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The Jones Walker Energy E*Zine reviews and discusses developments in the energy industry, with a particular focus on matters that affect Louisiana. It addresses all legal disciplines within the energy industry, including the exploration and production of oil, gas, and other hydrocarbons; as well as the processing, marketing, and valuation of these products.

Louisiana Appellate Court Orders Property Restoration, Instead of a Monetary Award, in a Suit by a Landowner Seeking to Enforce Its Oil and Gas Lessees' Implied Obligation to Restore the Leased Premises

Terrebonne Parish School Board v. Castex Energy, Inc., 2001-2634 (La. App. 1st Cir. 3/19/04), -- So.2d --, 2004 La. App. LEXIS 615; 2004 WL 540521, *writ granted*, 2004-0968 (La. 6/25/04), 876 So.2d 816.

The Louisiana First Circuit Court of Appeal recently affirmed a trial court's decision to order oil and gas lessees to implement a restoration plan to restore two canals and a slip dredged on property owned by the Terrebonne Parish School Board. The appellate court, however, vacated the trial court's $1,100,000 damage award against the oil and gas lessees and found that the trial court erred in appointing a special master to design and oversee the restoration plan for property. In June 2004, the Louisiana Supreme Court granted defendants' writ application, agreeing to review the First Circuit's decision.

Originally, in 1963, the School Board, as lessor, granted an oil and gas lease to Shell Oil Company in 1963. While the 1963 lease expressly granted the lessee authority to dredge canals, it was silent on whether the lessee had any duty to restore the surface of the property. In 1999, the School Board brought suit against lessees/assignees of the lease seeking to enforce their alleged obligation to restore the property. The School Board asserted that the canals dredged on its coastal wetlands property pursuant to the lease had caused and were continuing to cause damage by altering and eroding the natural hydrology of the marsh.

After trial, the trial court rendered a judgment finding that the two assignees, Bois D'Arc and Samson, were solidarily liable to the School Board for restoration of the property in an amount not to exceed $1,100,000. In the judgment, the court further required the defendants to deposit the

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$1,100,000 into the court registry and ordered any amounts not used to be refunded to them. To design and oversee the restoration plan, which required backfilling the canals, the court appointed a special master.

On appeal, the assignees challenged the trial court's conclusion that they were liable for restoration based on the absence of any express provision in the lease imposing a restoration obligation. Further, the School Board, Bois D'Arc and Samson all asserted that the trial court erred in appointing a special master without their consent. The School Board also sought an award of a "sum certain" and an unconditional award of the $1,100,000.

Challenging the trial court's decision to hold them liable, Bois D'Arc and Samson argued that they owed no duty to restore the surface based on their compliance with State regulations upon cessation of operations and the lack of any express restoration provision in the lease. Addressing their argument, the First Circuit pointed to La. R.S. 31:122, the prudent operator standard set forth in the Louisiana Mineral Code. The court then examined pre-Mineral Code jurisprudence, concluding that a lessee's "good administrator" duty includes the obligation to restore the surface as near as practical to its original condition on completion of operations. The court observed that the Mineral Code codified existing jurisprudence and that the Code, accordingly, imposed an obligation to restore the surface even in the absence of an express restoration provision in the lease. The court, therefore, determined that the trial court correctly concluded that the assignees were solidarily obligated to the School Board for restoration of the property to a condition as near as practicable to its pre-lease condition.

Examining the scope of the assignees' duty to restore, the First Circuit, although agreeing that the assignees had a duty to restore the two canals and the slip, disagreed with the School Board's contention that the duty to restore extended to a third canal used by the assignees in their oil and gas operations. The appellate court rejected the School Board's contention concerning the third canal upon finding that there was no evidence to establish that the canal was dredged under the authority of the 1963 lease. In doing so, the court stated: "Since it is an oil and gas lease to which an implied obligation to restore the surface attaches, see La. R.S. 31:122, and not a mere right of use agreement, [the School Board] failed to prove that the [third canal] was within the scope of the covenant to restore the surface implicit in the 1963 Shell lease."

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The court next considered the argument raised by Bois D'Arc and Samson that the implied obligation to restore arising from the prudent operator standard required lessees to undertake only those restoration measures falling within customary practices in the oil and gas industry. Finding that the evidence confirmed that the custom in the industry with respect to surface restoration at the termination of the lease is that dredged canals are not backfilled by oil companies, the appellate court nevertheless affirmed the trial court's decision to order the filling of the canals. Viewing the trial court's judgment, the appellate court observed that, in imposing liability, the trial court did not adopt in totality any of the proposals offered by the parties and did not order perfect restoration of the marsh. Instead, the court noted that the trial court "balanced the cost of a less-than-perfect restoration against the intrinsic value of the wetlands and weighed that determination in favor of the marsh." Emphasizing the "non-pecuniary, aesthetic, and far-reaching benefits this State's wetlands provides to the entire ecosystem," the First Circuit held that the "the trial correctly fashioned an approach within the ambit of the express requirements of Article 122."

Relying on *Corbello v. Iowa Production*, 850 So. 2d 686, 694 (La. 2/25/03), the appellate court further rejected the contention by Bois D'Arc and Samson that the cost to restore the surface in accordance with the trial court's judgment improperly exceeded the market value of the property. In so rejecting, the First Circuit observed that the lessees could have bargained for a provision in the lease to limit their restoration liability to the market value of the property but did not.

Finding that the award of $1,100,000, conditioned on the return to the defendants of any amounts not spent in implementing the restoration plan, violated the Louisiana requirement that judgments be precise, definite and certain, the First Circuit vacated the "refund" condition imposed by the trial court. The First Circuit further agreed with Bois D'Arc, Samson and the School Board that the trial court erred in appointing a special master to oversee the restoration plan because Louisiana law, La. R.S. 12:4165, requires that all parties consent to the appointment of a special master.

The court also vacated the judgment to the extent it awarded $1,100,000 to the School Board, noting that "the implied covenant that the assignees of the lessee . . . are bound to perform is one to actually restore the surface (not simply to tender an amount sufficient to accomplish restoration)." Finally, the court amended the judgment "to expressly order

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Bois D'Arc and Samson to restore the two canals and the slip . . . in accordance with the methodology of restoration fashioned by the trial court."

In a concurring opinion, Judge McClendon stressed that "the obligation to restore is not without limits" and that a standard of reasonableness, balancing perfect restoration against the use to which the land is being put, "must be applied to the facts of each case." Viewing the particular facts in the case, Judge McClendon agreed that the trial court did not err in adopting its methodology for restoration.

Dissenting in part, Judge McDonald first noted the lease's silence with respect to an obligation to restore and next examined the implied obligation to restore arising from Article 122 of the Mineral Code. In doing so, the dissenter observed that there was no evidence that the assignees acted negligently and that the evidence instead indicated that the assignees had acted as reasonably prudent operators. Judge McDonald also stated that there was no evidence that the custom in the industry required filling canals upon cessation of operations. Pointing to Civil Code lease law, La. Civ. Code arts. 2719 and 2720, he opined that digging the canals "certainly seems to be normal wear and tear in furtherance of the objectives of the lease and expected by the parties" and concluded that, to the extent restoration was properly ordered at all, the assignees' proposed restoration plan was more appropriate than the plan affirmed by the majority.

Next, Judge McDonald noted that, although he did "not ascribe to the idea that § 122 requires restoration of the marsh to its original condition," even it did, the obligation did not apply under the circumstances. Relying on *Corbello*'s enforcement of a "contractual obligation that was bargained for and between the parties," the dissenter concluded that the School Board and Shell "clearly contemplated, intended, and authorized the dredging of canals by the lessee." Emphasizing that the School Board did not bargain for restoration, he concluded that, "If section 122 provided for an implied obligation to restore the surface, there would have been no reason for the supreme court to interpret the contract in *Corbello*" because the obligation "would exist with or without a contract and regardless of what the contract provisions provided."

In the aftermath of *Corbello*, the First Circuit in *Castex* addressed some of the questions that remained unanswered and raised some new ones.

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For example:

- In holding that "the implied covenant that the assignees of the lessee... are bound to perform is one to *actually restore* the surface (not simply to tender an amount sufficient to accomplish restoration)," the court determined that the implied restoration obligation arising from Article 122 of the Mineral Code requires actual restoration, refusing to award monetary damages to the landowner. In contrast, in *Corbello*, the Louisiana Supreme Court awarded $28 million in damages to the landowner for groundwater contamination and the threat it posed to the public Chicot Aquifer. The landowner, however, had no obligation to perform remediation to address the contamination. Unlike *Castex*, *Corbello* concerned an explicit contractual provision requiring the surface lessee to restore the property. In response to *Corbello*, the legislature enacted Act 1166 of 2003, La. R.S. 30:2015, *et seq.*, requiring the courts, upon finding that a threat to usable groundwater exists, to adopt a plan to address the contamination and to hold in the court registry and administer the funding for the plan. By awarding no monetary damages to the landowner and instead ordering defendants to perform actual restoration of canals, the First Circuit in *Castex* directly addressed the concern raised by the *Corbello* decision that a landowner has a right to sue for property restoration and recover a monetary award for environmental damages with no corresponding obligation to restore the property by remediating the contamination. Of course, whether it is feasible to require actual restoration in every case remains to be seen (and the Louisiana Supreme Court may address this point on review).

- After *Corbello*, which concerned a specific contractual obligation to restore the property as near as practicable to its original condition, it was unclear whether a lessee's compliance with State regulations upon cessation of its operations satisfied the Mineral Code's Article 122 prudent operator standard (and the implied restoration obligation arising therefrom). In *Castex*, the First Circuit answered that compliance did not, finding that the implied obligation to restore requires more than conducting and ceasing operations in accordance with State law.

- The First Circuit restricted the implied obligation to restore to cover only activities conducted directly pursuant to the lease, refusing to expand the obligation to cover all activities conducted with respect to the lessees' oil and gas operations.

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- In concluding that the implied restoration obligation required the lessees to backfill the canals, despite conclusive evidence that it was not industry custom for a lessee to fill canals upon completion of operations, the court emphasized the "aesthetic, and far-reaching benefits this State's wetlands provides to the entire ecosystem." In other words, stressing the importance of Louisiana's wetlands, the court imposed a restoration obligation on the lessees that, at least based on industry custom, exceeded the prudent operator standard. Assuming the Louisiana Supreme Court does not address this issue directly, in future cases, it remains to be seen whether courts facing oil and gas property restoration claims by landowners will require restoration exceeding industry custom when the property involved is not wetlands.

- In *Corbello*, the Louisiana Supreme Court held that, although property damage awards in tort cases must be tethered to the market value of the property, in breach of contract cases, property damages need not be. Again, *Corbello* concerned an alleged breach of an explicit contract provision requiring restoration. After *Corbello*, it remained uncertain whether a mineral lessee's implied restoration obligation required the lessee to perform restoration when the cost to do so would exceed the market value of the property. Like *Corbello*, the court in *Castex* concluded that the cost to perform restoration arising from a lessee's implied obligation to restore need not be tethered to the market value of the property, reasoning that the *Castex* lessees could have bargained for a contract provision limiting their restoration obligation. Accordingly, as the dissent pointed out, rather than requiring the lessor, the School Board, to bargain for a contractual provision in the lease specifying the lessee's obligation to restore, the *Castex* court put the burden on the lessee to bargain for a provision limiting its restoration obligation. In other words, under *Castex*, a lease that is silent on the obligation to restore favors the lessor.

Given the Louisiana Supreme Court's decision to grant writs, we may soon have greater guidance on some of these issues, such as the scope of an oil and gas lessee's implied restoration obligation and/or on whether judicial authority properly extends to require the lessee to perform actual restoration, rather than to require payment of a monetary award sufficient to cover the cost of restoration.

- Alida Hainkel

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Finding in Favor of Companies Using 3-D Seismic Technology, Texas Courts Continue to Require Surface Entry to State a Claim for Geophysical Trespass

Villarreal v. Grant Geophysical, Inc., et al., 136 S.W.3d 265 (Tex. App. -- San Antonio 2004, pet. ref'd)

The Texas Supreme Court recently denied a Petition for Review filed by mineral estate owners who argued that geophysical companies who use 3-D seismic technology owed damages to them for geophysical trespass even though the companies never physically entered the plaintiffs' property. Claims asserted by plaintiffs under assumpsit in lieu of geophysical trespass and unjust enrichment also were dismissed.

The Fourth Court of Appeals in San Antonio affirmed the trial court's grant of summary judgment in the defendants' favor after finding that Texas law requires an actual physical surface entry in order to successfully sustain a claim of geophysical trespass. The appellate court specifically found that no trespass occurred because none of the defendants physically invaded or injured the surface estate lying above the plaintiffs' mineral estate.

With regard to the unjust enrichment claims, the appellate court held that "since a trespass did not occur under current Texas law, [defendants] did not wrongfully secure a benefit nor did they passively receive one which would be unconscionable to retain."

During the litigation, plaintiffs advocated a change in Texas law to find a cause of action for geophysical trespass without any entry upon the surface estate. Plaintiffs argued that if information was incidentally gathered from an unpermitted estate while conducting a survey from the surface of neighboring permitted lands, this constituted a geophysical trespass onto the unpermitted estate. The defendants, seismic companies in Texas, argued that such a finding would radically hamstring the use of 3-D seismic technology, would severely hamper exploration efforts in Texas, and would allow the owner of an unpermitted mineral estate in the midst of an otherwise permitted survey to prevent all surrounding mineral estate owners from enjoying the full benefits of their property ownership.

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The defense victory at the trial and appellate levels reinvigorates forty-year-old Texas precedent that the mere entry of seismic waves into a mineral estate is not trespass in the absence of surface entry. The courts flatly rejected plaintiffs' argument that modern advances in seismic technology necessitated a change in the law. The ruling protects the important right of geophysical companies to continue using invaluable 3-D seismic technology in responsible and effective energy exploration in Texas.

David Radlauer, Carl Rosenblum, Madeleine Fischer and Tara Richard handled this case for Grant Geophysical, Inc. and Grant Geophysical Corp.

- *Tara Richard*

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

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