Gloria's Ranch, L.L.C.: Louisiana Appellate Court Holds Mineral Lessees and Lender Solidarily Liable for Damages Under the Louisiana Mineral Code for Failure to Release Mineral Lease and Pay Royalties

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The Louisiana Second Circuit Court of Appeal in Shreveport, Louisiana decided *Gloria's Ranch, L.L.C. v. Tauren Exploration, Inc.*[1] on June 2, 2017, holding mineral lessees and their lender solidarily liable for damages for failure to release a mineral lease and pay royalties. Although the Second Circuit concluded that the "case is highly fact-intensive and should not be construed as governing other cases that may follow unless the same facts exist,"[2] the potential negative impact of the decision cannot be overstated. As the two judges who were in favor of reversing the decision on rehearing noted in their aggressive dissent, "[t]he majority opinion has far-reaching implications on the banking industry as well as the oil and gas industry."[3]

The Second Circuit's solidary liability holding in *Gloria's Ranch* is important to the banking and oil and gas industries for at least two reasons. First, lenders, faced with the possibility of being held solidarily liable with oil and gas companies, will likely be hesitant to make loans to the oil and gas industry, which, as the dissent on rehearing noted, will have "a most chilling effect on their businesses."[4] Second, mineral lessees owning only a percentage interest in a lease can be, as solidary obligors, required to pay damages arising from the failure to release a lease in its entirety, including damages for lost leasing opportunities encompassing an entire lease. The only source of relief being the ability to pursue contribution from other solidary obligors or seeking a reduction of the damages amount in the virile portion of any solidary obligor who may have settled with the plaintiff.[5]

Factual Background and Ruling of the District Court

In 2004, Gloria's Ranch, L.L.C. ("Gloria's Ranch") granted a mineral lease (the "Lease") covering five sections in Caddo Parish, Louisiana, to Tauren Exploration, Inc. ("Tauren"). In 2006, Tauren assigned an undivided 49% interest in the Lease to Cubic Energy, Inc., now known as Cubic Louisiana, L.L.C. ("Cubic").[6]

Tauren and Cubic borrowed money from Wells Fargo Energy Capital, Inc. ("Wells Fargo") in 2007, each executing separate credit agreements.[7] Although Tauren's credit agreement was not included in the record,[8] the Second Circuit's decision states that Cubic received a revolving credit facility not to exceed $20 million outstanding at any time and a $5 million convertible term loan. As security, Cubic mortgaged

1 51,077 (La. App. 2 Cir. 6/2/17); 223 So.3d 1202.

2 *Id.* at 1225.

3 *Id.* at 1226 (Dissent, Bleich J. (Pro Tempore)).

4 *Id.* at 1225 (Dissent, Bleich J. (Pro Tempore))

5 This article focuses on the Second Circuit's decision to uphold the trial court's finding of solidary liability as to the mineral lessees and lender, but the Second Circuit's decision also addressed termination of a lease for failure to produce in paying quantities and failure to pay royalties under the Louisiana Mineral Code. To review the Second Circuit's analysis of these issues, *see id.* at 1210-1213 (failure to produce in paying quantifies) and 1215-1218 (failure to pay royalties).

6 *Id.* at 1207. After the trial court entered its judgment, Cubic Energy, Inc. filed for bankruptcy. After the effective date of the bankruptcy judgment, March 1, 2016, Cubic Louisiana, L.L.C. was substituted as defendant. *Id.* at 1210 n.8.

7 *Id.*

8 *Id.* at 1208 n.4.

its interest in various mineral leases with landowners, including Gloria's Ranch, and collaterally assigned the profits therefrom (the "Cubic Mortgage").[9]

Under Cubic's credit agreement with Wells Fargo, the borrowed money had to be used for certain purposes (for example, drilling) and Wells Fargo retained the right, among other things, to approve (i) the location and depth of wells; (ii) Cubic's entry into new operating agreements or amendments of the original operating agreement, and (iii) Cubic's alienation of its oil and gas lease rights. Wells Fargo, however, did not obtain a working interest in the Lease.[10]

In November 2009, Tauren assigned its interest in the deep rights of the Lease to EXCO USA Asset, Inc. ("EXCO"), with Tauren maintaining a 51% interest in the shallow rights. At the same time, Cubic assigned to Tauren an overriding royalty interest in its 49% interest in the deep rights.[11]

As a result of the EXCO sale, Tauren made a cash payment to Wells Fargo; assigned Wells Fargo a 10% net profits interest in its shallow rights interest in the Lease; and assigned to Wells Fargo a portion of the overriding royalty interest in the deep rights in the Lease it had received from Cubic. In return, Wells Fargo cancelled the mortgage affecting Tauren's interest in the Lease.[12]

Later, in December 2009, Gloria's Ranch sent a letter to Tauren, Cubic, EXCO, and Wells Fargo requesting information regarding the Lease, and expressing its belief that the Lease had terminated, in whole or in part, for lack of production in paying quantities.[13] Unsatisfied with Tauren's reply, Gloria's Ranch sent a second later dated January 28, 2010 demanding that Tauren, Cubic, EXCO, and Wells Fargo present a recordable act evidencing termination of the Lease.[14]

When Gloria's Ranch did not receive a release of the Lease, it filed a lawsuit against all four entities – Tauren, Cubic, EXCO, and Wells Fargo ("Defendants"). Gloria's Ranch argued that the Lease had terminated in 2009, in whole or in part, for failure to produce in paying quantities and that Defendants' failure to release the Lease prevented Gloria's Ranch from leasing the property to others, damaging it in the amount of bonus payments, rentals, and royalties it would have received. Gloria's Ranch later amended its Petition to include a claim for unpaid royalties on the grounds that if the trial court found the Lease was maintained in the fifth section by well production, the Defendants had failed to pay royalties.[15]

Before trial, Gloria's Ranch settled with EXCO, granted it a new lease, and dismissed it from the lawsuit (the "EXCO Settlement").[16]

After a four-day bench trial, the trial court issued a written judgment that the Lease had terminated in its entirety. But, in its oral reasons, the trial court concluded that in only four of the five sections the Lease had terminated for lack of production in paying quantities. As for the fifth section, the trial court concluded that Gloria's Ranch was entitled to payment for unpaid royalties and punitive damages for failure to pay upon written notice of nonpayment.[17] Although the trial court's oral reasons did not

9 *Id.* at 1207-08.

10 *Id.* at 1223.

11 *Id.* at 1208.

12 *Id.* at 1208.

13 *Id.* at 1208-09.

14 *Id.* at 1209.

15 *Id.* at 1209.

16 *Id.* at 1209.

17 *Id.* at 1209.

specifically cancel the fifth section, on appeal, the Second Circuit refused to revise the written judgment on the grounds that a sufficient basis existed for the trial court to find damages (royalty payments) alone were insufficient such that the fifth section should be cancelled as well.[18]

With respect to damages, the trial court held that ***all*** remaining defendants – Tauren, Cubic, and Wells Fargo – were solidarily liable for damages and attorneys' fees. The trial court held that the mineral lessees were solidarily liable without discussion, but it did address its decision to hold Wells Fargo solidarily liable with the mineral lessees.[19]

The trial court found Wells Fargo solidarily liable with the mineral lessees for four reasons: (i) the Cubic Mortgage contained an assignment of the Lease to Wells Fargo; (ii) the Cubic Mortgage provided that Cubic could not release the lease without prior consent from Wells Fargo; (iii) Tauren had assigned Wells Fargo an overriding royalty and net profits interest in the Lease; and (iv) Wells Fargo received cost information from Tauren and Cubic and regularly audited their records.[20]

The trial court originally granted damages against Tauren, Cubic, and Wells Fargo as follows: (i) $22,806,000 for lost leasing opportunities in three sections ($18,000 per acre for 1,267 acres);[21] (ii) $242,029.26 for unpaid royalties from the fifth section; (iii) $484,058.52 as a penalty for failure to pay royalties due from the fifth section; and (iv) attorneys' fees and expert costs.[22]

After damages were awarded, Tauren, Cubic, and Wells Fargo filed motions for new trial, and the trial court granted them in part to reduce the damage awards by 25% to account for the EXCO Settlement.[23]

The Second Circuit Affirms the Trial Court's Decision

Tauren, Cubic, and Wells Fargo, each asserting separate assignments of error, appealed but the Second Circuit affirmed the trial court's judgment.

With respect to the cancellation of the Lease, the Second Circuit affirmed the trial court's decision on the grounds that (i) in four of five sections, the Lease terminated for lack of production in paying quantities[24] and (ii) in the fifth section, the Lease terminated for failure pay royalties due.[25]

Only Tauren and Wells Fargo appealed the trial court's decision to hold them solidarily liable for damages, but the Second Circuit, as discussed below, was not persuaded by their independent arguments. Cubic did not appeal the trial court's decision regarding solidary liability.

[18] *Id.* at 1217-18.

[19] *Id.* at 1219.

[20] *Id.* at 1219.

[21] The trial court did not award lost leasing damages for the fourth section because Gloria's Ranch had granted a top lease to another entity. *Id.* at 1209 n.7. Additionally, it appears that because of the discrepancy between the trial court's oral reasons for judgment and the written judgment with respect to the cancellation of the fifth section, the fifth section was not included in the calculation of lost leasing opportunity damages. From a reading of the case, it does not appear that Gloria's Ranch appealed this discrepancy.

[22] *Id.* at 1209.

[23] *Id.* at 1209.

[24] *Id.* at 1213.

[25] *Id.* at 1217-18. Although the trial court's oral reasons did not specifically cancel Section 15, the Second Circuit rejected the argument to revise the written judgment (which held the entire Lease cancelled without excluding the fifth section) on the grounds that a sufficient basis existed for the trial court to find damages (royalty payments) alone were insufficient such that the fifth section should be cancelled as well. *Id.*

When reviewing the Second Circuit's opinion with respect to solidary liability, it is important to note that at the time Gloria's Ranch sent its January 28, 2010 demand letter requesting a release of the Lease, Tauren owned a 51% undivided interest in the shallow rights; EXCO owned a 51% undivided interest in the deep rights; and Cubic owned a 49% interest in the shallow and deep rights. And although Wells Fargo held a mortgage over Cubic's interest in the Lease, as well as an overriding royalty and net profits interest in the Lease, it was not a working interest owner.[26]

The Second Circuit's Holding that All Mineral Lessees Are Solidarily Liable, and Arguments in Response to the Holding

On appeal, Tauren argued that it should only be held responsible for damages related to its interest in the Lease.[27] In other words, Tauren argued that the trial court erred in finding it liable for damages related to interests it did not own.

The Second Circuit, in addressing Tauren's argument, conducted a review of basic principles of solidary liability under the Louisiana Civil Code and liability under the Louisiana Mineral Code, but failed to conduct a thorough application of those principles to the facts at hand.

Citing Article 1788 of the Civil Code, the Second Circuit noted that "[w]hen different obligors owe together just one performance to one obligee, but neither is bound for the whole, the obligation is joint for the obligors."[28] The Second Circuit further referenced Articles 1815 and 1789, stating that "[a]n obligation is indivisible when the object of the performance, because of its nature or because of the intent of the parties, is not susceptible of division,"[29] and "[w]hen a joint obligation is indivisible, joint obligors are subject to the rules governing solidary obligors."[30]
With respect to the Mineral Code, the Second Circuit, citing the comments to Article 168, concluded that a "lessee's interest in a mineral lease, like any other 'thing,' is susceptible of co-ownership."[31] The Second Circuit also cited Article 206 of the Mineral Code, noting that it "requires the former owner of the mineral right to furnish a recordable act evidencing the expiration of the right within 30 days of receiving a written demand from the person in whose favor the right has been extinguished,"[32] and stating that "[w]hether or not a defendant is a 'former owner' of the lease is a mixed question of law and fact . . . ."[33]

Noting that Tauren held a 51% working interest in the shallow rights of the lease, the Second Circuit held that Tauren was "clearly a former co-owner of the lease," and, as such, "was obligated to provide Gloria's Ranch with a recordable act evidencing the expiration of *its* interest in the lease."[34]

But, despite the Second Circuit's acknowledgment that Tauren could only release "*its* interest in the lease,"[35] the Second Circuit held that Tauren should be responsible for damages relating to the entire lease on the grounds that Gloria's Ranch had demanded "release from the *entire lease* for failure to

[26] *Id.* at 1218.

[27] *Id.* at 1219.

[28] *Id.* at 1218 (citing La. Civ. Code art. 1788).

[29] *Id.* at 1218 (citing La. Civ. Code art. 1815).

[30] *Id.* at 1218 (citing La. Civ. Code art. 1789).

[31] *Id.* at 1218 (citing La. R.S. 31:168, official comment).

[32] *Id.* at 1219 (citing La. R.S. 31:206).

[33] *Id.* at 1219 (citing *Armenia Coffee Corp. v. Am Nat. Fire Ins.*, 2006-0409 (La. App. 4 Cir. 11/21/06); 946 So.2d 249, 253, *writ denied*, 2006-2983 (La. 2/16/07); 949 So.2d 422.

[34] *Id.* at 1219 (emphasis added).

[35] *Id.* at 1219 (emphasis added).

produce in paying quantities, which included both the shallow and deep rights in the lease."[36] It appears that the Second Circuit was swayed in this respect by testimony from Gloria's Ranch's expert that "if any party who held an interest in the lease failed to release its interest, it would create a cloud on the title that would discourage potential lessees from executing a new lease with Gloria's Ranch."[37]

Against this backdrop, the Second Circuit appears to have interpreted Article 168 of the Mineral Code as absolutely providing that the "ownership of a mineral right, such as a mineral lease, is indivisible,"[38] holding that "the obligation of the owners of the lease to produce a recordable act evidencing the release of the lease was indivisible, and [that] the trial court correctly found Tauren solidarily liable with the remaining defendants."[39]

Several legal arguments, however, can be made in support of the argument that the Second Circuit's decision to affirm solidary liability with respect to Tauren and the other mineral lessees is simply wrong.

First, the Second Circuit's determination in *Gloria's Ranch* that a solidary obligation existed arguably hinged on the fact that <u>*all*</u> leasehold interest owners were sent a written demand to release the Lease, and, in order to effect a full release of the Lease absent any cloud on title, <u>*each*</u> had to act "to produce a recordable act evidencing the release of the lease," meaning that obligation was "indivisible . . . ."[40] Nevertheless, while the Second Circuit examined various Civil Code articles regarding solidary liability, it addressed them sporadically and failed to address key Civil Code articles that address when solidary liability exists. For example, the Second Circuit did not mention Article 1794, which provides that "[a]n obligation is solidary for the obligor when each obligor is liable for the whole performance. A performance rendered by one of the solidary obligors relieves the others of liability toward the obligee."[41] Nor did the Second Circuit address Article 1795, which provides that "[a]n obligee, at his choice, may demand the *whole performance from any of his solidary obligors*," and "[u]nless the obligation is extinguished, an obligee may institute action against any of his solidary obligors even after institution of action against another solidary obligor."[42] Thus, although each leasehold interest owner was issued written demand for release, the Second Circuit's decision in *Gloria's Ranch* does not comport with Louisiana law regarding the solidary obligations, specifically Articles 1794 and 1795. Contrary to the dictate of Article 1795, Gloria's Ranch could <u>*not*</u> have demanded the "whole performance [(release of the entire lease)] from any of [its] solidary obligors,"[43] a basic tenant of solidary liability. In other words, how could any of the defendant owners of a *partial* leasehold interest release the <u>entire</u> Lease? And if they could not do so, how could they be "liable for the whole performance"[44] as required for a finding of solidary liability under Article 1794?

Second, it can be argued that the Second Circuit incorrectly applied Article 168 of the Mineral Code to hold that mineral leases are indivisible, when the statutory language actually provides only that "[m]ineral rights are *susceptible* of ownership in indivision."[45] Under Louisiana law, the mere presence of a contract with multiple obligors does not automatically mean that the obligors are subject to

[36] *Id.* at 1219 (emphasis added).

[37] *Id.* at 1219.

[38] *Id.* at 1219 (citing La. R.S. 31:168).

[39] *Id.* at 1219.

[40] *Gloria's Ranch*, 223 So.2d at 1219.

[41] La. Civ. Code art. 1794.

[42] La. Civ. Code art. 1795 (emphasis added).

[43] La. Civ. Code art. 1795.

[44] La. Civ. Code art. 1794.

[45] La. R.S. 31:168 (emphasis added).

solidary liability;[46] a contractual obligation will not be considered a solidary obligation if the obligors "agree to render one inseparable performance."[47]

The Second Circuit, however, does not appear to have conducted an analysis of the Lease at issue to determine whether it contemplated the ability of divided ownership and divided obligations upon assignment. In its application to the Louisiana Supreme Court for supervisory writs, Tauren has argued that the Lease permits a partial assignment of obligations because it contains a "consent to assign provision," and further argues that, under the Lease, the parties "did not express a clear intent to be solidarily liable," but instead, "the Lease clearly expresses an expectation that their respective obligations would be several or joint and in either case divisible."[48]

Third, although not argued by Tauren or other mineral lessees, it can be argued that the trial court erred in calculating the virile portion owed by each. Article 1804 of the Louisiana Civil Code provides that "[i]f the obligation arises from a contract or quasi-contract, virile portions are equal in the absence of agreement or judgment to the contrary."[49] The trial court's decision to simply divide liability by the number of defendants, arguably runs afoul of Article 1804 since the percentage of liability for the mineral lessees arguably should reflect the percentage in the lease owned by the mineral lessees.

The Second Circuit's Decision to Hold Wells Fargo Solidarily Liable with the Mineral Lessees and Arguments in Response to the Holding

On appeal to the Second Circuit, Wells Fargo argued that the Second Circuit erred in holding that the Cubic Mortgage contained an assignment of the Lease and in holding it solidary liable with the mineral lessees. As previously noted, Wells Fargo held a mortgage over Cubic's interest in the lease, as well as having an overriding royalty and net profits interest in the Lease as assigned by Tauren.[50]

First, Wells Fargo argued that the Cubic Mortgage was not an assignment of the Lease because Wells only received a security interest in the Lease under its terms.[51] Gloria's Ranch argued that the use of the word "assign" in the Cubic Mortgage proved it included an assignment of the lease.[52] The Second Circuit disagreed, noting that use of the words "assign" and "assignment" in an instrument does not mandate a finding that the instrument included an assignment, and that, instead, a review of the entire instrument was in order.[53] Since it determined that the Cubic Mortgage did not include a transfer of Cubic's working interest in the Lease, the Second Circuit held that the Cubic Mortgage did not include an assignment of the Lease.[54]

Second, Wells Fargo argued that it should not have been held solidarily liable with the remaining defendants; however, the Second Circuit did not agree, holding that the trial court properly held all defendants solidarily liable for the damages awarded. The Second Circuit seems to have been persuaded by Wells Fargo's right to control elements of the Lease under the Cubic Mortgage, holding

46 *Notre Dame, LLC v. Kolbe & Kolbe Mill Work Co.*, 151 F.Supp.3d 715, 722 (E.D. La. 2015) (citing La. Civ. Code art. 1796). Solidary liability is not presumed, it must arise by law or by a clear expression of the parties' intent. *Id.*

47 *Notre Dame*, 151 F. Supp. at 722 (citing La. Civ. Code art. 1794).

48 Application for Writ of Certiorari and/or Review on Behalf of Tauren Exploration, Inc., *Gloria's Ranch, L.L.C. v. Tauren Exploration, Inc., et al.*, No. 17-C-1522, Supreme Court of Louisiana ("Tauren's Writ Application"), pp. 6-7.

49 La. Civ. Code art. 1804.

50 *Gloria's Ranch*, 223 So.2d at 1218.

51 *Id.* at 1219.

52 *Id.* at 1221.

53 *Id.* at 1221.

54 *Id.* at 1222.

that it should be held solidarily liable with the mineral lessees because it "owned or controlled the bundle of rights that make up ownership, *i.e.,* the rights to use, enjoy, and dispose of the lease."[55]

The Second Circuit found that the trial court had a legitimate factual basis for finding Wells Fargo solidarily liable with the remaining defendants, specifically referencing Article 1979, and noting that it provides that "'[a]n obligation may be solidary though it derives from a different source for each obligor.'"[56] The Second Circuit also relied on its contention that "'[i]t is the coextensiveness of the obligations for the same debt, and not the source of liability, which determines the solidarity of the obligation.'"[57]

The appellate court, in further support of its decision, relied on testimony from Gloria's Ranch's expert, who testified that "the Cubic mortgage was a 'very sophisticated financial instrument' which conveyed certain rights in the lease to Wells Fargo . . ." such that Wells Fargo "exercised control over Cubic's oil and gas operations on the lease, and controlled Cubic's ability to release the lease for failure to produce in paying quantities."[58] Citing the various aspects of control available to Wells Fargo, the Second Circuit held that "Wells Fargo shared coextensive liability with Cubic to provide a recordable act evidencing the release of its interest in the lease . . .," such that it should be held solidarily liable of damages arising from the failure to release the Lease.[59]

The Second Circuit's holding seems to have improperly expanded solidary liability to a mortgagor, particularly since, under Article 1796 of the Civil Code, "[s]olidarity of obligation shall not be presumed."[60] Moreover, for Wells Fargo to be solidarily liable with the mineral lessees, it also must, like the mineral lessees, be an obligor to an obligee. Under Article 1786, it is only when "an obligation binds more than one obligor to an obligee . . . [that] an obligation may be several, joint, or solidary."[61]

It can certainly be argued that Wells Fargo did not owe any obligations to Gloria's Ranch via contract or law. As such, it was not an obligor of Gloria's Ranch, and if it was not an obligor, how could it be held solidarily liable as with other obligors?

Conclusion

Although the Second Circuit noted that the case was "highly fact-intensive and should not be construed as governing other cases that may follow unless the same facts exist,"[62] this attempt to limit the scope of *Gloria's Ranch* is little comfort to lenders or mineral lessees now facing solidary liability for damages resulting from failure to release a lease or make royalty payments. As expected, Wells Fargo and the two remaining mineral lessees in the case, Tauren and Cubic, have applied for supervisory writs to the Louisiana Supreme Court, and it is anticipated that industry amicus briefs will be filed as well. This ruling represents an important case to lenders and others in the oil and gas industry, and a strong push will be expected for the Louisiana Supreme Court to review and to reverse the Second Circuit's decision to hold mineral lessees and their lender solidarily liable.

55 *Id.* at 1222.

56 *Id.* at 1223 (quoting La. Civ. Code art. 1797).

57 *Id.* at 1223 (quoting *Glasgow v. PAR Minerals Corp.*, 2010-2011 (La. 5/10/11); 70 So.3d 765).

58 *Id.* at 1223-24.

59 *Id.* at 1224.

60 La. Civ. Code art. 1796.

61 La. Civ. Code art. 1786.

62 *Gloria's Ranch*, 223 So.3d at 1225.