

PUBLICATION

Gloria's Ranch LASC Opinion

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In August 2017, we wrote about an opinion from the Louisiana Court of Appeal, Second Circuit in the matter of *Gloria's Ranch, L.L.C. v. Tauren Exploration, Inc.* The Louisiana Supreme Court recently issued a highly anticipated opinion in the matter *Gloria's Ranch, L.L.C. v. Tauren Exploration, Inc.*, overturning the Louisiana Court of Appeal, Second Circuit's ruling that a lender could be held solidarily liable with mineral lessees for breach of certain obligations under a mineral lease.

In 2004, the lessor, Gloria's Ranch, L.L.C., granted a mineral lease to Tauren Exploration, Inc. Tauren later assigned portions of its interest in the lease to Cubic Energy, Inc., and to EXCO USA Asset, Inc. Tauren and Cubic then executed separate credit agreements with Wells Fargo Energy Capital, Inc. As security for Cubic's credit agreement with Wells Fargo, Cubic mortgaged its interest in mineral leases with various lessors, including Gloria's Ranch, and assigned as collateral the profits earned from the leases.

Later, Tauren and EXCO negotiated a purchase agreement whereby EXCO purchased Tauren's 51 percent interest in the lease as to certain depths (the "deep rights"). Cubic then conveyed to Tauren an overriding royalty interest in Cubic's interest in the deep rights. Tauren simultaneously made a cash payment to Wells Fargo, assigned it ten percent net profits interest in the "shallow rights," and assigned it the overriding royalty interest in the deep rights it received from Cubic. In exchange, Wells Fargo cancelled the Tauren mortgage.

In 2010, Gloria's Ranch sent written demand to Tauren, Cubic, EXCO, and Wells Fargo requesting a recordable act evidencing the expiration of the lease. When the recipients failed to reply, Gloria's Ranch filed suit against the four parties for failure to furnish a recordable act evidencing expiration and release of the lease, claiming that the lease expired for not producing in paying quantities and seeking damages.

Following a bench trial, the district court held the three litigating defendants – Tauren, Cubic, and Wells Fargo – solidarily liable, meaning the plaintiff could obtain the entirety of the damages owed to it from any one of the defendants, finding that the lease expired due to lack of production in paying quantities and that the defendants failed to furnish a recordable act evidencing the release. The Second Circuit Court of Appeal affirmed.

On writ application to the Louisiana Supreme Court, Wells Fargo argued that it should not be held solidarily liable with the other defendants because, as a mortgagee/creditor, it is not responsible for the obligations of a mineral lessee, the owner of the mineral right. Gloria's Ranch, however, argued that, because Wells Fargo was an assignee of the lease, had a "bundle of rights" by virtue of the credit agreement and mortgage giving it control over operations, had an overriding royalty interest, and had a net profits interest, that it became liable for breach of the mineral lease obligations. Thus, Gloria's Ranch argued that Wells Fargo was solidarily liable with the other defendants.

Both the Second Circuit and the Supreme Court rejected the argument the lease assignment transferred ownership. The Supreme Court held that Wells Fargo could not be considered an "owner" of the lease by virtue of the "assignment" contained in the mortgage, as it was not a true "assignment," which must assign the assignor's *entire* interest in the property. Because the mortgage did not transfer Cubic's working interest in the land to Wells Fargo, no assignment occurred.

The Second Circuit, on the other hand, accepted the theory, finding that Wells Fargo's "bundle of rights" over Cubic's oil and gas operations – such as the credit agreement's language providing Wells Fargo the right to approve the location and depth of the wells – rose to the level of ownership and, thus, the Second Circuit held Wells Fargo solidarily liable.

But the Supreme Court expressly disagreed with the Second Circuit as to the "control theory." The Supreme Court found that Wells Fargo did not become an "owner" by virtue of the "control" exercised via the "bundle of rights." Noting that the Louisiana Mineral Code specifically applies to mineral law and is supplementary to the Louisiana Civil Code, the Supreme Court held that the Louisiana Mineral Code governs the creation of ownership and transfer of mineral rights, not the Civil Code. The Court noted that the Louisiana Mineral Code does not address or sanction ownership via the "control of rights" theory, citing to articles 127 and 128 of the Mineral Code on assignment and sublease as support. Moreover, the Court noted that the Louisiana Mineral Code distinguishes ownership from security rights in articles 203 and 204. Based on the provisions of the Louisiana Mineral Code, which specifically provide for security instruments, the Court found that the credit agreement and mortgage did not convey ownership in the mineral lease simply because Wells Fargo asserted some control over the collateral described in the security instruments.

Continuing, the Court noted that none of the provisions of the mortgage or credit agreement conveyed to Wells Fargo the right to explore for and produce minerals on the property – the primary right granted in a mineral lease and the "stamp of ownership." By contrast, the Court opined that the rights that Wells Fargo enjoyed were broadly security interests and derivative rights related to safeguarding of the collateral – the mineral lease.

Lastly, the Court found no merit in the argument that Wells Fargo's overriding royalty interest and net profits interest from Tauren's interest in the lease conveyed ownership. Calling the rights "merely passive, derivative rights" given in exchange for cancellation for Tauren's mortgage, the Court opined that these rights also did not convey any right of ownership typical of a mineral owner set forth in Louisiana Mineral Code article 81, namely the right to conduct operations to explore for and/or produce minerals.

Finding that the lower courts improperly held Wells Fargo liable as an "owner" under Louisiana Mineral Code article 207 and "lessee" under Mineral Code article 140, the Louisiana Supreme Court reversed the judgment as to Wells Fargo.