that unit.

The lessor contended as follows:

the habendum clause of the amendment is the exclusive determinant of the lease term; that the primary term of the lease, as set out in the said clause, had expired on May 3, 1960, and the subsequent unitization order, although valid, came too late to operate as an extension of that portion of the lease unitized. It is claimed the drilling clause of the lease, providing for the right to continue drilling after the primary term had expired, was only for the purpose of allowing completion of any drilling operations already commenced or to allow additional drilling within 60 days after abandonment of a dry hole. But, contend plaintiffs, during such period the lease was "dead" for all other purposes and could only be revived in its entirety by actual production under the habendum clause.⁸⁵

The court rejected this contention, saying as follows:

Inasmuch as drilling of the Caldwell #1 began in April, before the expiration of the primary term and continued

84. 155 So. 2d 228 (La. App. 2d Cir. 1963), writ denied, 157 So. 2d 230 (La. 1963).

85. *Id.* at 229.

without interruption until June 14, 1960, and the conservation order was issued, effective May 19, 1960, *the lease was in full force and effect for all purposes* and forced pooling of plaintiffs' land in a unit containing a shut-in gas well amounted to production and effectually continued the lease upon payment of shut-in royalties.⁸⁶

An interesting factual scenario was presented in *Auzenne v. Lawrence Oil Co.*⁸⁷ In this case, a Commissioner's unit was formed for "production of oil" from a described "oil sand." The unit well was not located on plaintiff's property. The unit well—although completed in the unitized sand—was not capable of producing oil in commercial quantities, only gas. The unit well was shut-in. No unit production of oil—the unitized substance—ever occurred.

Lessee tendered a delay rental to plaintiff, who refused it. Plaintiff contended that, because of the shut-in gas well, lessee should have tendered a shut-in payment rather than delay rentals. Having failed to pay the shut-in gas well rental, plaintiff contended that the mineral lease expired. The court denied plaintiff's demand, saying as follows:

But here the acreage was unitized for the production of oil, but the well could not be completed successfully for oil production from the unitized sand. With regard to the unitized acreage (aside, of course, from the tract on which the well was situated), this well was therefore not a completed well capable of production within the meaning of the compulsory unitization order, because under the order's terms the unit was created only for the drilling for and production of oil from a certain sand.⁸⁸

Here, the well drilled on the unit did not result in production within the meaning of the drilling order that created the unit to produce a certain mineral substance only. Thus, with regard to the compulsory drilling unit, the unit well is to be regarded as incapable of producing the substance for the production of (only) which the acreage was force-pooled. Likewise, with regard to the non-drilled tracts included in the unit (which were force pooled with the drilled-tract for the sole purpose of producing the given substance), the unit well is simply a well situated on a

86. *Id.* at 230 (emphasis added).

87. 179 So. 2d 533 (La. App. 3d Cir. 1965).

88. *Id.* at 535-36.

nearby tract, since the drilling pursuant to the unitization was unsuccessful insofar as the unitizing order is concerned.⁸⁹

F. Lease Being Otherwise Maintained

Under Paragraph 6 of both of the so-called “South Forms,” leasehold rights may be maintained “in the absence of production or drilling operations” by the payment of a shut-in rental.

Paragraph 5 of the so-called “North Form” states that “for any part of a shut-in period that this lease is otherwise being maintained in force and effect no shut-in royalty shall be due.”

Therefore, unless the lease provides otherwise, no shut-in payment is due unless such payment would constitute the sole and exclusive basis on which leasehold rights are to be maintained.

One court said it this way: “Where there is actual production attributable to a mineral lease . . . there is no obligation to pay shut-in royalties in the event another commercial well capable of producing in paying quantities but shut-in, is drilled on the leased premises.”⁹⁰

This notion was invoked by the court in *Bernard v. Marathon Oil Co.*⁹¹ In this case, plaintiffs sued to declare a mineral lease terminated. Portions of the leased premises were included within certain units created by the Commissioner of Conservation. One of the unit wells was shut-in because of a hurricane, but the lessee was not able to restore it to production after the hurricane subsided.

The court found that, despite the fact that the unit well was shut-in, at no time was there not production allocable to some portion of the leased premises, as a second unit well produced at all times. The mineral lease did not contain a “Pugh clause.” Thus, such unit production, without more, was sufficient to maintain leasehold rights under *Hunter Co., Inc. v. Shell Oil Co.*⁹²

The lessors then contended that the mineral lease terminated when the lessee failed to pay shut-in payments with respect to the well that was shut-in as a consequence of the hurricane. The lessors relied upon *Nordan-Lawton Oil & Gas Corp. v. Miller*,⁹³ wherein the court held that although there was actual production

89. *Id.* at 536.

90. *Bennett v. Sinclair Oil & Gas Co.*, 405 F.2d 1005, 1010 (5th Cir. 1968).

91. 381 So. 2d 1286 (La. App. 3d Cir.), *writ denied*, 384 So. 2d 793 (La. 1980). In the interest of full disclosure, your author represented the defendant-lessee in this suit. See LA. REV. STAT. ANN. § 31:114 (2000).

92. 31 So. 2d 10 (La. 1947). This jurisprudential rule is now codified in Louisiana Mineral Code article 114.

93. 403 F.2d 946 (5th Cir. 1968).

attributable to a mineral lease, the lessee nevertheless had the obligation to pay shut-in royalties where there was another well capable of producing in “paying quantities,”⁹⁴ which was shut-in on the leased premises by reason of the fact that “a market cannot be secured for gas from a well or wells producing gas only.”⁹⁵ The court distinguished *Nordan-Lawton* on the basis of the particular provision contained in that mineral lease. Since the mineral lease in this case did not contain a similar provision, *Nordan-Lawton* was not controlling. The court stated:

It is the opinion of this Court that where there is actual production attributable to a mineral lease, there is no additional obligation to tender shut-in royalties in the event a second well capable of producing in paying quantities is shut-in on the leased premises. Where there is actual production in paying quantities, the necessity for constructive production does not exist.⁹⁶

This holding is consistent with prior decisions holding that, if a well is producing gas, which is being used by the lessee, the “shut-in clause” has no application and the lessee cannot maintain the lease by paying a shut-in payment when production royalties are actually due.⁹⁷

G. What is a Well Producing “Gas Only”?

Some mineral leases provide that the “shut-in clause” will operate only if the well which is shut-in is a well capable of producing “gas only.” Because it is not uncommon for a well classified as a gas well to also produce some liquids—for example, condensate or distillate—the question arises as to whether such a well is one producing “gas only” for purposes of the “shut-in clause.”

The mineral lease involved in *Davis v. Laster*⁹⁸—quoted above in Part III.E hereof—is an illustration of this provision. In *Davis*, the lessor contended that the “shut-in clause” applied to wells “producing gas only” and further alleged that the well produced

94. *Id.* at 948.

95. *Id.* at 947.

96. *Bernard*, 381 So. 2d at 1289.

97. See *Bollinger v. Texas Co.*, 95 So. 2d 132 (La. 1957); *Melancon v. Texas Co.*, 89 So. 2d 135 (La. 1956). In *Bollinger*, the lease was cancelled notwithstanding the fact that the shut-in royalties, which were paid by the lessee, were actually in excess of the amount due as production royalties.

98. 138 So. 2d 558 (La. 1962).

some condensate, thereby rendering the “shut-in clause” unavailing.

The court quoted extensively from a federal case arising out of Texas,⁹⁹ which noted that, considering the purpose of the “shut-in clause,” a “holding that the constructive production provision applies only to wells producing no liquid condensate would render that provision almost nugatory.”¹⁰⁰

The supreme court ultimately held that even if the lessor’s interpretation was correct, the lessor failed in his burden to show production of condensate in “paying quantities.”

The Commissioner of Conservation had classified the well as a gas well.¹⁰¹ The court indicated that all “circumstances would not justify acceptance of the classification given to a well by the Commissioner for purposes not clearly related to the reasons for the classification.”¹⁰² However, because the “lessors, who have urged this issue, have brought no evidence to contradict the Commissioner’s classification,” the court stated that it “will, therefore, accept that classification.”

H. What Constitutes a “Market” for Purposes of a “Shut-in Clause”?

In *Nordan-Lawton Oil & Gas Corp. v. Miller*,¹⁰³ after the lessor asserted that the mineral lease had terminated, the lessee sued for a declaratory judgment that the mineral lease had been maintained in force and effect. The lessor filed a counterclaim asserting the invalidity of the mineral lease.

99. *Vernon v. Union Oil Co.*, 270 F.2d 441 (5th Cir. 1959).

100. *Id.* at 446.

101. See LA. ADMIN. CODE tit. 43, pt. 19, §§ 3501–3511 (2008) (listing the rules of the Office of Conservation relative to the classification of wells as oil or gas wells).

102. Louisiana Revised Statutes section 30:3 provides the following definitions of the terms “oil” and “gas,” but, as seen by the opening of the cited section, such definitions only apply “when found in this Chapter.” That is to say, such definitions are only pertinent for purposes of the Conservation Act, to-wit:

Unless the context otherwise requires, the words defined in this Section have the following meaning when found in this Chapter:

(4) “Oil” means crude petroleum oil, and other hydrocarbons, regardless of gravity, which are produced at the well head in liquid form by ordinary production methods.

(5) “Gas” means all natural gas, including casinghead gas, and all other hydrocarbons not defined as oil in Paragraph (4) above.

Thus, these definitions of the terms “oil” and “gas” are not controlling for purposes of lease maintenance. LA. REV. STAT. ANN. § 30:3 (2007).

103. 272 F. Supp. 125 (W.D. La. 1967).

Under the specially prepared mineral lease form drafted by the lessor, the lessee was obligated to pay “lieu royalties” in the event that “a market cannot be secured for gas from a well or wells producing gas only.”¹⁰⁴ Certain wells were drilled and were producing, but two wells—the No. 5 and the No. 7 wells—were shut-in for some period of time. The lessee did not pay “lieu royalties” in respect of these wells, and the lessor asserted that the failure to make such payments resulted in the termination of the mineral lease.

The court stated that the “true bone of contention in this conflict” was “whether the wells were shut-in because a market could not be secured.”¹⁰⁵

The trial court observed that, “crucial to this issue is a finding of what constitutes a ‘market’ for discovered gas.”¹⁰⁶ The court determined that the execution by the lessee of a gas purchase contract—“one of the most favorable gas contracts ever executed in this area”—constituted a “market” such that the wells could not be said to have been shut-in “for lack of a market.” Rather, the court determined that the wells were shut-in for reasons other than “lack of market,” that is, because of a lower rate of flow and to avoid a price redetermination resulting therefrom. Lessor’s demand for cancellation was rejected.

In *McDowell v. PG&E Res. Co.*,¹⁰⁷ the lessee had to mix wet gas from one well with dry gas from another well in order to meet the quality standards of the pipeline purchaser. When the well from which the dry gas was obtained ceased producing, the purchaser “refused to accept the unmixed wet gas from [the] McDowell” well. During the period of time in which the lessee was endeavoring to rectify the problem it faced, it tendered “shut-in royalties” to the lessors. Despite accepting such payments, the lessors subsequently granted a new lease to a third party and made demand on the lessee to release its lease. When the lessee refused to comply, the lessors brought suit “seeking a judicial declaration that as a result of a 90-day cessation of production, the two older leases had expired by their terms.”¹⁰⁸

104. *Id.* at 128. Seemingly, the mandatory nature of the “obligation” to pay “lieu royalties” arose under the unique “shut-in clause,” notwithstanding that the mineral lease was being otherwise maintained by the producing wells.

105. *Id.* at 132. “What is *not* clear, and what forms the crux of this litigation, is *why* were these wells shut-in?” *Id.* at 130.

106. *Id.* at 132.

107. 658 So. 2d 779 (La. App. 2d Cir.), *writ denied*, 661 So. 2d 1382 (La. 1995).

108. *Id.* at 782.

The plaintiffs contended “that the gas purchase offers [which the lessee had obtained in its efforts to sell its ‘wet gas’] contravene a finding that no market existed and preclude application of the shut-in clause.”¹⁰⁹ The court disagreed and denied cancellation, saying:

Essentially, the lease contemplates the continuous need for transporting gas from the well-head site. Thus, the wording of Paragraph 5 comports with the general concept that a shut-in provision serves to address equitably the transportation difficulties inherent in gas marketing, and, also, to balance the competing interests of the contracting parties Basically, because natural gas ordinarily cannot be stored upon production, a pipeline provides the only economic means of transportation.¹¹⁰

I. Status of Lease While Shut-in Payments are Made

In some mineral leases, the “shut-in clause” provides that, upon the payment of a shut-in royalty, it is “to be considered that gas is being produced within the meaning” of the “habendum clause.”¹¹¹ Judicial consideration has been given to the consequences that might arise from a lease provision, which stipulates that a shut-in well will result in the deemed characterization that “gas is being produced.”

In *Lelong v. Richardson*,¹¹² the lessee drilled and completed a well capable of producing gas in “paying quantities,” but the well was shut-in for lack of market. The lessee paid shut-in royalty payments in accordance with the terms of the mineral lease.

The lessor sued to cancel the mineral lease. “The failure of compliance upon which plaintiff predicates his demand for cancellation, in the final analysis, rests upon the alleged failure of lessees to adequately develop the leased property under the provisions of the lease agreement.”¹¹³

The court stated that, in its opinion, the “lessees, from and since the completion of Well No. 1 in November 1957, in good faith exerted every reasonable and diligent effort in attempting to procure a market for the gas.”¹¹⁴

109. *Id.*

110. *Id.*

111. Such was the case in the lease involved in *Sohio Petroleum Co. v. V.S. & P.R.R.*, 62 So. 2d 615 (La. 1953).

112. 126 So. 2d 819 (La. App. 2d Cir. 1961).

113. *Id.* at 823.

114. *Id.* at 822.

Remuneration attendant upon the discovery of gas is completely dependent, first, upon a market, and, second, upon transportation thereof. Additional factors which influence both the buyer and seller of gas involve the determination of potential reserves and the distance to a pipeline transportation facility. These elements are mentioned because in our opinion they have a definite bearing upon the equities of the instant case.¹¹⁵

The controlling issue with which we are confronted resolves itself into the necessity for determination as to whether the payment of a shut-in royalty on a commercially productive gas well in the absence of a market for said gas constitutes a payment of royalty justifying the continued effect of the lease beyond its primary term under the habendum clause. Defendants rest upon an affirmative answer to this proposition. The contrary position upon which plaintiff depends requires determination as to whether failure to develop extensive acreage by continued drilling operations justifies cancellation of the lease.¹¹⁶

The court, quoting from *Sohio Petroleum Co. v. V.S. & P.R.R.*,¹¹⁷ observed that, under the form of mineral lease at issue, the payment of a shut-in royalty was optional with the lessee if the lessee wanted it "to be considered that gas is being produced within the meaning" of the "habendum clause."¹¹⁸

The court also quoted from *Gennuso v. Magnolia Petroleum Co.*¹¹⁹ wherein it was noted:

The rule which imposes the implied obligation upon a lessee to operate the leased premises to the mutual profit and advantage of both parties to the contract cannot be invoked so as to erase entirely from the contract those provisions which expressly declare that the lessee's rights shall continue so long as gas is produced in paying quantities.¹²⁰

115. *Id.* at 823-24.

116. *Id.* at 824.

117. 2 So. 2d 615.

118. *Id.* at 387.

119. 14 So. 2d 445 (La. 1943).

120. *Id.* at 563 (quoting *Louisiana Gas Lands, Inc. v. Burrow*, 1 So. 2d 518 (La. 1941)).

After a thorough review of legal commentary and other jurisprudence, the *Lelong* court reversed the decree of cancellation with the following statement, to-wit:

Under the facts and circumstances narrated in this opinion we sum up our conclusions to the effect, first, that the payment of shut-in royalty on the wells drilled by lessees preserved the valid extension of the lease against forfeiture. Second, that continued development was prevented, first, by the lack of a market for gas, and, second, by the institution of plaintiff's suit. For these reasons we think the judgment ordering cancellation of the lease is erroneous.¹²¹

In *Odom v. Union Producing Co.*,¹²² the plaintiff sought cancellation of a mineral lease. The lessee had pooled part of leased premises with other acreage on which there was a shut-in well. The lessee contended that this maintained the mineral lease. Judgment was rendered in the trial court for plaintiff but was reversed on the appeal.

The mineral lease provided for unitization before or after production. It also provided for the maintenance of leasehold rights by the payment of "lieu royalty" in the case of a shut-in well. The court held that the mineral lease treated production within the unit as though it were obtained on the leased premises. Thus, for purposes of lease maintenance, the shut-in well on another tract with which plaintiff's lands were unitized had the effect of being on the plaintiff's land. Consequently, the payment of in lieu royalty (shut-in royalty payment) sufficed to maintain the mineral lease outside of the unit.

J. Characterization of the Shut-in Payment

The mineral lease will characterize the shut-in payment as a payment in the nature of either a rental or a royalty. The manner in which it is characterized under a particular mineral lease will have consequences as was illustrated in *Acquisitions, Inc. v. Frontier Explorations, Inc.*¹²³

The mineral owner, as successor of a party who granted a mineral lease to the defendant, sued the defendant-lessee seeking judicial recognition of termination of the mineral lease for failure to pay shut-in payments due pursuant to the lease. The mineral lease was granted on August 11, 1980, for a primary term of sixty

121. *Lelong v. Richardson*, 126 So. 2d 819, 830 (La. App. 2d Cir. 1961).

122. 141 So. 2d 649 (La. 1962).

123. 432 So. 2d 1095 (La. App. 3d Cir. 1983).

days. On October 10, 1980, drilling on the property was begun, and a gas well was completed on November 9, 1980. The well was shut-in for want of a pipeline and an available market.

According to the mineral lease, shut-in “royalties” for the remainder of 1980 in the amount of \$100.00 per month were due and owing to the lessor in January 1981, and in January 1982. A total of fourteen months of shut-in “royalties” were due and unpaid when payment was tendered on July 27, 1982, without demand by the lessor.

The court stated that the

central question presented for our resolution is whether the shut-in payment provision of the lease creates a resolutive condition whereby failure to make payments automatically terminates the lease, or whether this provision provides for payment of “royalties” to which would apply the requirements of notice and delay pursuant to LSA-R.S. 31:137 et seq.¹²⁴

The court held that the shut-in payments under that particular form of mineral lease were in the nature of “royalties” rather than “rentals.” Consequently, the statutory requirements of notice and delay applied to the untimely payments.¹²⁵ Therefore, even though the lessee was fourteen months behind in payment of shut-in “royalties” when demand for release of the mineral lease was made by the lessor, the payment of the shut-in “royalties” within thirty days after such demand made the remedy of dissolution of the lease unavailable, in the absence of fraud by the lessee.

The “shut-in clause” contained in the *Acquisitions* mineral lease provided that, in the case of shut-in conditions, the lessee “shall pay” shut-in royalties—not using the words “may pay,” the payment of shut-in royalties was seemingly mandatory, not merely permissive. Notwithstanding the seeming mandatory nature of the payment, the court did not hold that the failure to pay the shut-in royalties resulted in the termination of the mineral lease. Rather, because the payment was characterized as a “royalty,” the notice provisions of the Louisiana Mineral Code were applicable.¹²⁶

In any event, there are certain consequences that arise from the characterization of the shut-in payment. This was noted by the

124. *Id.* at 1096.

125. “If a mineral lessor seeks relief for the failure of his lessee to make timely or proper payment of royalties, he must give his lessee written notice of such failure as a prerequisite to a judicial demand for damages or dissolution of the lease.” LA. REV. STAT. ANN. § 31:137 (2000).

126. *Id.* §§ 31:137–143.

Louisiana Supreme Court in *Davis v. Laster* in the following terms:

[T]he fact that the shut-in payments which lessees may make, having been designated by the parties as royalty, allow others besides the mineral owner-lessor to become entitled to these payments. In many instances the mineral-owner lessor has sold royalties, and the royalty owners thereby created do not enjoy the right to participate in bonus and rentals under the lease due the mineral-owner lessor, but these nonparticipating royalty owners do become entitled to their acquired portion of royalties. To permit the lessees to elect to pay rentals where royalties are due would be to invest them with the power to foreclose nonparticipating royalty owners from receipts to which they are entitled under the lease.¹²⁷

As a general proposition, the forms in prevalent use in South Louisiana characterize the payment as a rental while the so-called “North Form” treats the payment as a royalty. The following table illustrates certain consequences that arise out of the distinction between a shut-in payment characterized as a rental or a royalty.

Attribute	Rental	Royalty
To whom payable?	Mineral Owner, but not Royalty Owner	Mineral and Royalty Owner, if any
Time for payment	As rental	As royalty
Consequences of default	<i>Ipso facto</i> termination	Article 137 applies—must give written notice of non-payment
Tax consequences	Ordinary income, not subject to depletion allowance ¹²⁸	Ordinary income, subject to depletion allowance ¹²⁹

The Mineral Code defines “rental” and “royalty” in a way that becomes relevant to a shut-in situation. “Rental” is defined in article 213(4) as follows: “‘Rental’ means money or other property given to maintain a mineral lease in the absence of drilling or

127. 138 So. 2d 558, 563 (La. 1962).

128. *Johnson v. Phinney*, 287 F.2d 544, 547 (5th Cir. 1961) (“The [shut-in rental] payments covered by the instant lease are not in contemplation of production but are payments made *solely because there will be no production*. Obviously, there will be no depletion of the wasting assets owned by taxpayers.”) (emphasis added).

129. Treas. Reg. § 1.613-2(c)(5)(i) (as amended in 1977).

mining operations or production of minerals. 'Rental' does not include payments classified by a lease as constructive production."¹³⁰ "Royalty" is defined in article 213(5) as follows:

"Royalty," as used in connection with mineral leases, means any interest in production, or its value, from or attributable to land subject to a mineral lease, that is deliverable or payable to the lessor or others entitled to share therein. Such interests in production or its value are "royalty," whether created by the lease or by separate instrument, if they comprise a part of the negotiated agreement resulting in execution of the lease. "Royalty" also includes sums payable to the lessor that are classified by the lease as constructive production.¹³¹

Thus, if the mineral lease classifies the shut-in payment as "constructive production," the payment would be characterized as a "royalty," and not as a "rental."

In *Davis v. Laster*, the supreme court—construing the mineral lease before it—found the shut-in payment to be in the nature of "royalties."¹³² The court stated that such payments are a "substitute for actual production" and are to be characterized as "constructive production."¹³³

The concept of "constructive production" was considered in *Smith v. West Virginia Oil & Gas Co.*¹³⁴ There, the court said as follows:

In the decision of *Davis v. Laster* . . . a gas well drilled and completed capable of production was permitted to maintain the lease beyond the primary term solely upon the basis that constructive production was in effect by virtue of the lessee paying shut-in royalties:

The production required to maintain the lease must be either actual or constructive. It is not actual production here. Lessees, by paying the shut-in royalty prior to the expiration of the primary term, seek thereby to put constructive production into operation effective with the expiration of the primary term and thereby continue the life of their lease.

130. LA. REV. STAT. ANN. § 31:213.

131. *Id.* (emphasis added).

132. *Davis*, 138 So. 2d at 562.

133. *Id.*

134. 365 So. 2d 269, 275–76 (La. App. 2d Cir. 1978), *rev'd and remanded*, 373 So. 2d 488 (La. 1979).

The shut-in clause is specifically designed to enable the lessees to protect their investment in a shut-in well beyond the primary term—for, at the expiration of the primary term, they can no longer pay delay rentals to maintain the lease and they cannot produce the gas from the well they have discovered where no market is available. Therefore, if it were not for the shut-in clause, and the constructive production resulting from its application, the lease would be forfeited for expiration of its term at the end of the primary term.

In the instant case there was no provision for shut-in royalty provided for in the Bernstein lease. There has been neither actual nor constructive production from the four wells drilled on the plaintiff's property during September and October 1977. Because of the absence of production and marketing, the lease has terminated.¹³⁵

In *McDowell v. PG&E Resources Co.*,¹³⁶ the court said the following with regard to the consequences of a shut-in payment under the so-called “North Form,” to-wit:

Paragraph 5 provides that, in a shut-in or force majeure situation, with the payment of shut-in royalties, the lease continues in effect during such shut-in period “as though production were actually being obtained” The trial court found that, around March 11, 1990, when United Gas Pipeline refused to accept the “wet” gas from McDowell, a shut-in situation came into existence. Defendants, as stated, thereafter paid shut-in royalties in accordance with the contract.¹³⁷

In its reasons for judgment, the trial court referred to the 90-day cessation clause enunciated in Paragraph 6 of the lease. That provision applies, however, only “if production previously secured should *cease* for any cause” Very importantly, in a Paragraph 5 shut-in situation, production does not “cease” but continues constructively. See *Davis, supra* (observing that the very purpose of a shut-in royalty clause is to maintain the lease as though the gas had not ceased flowing). Thus, the 90-day cessation of production provision never applied “by its own terms.”¹³⁸

135. *Id.* at 275–76.

136. 658 So. 2d 779 (La. App. 2d Cir. 1995).

137. *Id.* at 782.

138. *Id.* at 783.

The comments to article 123 are instructive in this regard. Those comments read, as follows:

The standard ‘unless’ form of mineral lease provides that the lease ‘shall terminate’ unless delay rentals are paid. However, there is often no payment date fixed for production royalties, the timing of such payments being established by industrial custom. So-called ‘shut-in payments’ fall into two basic categories. One is the ‘shut-in royalty’ or ‘lieu royalty’ type, *upon payment of which there is constructive production within the meaning of the habendum clause of the lease*. Although a due date for these payments is normally established, the lease does not usually terminate automatically for nonpayment. The second type of shut-in payment is the shut-in rental. Under this type of clause the shutting in of a well with commercial potential is treated the same as cessation of operations after a dry hole, permitting the commencement or resumption of rental payments. Under this type of clause, the failure to make the shut-in payment usually results in the automatic termination of the lease. The right of contracting parties to provide for automatic termination for nonpayment of any form of rent can be seen as an exercise of the general freedom of contract.¹³⁹

The comments do not indicate that any special words need to be used to “classify” the payment so as to invoke the distinction between the two types of shut-in payments.

Further support is found in the last paragraph of the comments to article 123, where the redactors note that, “[i]n the case of a shut-in payment of the kind which is *construed* as establishing constructive production within the meaning of the habendum clause, it has been held that late payment did not constitute occurrence of an express resolutive condition, and further time for performance was properly allowed.”¹⁴⁰ Citing *Risinger v. Arkansas-Louisiana Gas Co.*¹⁴¹ as authority for this proposition, this comment can only pertain to a “shut-in clause,” which characterizes the payment as in the nature of a royalty (e.g., the so-called “North Form”) as the opposite result applies to a “shut-in clause” which characterizes the payment as in the nature of a rental (e.g., the so-called “South Form”). The comments’ recognition that

139. LA. REV. STAT. ANN. § 31.123 cmt. (2000) (emphasis added).

140. *Id.*

141. 3 So. 2d 289 (La. 1941).

this consequence flows from a “construction” of the lease form strongly suggests that it is not necessary to expressly so provide.

One consequence of these definitions is that the owner of an executive interest would be entitled to receive a shut-in payment if it were “classified” by the lease contract as a “rental” (unless the lease attempts to expressly “classify” the rental “as constructive production”), but would not be entitled to a payment “classified” by the lease as a “royalty,” which, by its own force, is characterized as “constructive production.”¹⁴² In other words, the mere characterization of the shut-in payment as a “rental” is not dispositive of the issue of an executive owner’s entitlement to such payment—the executive owner would not be entitled to receive such “rental” if the payment is “classified by [the] lease as constructive production.”

The executive owner has the power to select the form of mineral lease that it is willing to execute (inherent in which power is the prerogative to negotiate and determine its precise terms). It is within the power of the executive owner to effectuate or compel the conclusion that it, rather than the non-executive, is entitled to receive shut-in payments by the simple expediency of characterizing such payments as a rental.¹⁴³

K. Requirement for Notice and an Opportunity to Cure

Unless the mineral lease has a special or unique provision, there is no requirement under the so-called “South Forms” for the lessor to give the lessee notice of a failure to pay the shut-in rental. This is so because the “shut-in clause” under such “unless” forms constitutes an express resolutive condition¹⁴⁴ and is constructed as a matter of term.

“A mineral lease terminates at the expiration of the agreed term or upon the occurrence of an express resolutive condition.”¹⁴⁵

In *Smith v. Sun Oil Co., Inc.*,¹⁴⁶ the lessee argued that it was entitled to an opportunity to cure the default in payment of the

142. LA. REV. STAT. ANN. § 31:195. *See also id.* § 31:105 (“The executive right is the exclusive right to grant mineral leases of specified land or mineral rights. Unless restricted by contract it includes the right to retain bonuses and rentals.”).

143. In this regard, consideration must be given to Louisiana Mineral Code article 109, which provides that the “owner of an executive interest is not obligated to grant a mineral lease, but in doing so, he must act in good faith and in the same manner as a reasonably prudent landowner or mineral servitude owner whose interest is not burdened by a nonexecutive interest.” *Id.* § 31:109.

144. LA. CIV. CODE ANN. arts. 1767–1768 (2008).

145. LA. REV. STAT. ANN. § 31:133.

shut-in rental, relying on the “judicial ascertainment” clause. The court held that such clause did not apply to this case, “where the sole inquiry is whether or not the lease has expired and terminated by its own terms; no more, in fact, than if the lease had expired on a fixed date instead of an uncertain date.”¹⁴⁷

Under the “North Form,” because the “shut-in clause” characterizes the payment as in the nature of a royalty, the provisions of the Louisiana Mineral Code relative to unpaid royalty would apply.¹⁴⁸ This would require prior notice to the lessee of the non-payment of royalties with an opportunity to pay or respond as a prerequisite to a suit for damages, cancellation, etc.¹⁴⁹

L. Does the Existence of a “Shut-in Clause” Override Implied Duty to Market?

There is an implied duty in every mineral lease to prudently market the product, once obtained.¹⁵⁰ How does this duty to market square with a “shut-in clause,” the effect of which is to allow the lessee to maintain the mineral lease in the absence of production? Does the “shut-in clause” itself implicate the marketing covenant? This clause permits the lessee to continue the life of the mineral lease—“in the absence of production or drilling operations”—by the tender of a stipulated sum as royalty or rental on a non-producing well. As noted by one distinguished commentator:

It could be argued by analogy to the relation of the unless clause to the initial exploratory well obligation, that the shut-in gas royalty clause gives the lessee the option either to pay money to keep the well closed down or to produce the product and sell it [T]his is an unsound view because . . . it misunderstands the purpose of the shut-in royalty clause.¹⁵¹

The clause is intended to modify the “habendum clause” so that the mineral lease may be preserved in the interim between the discovery of gas and the commencement of the marketing thereof. The clause came into being because of the risk of lease termination

146. 135 So. 15 (La. 1931).

147. *Id.* at 657.

148. See discussion in Pt. III.J, *supra*.

149. LA. REV. STAT. ANN. §§ 31:137–143.

150. *Hutchinson v. Atlas Oil Co.*, 87 So. 265 (La. 1921).

151. Charles J. Meyers, *The Effect of Express Provisions in an Oil and Gas Lease on Implied Obligations*, 14 ANN. INST. ON MIN. LAW 90, 119 (1967). This source is paraphrased in this section and attribution to Professor Meyers is due.

for non-production at the end of the primary term when the lessee has a commercial gas well that it has not as yet been able to put on stream.¹⁵²

The “shut-in clause” thus says that the shut-in gas well is a producing gas well for the purposes of the “habendum clause” so long as royalty or rental is paid for keeping it shut-in. The “shut-in clause” does not say that the royalty or rental is paid in lieu of seeking a market for the product.

In *Risinger v. Arkansas-Louisiana Gas Co.*,¹⁵³ plaintiff-lessor sought cancellation of a mineral lease and damages for defendant-lessee’s failure to produce and market gas. Judgment was rendered for plaintiff and, on appeal by the defendant, the supreme court reversed.

Due to unusual circumstances, the lessees were not able to market the gas. The well was producing excessive amounts of salt water. Because of this situation, the court found that it

would be wholly uneconomic because it would necessitate the employment of workmen to have charge of the well twenty-four hours per day, the installation of expensive equipment consisting of large separators and traps, and the building of a pipe line from the well to the main line about three miles away, all of which would make the operation of this one well a losing financial proposition.¹⁵⁴

The lessees were at all times in good faith and exercised due diligence under the circumstances. The mineral lease provided that the lessee may make payments to the lessor “until such time as the gas shall be utilized or sold off the premises.” Thus, the mineral lease envisioned that the lessee need not produce immediately upon discovery of minerals, especially where, as here, the circumstances prevented him from doing so.

The court noted that the “purpose of [the “shut-in clause”] in the lease was to give the lessees reasonable opportunity to secure the right-of-way for the laying of a pipe line and connecting it to the main line, in order that the gas could be marketed when a market therefore was available.” The court concluded, “. . . [I]t is our opinion that the defendants have not violated the provisions of the leases which require due diligence in the operation of this well.”¹⁵⁵

152. See *Landry v. Flaitz*, 157 So. 2d 892 (La. 1963).

153. 3 So. 2d 289 (La. 1941).

154. *Id.* at 291.

155. *Id.* at 293–94.

If the court had thought that the "shut-in clause" barred enforcement of the implied marketing covenant, it would have said so, since this was an easier and more nearly complete ground for disposing of the case. The fact that the court held that the lessee had not breached its implied obligation to market the product and did not simply base its decision on the "shut-in clause" in the mineral lease strongly encourages the inference that the court felt that the express "shut-in clause" did not supplant the implied obligation.

M. The "Shut-in Clause" as Affected by Unitization of the Leased Premises

In *Dubois v. Midwest Oil Corp.*,¹⁵⁶ plaintiff-lessor sued its lessee to declare a mineral lease to have terminated. Prior to the grant of the mineral lease (which was for a one year primary term), a well had been drilled on a nearby tract and was shut-in for lack of marketing facilities. Contemporaneously with the grant of the mineral lease, a letter agreement was executed whereby the lessee obligated itself to "appear at hearings of the Louisiana Department of Conservation at its expense and attempt to have all or some part of the land included in a unit or units on which there was located a well capable of production in paying quantities."¹⁵⁷ A compulsory unit was formed for the nearby well and included seventeen acres of the plaintiff's land. Prior to the first anniversary date of the mineral lease, the lessee tendered the appropriate shut-in rental payment, which the lessor refused.

According to the court, the "unique argument is made that the shut-in rentals payable for a well with which the property is unitized applies only to wells drilled by the lessee during the primary term, and not to wells drilled before the lease was executed, even though unitization took place during the primary term."¹⁵⁸ The court rejected this contention and upheld the mineral lease, relying on *Delatte v. Woods*.¹⁵⁹

In *Delatte*, plaintiff-lessors sought cancellation of a mineral lease. Before the primary term of the lease expired, the parties entered into extension agreement in which the lessee assumed obligation to drill a well or pay \$1,000 per month rental. If a well was drilled, from the date of "spudding in," the lessee would only pay \$500 per month rental. The leased area was partially unitized

156. 219 F. Supp. 593 (W.D. La. 1963).

157. *Id.* at 594.

158. *Id.*

159. 94 So. 2d 281 (La. 1957).

with other acreage on which there was situated a shut-in gas well. From that date of unitization, the lessee commenced paying rentals based on \$500 per month, but the lessor rejected those tendered payments. The lessor sued to cancel the lease, contending that the unitization of a portion of the leased premises with other lands on which there was situated a shut-in gas well did not serve to satisfy the terms of the mineral lease, as extended, and that the lease had expired.

Judgment was rendered in the trial court for the plaintiff-lessor. The supreme court reversed. The court noted that the Commissioner's order only permitted one well per unit. Thus, the lessee could not drill a well. Furthermore, production from a unit well maintains the mineral lease as to entirety of the leased premises. Observing that the "completion and the existence of a shut-in gas well on a validly created unit are equivalent to production on all tracts in order to interrupt the prescription accruing against royalty interest and preserve same from extinction by prescription,"¹⁶⁰ the court then stated that the "existence of a shut-in gas well on Unit B . . . rather than a producing or drilling well, in no way alters the application of these cited principles."¹⁶¹

IV. SHUT-IN WELLS AND THE MINERAL SERVITUDE AND MINERAL ROYALTY

A. Preface

Louisiana law recognizes three mineral rights—the mineral servitude, the mineral royalty, and the mineral lease.¹⁶² The first two are subject to a regime of prescription of non-use while the mineral lease is a contract subject to a term.

Prescription accruing against a mineral servitude and a mineral royalty is interrupted by a "use," among other means. A "use" sufficient to interrupt prescription accruing against a mineral servitude includes a dry hole drilled in good faith as well as production. As to a mineral royalty, only production will serve to interrupt prescription.

But what if the well is capable of producing but is shut-in? In what manner does such a well affect prescription accruing against either a servitude or a royalty?

160. *Id.* at 287.

161. *Id.* at 287.

162. LA. REV. STAT. ANN. § 31:16 (2000).

B. Effect of a Shut-in Well on Prescription of Nonuse Accruing Against a Mineral Servitude

1. Pre-Code Jurisprudence

There are no reported decisions considering the issue of the effect of a shut-in well on prescription accruing against a mineral servitude, probably for the reason that the very drilling of the well (which is then shut-in) would, of itself, effectuate an interruption of prescription. As will be seen in Part IV.C.1 hereof, the jurisprudence which did exist prior to the effective date of the Louisiana Mineral Code involved the issue of the effect of a shut-in well on prescription accruing against a mineral royalty interest.

2. Louisiana Mineral Code

Article 34 of the Louisiana Mineral Code reads as follows:

When there exists on a tract of land burdened by a mineral servitude, or on a conventional or compulsory unit that includes all or part thereof, a shut-in well proved through testing by surface production¹⁶³ to be capable of producing minerals in paying quantities, prescription is interrupted on the date production is obtained by such testing. If only a part of the tract burdened by the servitude is included in such a unit and the unit well is on land other than that burdened by the servitude, the interruption of prescription extends only to that portion of the tract burdened by the servitude included in the unit. Prescription commences anew from the date on which the well is shut in after testing.¹⁶⁴

Article 34 is consistent with the rules pertinent to the interruptive effect of unit operations or production.¹⁶⁵

The requirement that, in order for a shut-in well to interrupt prescription, it must be "proved through testing by surface production to be capable of producing minerals in paying quantities," is to be contrasted with the standard if the well were actually producing. Article 38 of the Louisiana Mineral Code tells

163. The Louisiana Office of Conservation has promulgated Statewide Order No. 29-B that dictates the manner in which the productive capability of a well might be demonstrated through an "initial potential test." See LA. ADMIN. CODE tit. 43, pt. 19, § 119 (1943).

164. LA. REV. STAT. ANN. § 31:34.

165. *Id.* §§ 31:33, 37.

us that in order to “interrupt prescription [accruing against a mineral servitude] it is not necessary that minerals be produced in paying quantities. It is necessary only that minerals actually be produced in good faith with the intent of saving or otherwise using them for some beneficial purpose.”¹⁶⁶ In other words, the economic or commercial standard for the maintenance of a mineral lease by production¹⁶⁷ is not the standard to be applied to the interruption of prescription accruing against a mineral servitude. Seemingly, in the case of an interruption of prescription by reason of a shut-in well, a higher standard applies. While valid, this is perhaps an academic observation since, in virtually every case, prescription would have already been interrupted by the drilling of the well (and prescription will have been commenced anew upon being “shut in after testing”), and production will certainly commence prior to the elapse of ten years from the shutting-in of the well.

As seen, article 34 applies to a non-unitized servitude tract on which there is situated a shut-in well. As discussed below, it also applies to a unit containing a tract burdened by a mineral servitude in which the unit well is subsequently shut-in.

Article 35 of the Louisiana Mineral Code provides as follows:

If the land, or part thereof, burdened by a mineral servitude is included in a conventional or compulsory unit on which there is a well located on other land within the unit capable of producing in paying quantities, as required by Article 34, and shut in at the time the unit is created, prescription is interrupted on and commences anew from the effective date of the order or act creating the unit.¹⁶⁸

In a situation involving a servitude tract included in a unit, articles 34 and 35 differ according to when the unit is formed in relation to when the well is shut-in. By its terms, article 34 applies to a tract burdened by a mineral servitude and included in a unit on which there is situated a shut-in well on another tract of land within the unit. In other words, article 34 applies to the situation where the unit is created and thereafter the well is shut-in. In contrast, article 35 pertains to the situation when a non-unitized well is shut-in and, thereafter, a unit is created around that well (or, as the article says it, well “shut in at the time the unit is created”), which subsequently created unit includes lands burdened by a

166. *Id.* § 31:38.

167. *Id.* § 124. *See* Ottinger, *supra* note 39.

168. LA. REV. STAT. ANN. § 31:35.

mineral servitude. Thus, article 35 addresses the circumstance in which the well is shut-in and thereafter the unit is formed.

In the factual situation regulated by article 35, assuming the shut-in well had, prior to unitization, been surface tested and was shown by such testing to be capable of producing minerals in "paying quantities," then, in such case, prescription accruing against the mineral servitude burdening the tract that has been brought into the unit containing the pre-existing shut-in well will be interrupted as of the effective date of the unit and prescription will immediately commence anew.

Unanswered is the question of whether article 35 envisions that an "order or *act creating the unit*"¹⁶⁹ can have retroactive effect if the (ostensible) date of prescription of the servitude is *prior to* the date of issuance of the order or confection of the act but *after* the effective date thereof. Insofar as compulsory units are concerned, the Commissioner of Conservation will generally make unit orders effective as of the date of the public hearing (as that is the first and usually last date on which the Commissioner will have received evidence in support of the order) and the order (with such an effective date) may not be issued for several weeks.¹⁷⁰ If, in that interim period of time prescription has accrued, is the servitude brought back to life by reason of the effective date of the order?

In *Baker v. Chevron Oil Co.*,¹⁷¹ a mineral servitude was created by reservation in an act of sale dated March 29, 1956. After the expiration of ten years, suit was brought by the owners of the mineral servitude to declare their servitude as being viable and outstanding. It was established that a well was completed on a nearby tract of land on January 6, 1966. The lessees undertook to form a voluntary unit. The pooling agreement was dated March 4, 1966, and was circulated for execution. The agreement was not signed by certain parties until April or May of 1966, and the document was recorded in the conveyance records on May 12, 1966.

The court noted that, inasmuch as no drilling operations were conducted on the servitude tract during the ten-year period, the plaintiffs' mineral interests had prescribed unless the forming of

169. The "act creating the unit" has reference to a declaration of unit (in the case of a "declared" unit) or a voluntary unit agreement (in the case of a "voluntary" or "contractual" unit). See Patrick S. Ottinger, *Conventional Unitization in Louisiana*, 49 ANN. INST. ON MIN. LAW (forthcoming) (on file with author).

170. See Policy Memorandum from the La. Office of Conservation (Aug. 20, 1985) (on file with author). See also *Exxon Corp. v. Thompson*, 564 So. 2d 387 (La. App. 1st Cir.), *writ denied*, 568 So. 2d 1054 (La. 1990).

171. 258 So. 2d 531 (La. 1972).

the voluntary unit containing that tract and the drill site tract effected an interruption of the prescription. The court found that “because a legal unit had not been established on or before March 29, 1966, the ten-year prescription accrued, its course not having been interrupted by the drilling and production on land other than the [servitude] tract.”¹⁷²

3. Comment: Incongruity in Articles 30, 34, and 36

There is an incongruity, or arguably a lack of consistency, in the interplay between articles 30,¹⁷³ 34, and 36¹⁷⁴ in a case where a servitude is included in a unit, a unit well is drilled, and that well later either produces or is shut-in.

Article 34 establishes the date of shutting-in as evidenced by proof “through testing by surface production” as the date of interruption of prescription, and then an immediate restarting of the prescriptive clock.

Article 36 regulates a producing well and provides that “prescription of nonuse is interrupted by the production of any mineral covered by the act creating the servitude.” According to article 36, the interruption occurs on the date on which “actual production begins.”

The inconsistency is that, because the servitude tract was in the unit on which the well was drilled, under article 30, the spudding-in of that well, in and of itself, would have already interrupted prescription as of the date of commencement of operations.

To say—as articles 34 and 36 clearly say—that there is an interruption as of a later date (surface testing or start of production) is to overlook the fact that there was already an interruption of prescription by the same well at an earlier date.

172. *Id.* at 533.

173. The court stated that:

An interruption takes place on the date actual drilling or mining operations are commenced on the land burdened by the servitude or, as provided in article 33, on a conventional or compulsory unit including all or a portion thereof. Preparations for the commencement of actual drilling or mining operations, such as geological or geophysical exploration, surveying, clearing of a site, and the hauling and erection of materials and structures necessary to conduct operations do not interrupt prescription. Prescription commences anew from the last day on which actual drilling or mining operations are conducted.

LA. REV. STAT. ANN. § 31:30.

174. “Prescription of nonuse is interrupted by the production of any mineral covered by the act creating the servitude. The interruption occurs on the date on which actual production begins and prescription commences anew from the date of cessation of actual production.” *Id.* § 31:36.

C. Effect of a Shut-in Well on Prescription of Nonuse Accruing Against a Mineral Royalty

1. Pre-Code Jurisprudence

As stated previously, a “mineral royalty” is a mineral right that is subject to a regime of prescription; it will prescribe in ten years unless a use occurs. In contrast to the mineral servitude, prescription is interrupted by actual production—a dry hole, even if drilled in good faith, will not suffice. Only production will interrupt prescription accruing against a mineral royalty.¹⁷⁵

In *LeBlanc v. Haynesville Mercantile Co., Inc.*,¹⁷⁶ plaintiffs conveyed a 1/64 mineral royalty interest to defendant on March 19, 1940. Prior to March 19, 1950, a well was drilled on an adjacent tract of land and was shut-in. That shut-in well had been tested on July 30, 1949, and was shown to be capable of producing gas and condensate in “paying quantities.” On February 13, 1950, a declared unit was formed around that shut-in well and included a portion of the tract of land burdened by the mineral royalty interest. Actual production commenced on November 18, 1951.

Plaintiffs filed suit to establish that the mineral royalty interest had prescribed. The trial court held that the mineral royalty interest had prescribed, because “production as was incidental to the completion and testing of the well is not sufficient to enable the royalty owner to share in such production, and will not be considered sufficient to interrupt the running of prescription.”¹⁷⁷ Defendant appealed and the supreme court reversed.

The supreme court rejected the plaintiffs’ contention that their interest could not be affected by a unit created under a mineral lease to which it had not consented, based on plaintiff’s argument “that in the creation of said unit there was no privity of contract between plaintiffs and defendant; that the defendant did not authorize the pooling of its royalties into a unit and cannot now take advantage of the provisions of a lease authorizing the creation of such a unit for the purpose of interrupting prescription.”¹⁷⁸

Said the court:

It is also well settled that the right to search and explore, which belongs to the owner of the servitude, is not given to

175. *Union Sulphur Co., Inc. v. Lognon*, 33 So. 2d 178 (La. 1947) (“[T]he date of the original royalty deed and that of production were the determining factors respecting the issue of the prescriptability of his interest.”).

176. 88 So. 2d 377 (La. 1956).

177. *Id.* at 379.

178. *Id.*

the royalty owner; that the latter must await such time as the land has been developed, and his right is restricted to a sharing in production if and when it is obtained by the landowner or a lessee It follows that the defendant was not a necessary party to the lease . . . the landowners having full power to enter into any lease contract they saw fit affecting the property—and that would include the power to grant a lessee the authority to pool and combine the leased acreage or any portion thereof with any lands or leases and mineral interests in the immediate vicinity—subject only to the right of the royalty owner to receive its 1/64th of the oil, gas or other minerals allocated to the acreage included in the unit.¹⁷⁹

The supreme court further stated:

The well . . . was capable of producing gas and gas condensate in paying quantities, and was on land included within the unit which was formed within ten years from the date of the royalty sale; consequently, the defendant was entitled to 1/64th royalty. The fact that the well was shut in for want of a market and that no gas was sold from it until after the expiration of ten years from the date of the royalty sale cannot defeat the rights of the defendant to share in the production, once begun.¹⁸⁰

In *Lee v. Goodwin*,¹⁸¹ a mineral royalty interest was created by deed dated March 2, 1945. The royalty interest burdened a sixty-acre tract of land.

Although no well was drilled on the royalty tract, a well was drilled on an adjacent tract and later unitized with the royalty tract. The unit well was tested on July 14, 1952, and “it was determined that the well was capable of producing.”¹⁸² It was then shut-in for lack of market. Production did not begin until November of 1955, or more than ten years after the royalty was created.

The landowner contended that the mineral royalty interest had prescribed. Citing *LeBlanc v. Haynesville Mercantile Co., Inc.*,¹⁸³ the court held that the royalty had not prescribed. In the course of its discussion, the court made several references to the fact that the production was in “paying quantities.” The court issued a

179. *Id.* at 380.

180. *Id.*

181. *Lee v. Goodwin*, 174 So. 2d 651 (La. App. 2d Cir.), *writ denied*, 177 So. 2d 118 (La. 1965).

182. *Id.* at 652.

183. 88 So. 2d 377 (La. 1956).

supplemental opinion stating that it did “not intend that the language used in our original opinion relating to the facts of the instant case be construed as holding that a royalty interest is dependent upon production *in paying quantities*.”¹⁸⁴ Said the court:

The inherent nature of a royalty interest is that of a right to share in any production, and it follows that production, regardless of whether it be in paying quantities or not, constitutes an interruption of prescription as against a royalty interest.

We think it reasonable to conclude that the consistent reference to a royalty right as a right to share in production, which is so clearly indicated by the language noted in the above opinions, excludes any requirement that the production be established as profitable to the operator.¹⁸⁵

2. Louisiana Mineral Code

The Louisiana Mineral Code considers these issues in articles 90 and 91. Article 90 of the Louisiana Mineral Code reads as follows:

When there exists on a tract of land burdened by a mineral royalty, or on a conventional or compulsory unit that includes all or part thereof, a shut-in well proved through testing by surface production to be capable of producing minerals in paying quantities, prescription is interrupted on the date production is obtained by such testing. If only a part of the tract burdened by the royalty is included in a unit and the unit well is on land other than that burdened by the royalty, the interruption of prescription extends only to that portion of the tract burdened by the royalty included in the unit. Prescription commences anew from the date on which the well is shut in after such testing.¹⁸⁶

Article 91 of the Louisiana Mineral Code provides as follows:

If the land or part thereof, burdened by a mineral royalty is included in a conventional or compulsory unit on which there is a well shut in prior to the creation of the unit,

184. *Goodwin*, 174 So. 2d at 655.

185. *Id.* The court cited passages from *Mays v. Hansbro*, 64 So. 2d 232 (La. 1953), *Union Sulphur Co., Inc. v. Andrau*, 47 So. 2d 38 (La. 1950), and *Union Sulphur Co., Inc. v. Lognion*, 33 So. 2d 178 (La. 1947).

186. LA. REV. STAT. ANN. § 31:90 (2000).

located on other land within the unit, and capable of producing in paying quantities as required by Article 90, prescription is interrupted on and commences anew from the effective date of the order or act creating the unit.¹⁸⁷

Articles 90 and 91 are essentially (but not precisely) identical to articles 34 and 35, respectively. Thus, the rules regulating the interruption of prescription accruing against a mineral royalty by reason of the presence of a shut-in well should operate in the same manner as those corresponding rules regarding the mineral servitude, with the obvious exception that only production will interrupt prescription accruing against a mineral royalty; a dry hole will not have that effect. Hence, unlike the situation involving the mineral servitude, the drilling of the well would not have a bearing on the prescription accruing against a mineral royalty.

3. Comment: Unit Must be Valid

Obviously, the unit must be valid in order to extend the interruptive consequences of a shut-in well to a mineral royalty burdening a non-drillsite tract of land included within the unit. This is illustrated by *Union Oil Co. v. Touchet*.¹⁸⁸ There, a concursus proceeding was instituted wherein a landowner and a mineral royalty owner contested the ownership of the proceeds of a 1/32 mineral royalty.

On March 6, 1940, Mr. Touchet, the landowner, granted a 1/32 mineral royalty. Mr. Touchet's mineral lease with Union, as amended, contained a pooling clause. A well was brought in on the Thibodeaux tract "in the immediate vicinity of the Touchet property."¹⁸⁹

On February 13, 1950, near the end of the ten-year prescriptive period on the mineral royalty established by Mr. Touchet, Union filed a declaration creating a pooled unit with adjacent land. The unit well was completed and shut-in. Included in that unit were the lands of a Mr. Sonnier. Mr. Sonnier's lease, which was owned by Union, did not have a pooling clause, as did Mr. Touchet's lease.

The question arose as to the interruption of prescription on the mineral royalty interest—if the unit was valid, prescription was interrupted; if the unit was not valid, prescription was not interrupted.

187. *Id.* § 31:91.

188. 86 So. 2d 50 (La. 1956).

189. *Id.* at 54.

The court held that the unit was not valid. The court stated as follows: "Obviously the only meaning that this provision of the lease could have was that the lessor granted to the lessee authority to combine his lease with any other land or lease in the vicinity which the oil company also had authority to unitize."¹⁹⁰

Because the lessee did not have the authority to pool the adjacent land, the formed unit was not valid. To hold otherwise would mean that a lessee could pool a leased premises with any other adjacent property without the power and authority of that adjacent landowner to do so, thereby extending the life of the lease on the pooled leased premises. "Such a result would be unthinkable."¹⁹¹

Since the unit was not valid, prescription accruing against the mineral royalty burdening the Touchet tract was not interrupted. The unit not being a valid unit, the shut-in well was simply a well situated on a nearby tract,¹⁹² having no bearing on prescription accruing against the mineral royalty.

V. CONCLUSION

Long gone are the days when natural gas produced in association with oil was flared because it was, at worst, a nuisance and, at best, not commercially profitable to produce. Natural gas is a major part of the national economy and its production is promoted by increasingly higher prices at the wellhead.

The case could be made that the "shut-in clause" is one of the most important clauses in a mineral lease. By definition, a lessee will have occasion to resort to it only in "happy times"—after the lessee has expended significant amounts of money and has discovered gas reserves which are capable of being produced in "paying quantities." For reasons that are favorable to the interest of both the lessor and lessee alike, it becomes necessary to spend still more money to attract a market and install necessary production facilities. The last thing that the lessee should face under such circumstances is an issue as to how the lessee might maintain leasehold rights pending first deliveries.

190. *Id.*

191. *Id.* at 54.

192. *Cf. Auzenne v. Lawrence Oil Co.*, 179 So. 2d 533 (La. App. 3d Cir. 1965) (mineral lease did not expire for failure of lessee to pay shut-in royalty where the plaintiffs' lands were unitized with a tract on which was situated a shut-in gas well since the compulsory unit was created for the production of oil, not gas, and the shut-in gas well was "simply a well situated on a nearby tract," which was not unitized with plaintiffs' land for purposes of gas production).

A properly confected “shut-in clause”—explicit in stating the circumstances under which it may be availed, limited in time and resulting in a monetary consideration of the lessor—brings certainty and predictability to the lessor-lessee relationship and facilitates the attainment of the “main consideration of such a lease [which] is the development of the land for oil and gas.”¹⁹³

193. *Caldwell v. Alton Oil Co., Inc.*, 108 So. 314 (La. 1926).