From *Corbello* to *Castex*: The Mineral Lessee's Obligation to Restore in Louisiana

by Boyd Bryan

Introduction

On January 19, 2005, the Louisiana Supreme Court decided *Terrebonne Parish School Board v. Castex Energy, Inc.*,[1] its second landmark opinion in two years addressing a lessee's obligation to restore the leased property. In the first, *Corbello v. Iowa Production*,[2] the court ordered a lessee to pay restoration costs far in excess of the value of the property based on a lease provision requiring restoration. The industry breathed a sigh of relief with the *Castex* ruling. In a four to three decision, the *Castex* court reversed a lower court judgment that had ordered the mineral lessees to backfill canals despite the absence of any lease provision requiring restoration. This article examines the *Corbello* and *Castex* decisions and the current status of Louisiana oilfield site restoration litigation.

The Corbello Decision: When the Lease Requires Restoration

At issue in *Corbello* was the effect of the following provision in a surface lease:

> Lessee agrees to indemnify and hold lessor harmless from any and all loss, damage, injury and liability of every kind and nature that may be caused by its operations or result from the exercise of the rights or privileges herein granted. Lessee further agrees that upon termination of this lease it will reasonably restore the premises as nearly as possible to their present condition.

The landowners alleged that Shell Oil Company, the lessee, had contaminated their property and breached its contractual obligation to restore the property to its original condition. The evidence indicated that the fair market value of the property, fully restored, was $108,000. The court nevertheless awarded the landowners restoration damages in the amount of $33 million — *more than 300 times the value of the property*. Of the $33 million damage award, $28 million was to compensate the landowners for the cost of installing a groundwater recovery system to protect the Chicot Aquifer from contamination, even though under Louisiana law landowners do not own the groundwater beneath their property. Significantly, the landowners were not required to use the damages awarded to restore the property, i.e., they could pocket the money rather than spend it to clean up the property or install the groundwater recovery system.

Corbello involved a surface lease rather than a mineral lease. Predictably, the same rules apply to mineral leases. In *Hazelwood Farm, Inc. v. Liberty Oil and Gas Corp.*,[3] the court, following *Corbello*, ordered a mineral lessee to pay $2 million as damages "for restoring the property," despite jury findings that the value of the property in an uncontaminated state was $304,000, and there was no reason to believe the landowner would, in fact, restore the property.

Problems Presented by the Decision

Corbello presents at least three potential problems for the oil and gas industry whenever there is a contractual obligation to restore the property. The first, and most obvious, is the poten-

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tial liability for restoration damages that may far exceed the value of the property.

A second problem is the risk of double payment. Parties other than the landowner — such as the regulatory agencies, neighboring landowners and citizen groups — may also have the right to sue the lessee to require restoration of the property, and their claims may not be affected by the prior payment of restoration damages to the landowner. Thus, if the landowner does not use the damages to restore the property, then the risk remains that another party will obtain a judgment ordering the lessee to pay, again, for the restoration.

Another industry problem is the potential proliferation of restoration damage lawsuits and the negative impact they may have on oil and gas investment and activity in Louisiana. The *Corbello* court's award of damages many times greater than the property value, with no concomitant obligation to spend the money on restoration, provides a substantial incentive to landowners, and their attorneys, to aggressively pursue restoration actions against past and present mineral lessees. Concern about this litigation appears to be well-founded. It has been reported that more than 80 restoration damage lawsuits have been filed in Louisiana since the *Corbello* decision in February 2003, as compared to 10 similar suits in Texas, Oklahoma and Mississippi combined during the same period, and that 60 percent of respondents to a recent poll of oil company executives stated that they have eliminated or reduced their investment in Louisiana because of these suits.[5]

Partial Legislative Solutions

The Louisiana Oilfield Site Restoration Law, La. R.S. 30:89.1, which pre-dates *Corbello*, provides some protection from double payment. Section 30:89.1 states that if the landowner is paid damages for injury to property resulting from oil and gas activities, then in any subsequent action brought by the state of Louisiana or its agencies involving the same activities and site, the payer receives a credit for the amount paid to the landowner. This statute, however, is not a cure-all for the problem of double

payment. First, it only applies if the claim involves an oilfield site; it provides no protection if the site is contaminated by non-oil and gas activities. Also, it applies only in subsequent actions brought by the state or its agencies; it arguably is inapplicable to subsequent claims brought by other parties — such as EPA, neighboring landowners or citizens groups.

Perhaps of greater importance is La. R.S. 30:2015.1 which was passed in response to *Corbello* and was signed into law in July 2003. To summarize generally, section 30:2015.1 states that in suits alleging contamination of "usable groundwater" (as defined in the statute) (i) the Louisiana Department of Environmental Quality and the Louisiana Department of Natural Resources must be notified and may intervene, (ii) the court must adopt a plan for the evaluation or remediation required to protect groundwater, (iii) the estimated costs of implementation of the plan, and/or all damages awarded for evaluation or remediation of groundwater, must be deposited into the registry of the court and may be expended only for those purposes, and (iv) upon completion of the groundwater evaluation and remediation, any funds remaining in the registry of the court must be returned to the depositor.

Section 30:2015.1 is a significant step in the right direction but leaves some *Corbello* problems unresolved. Most importantly, it only addresses "*usable groundwater*" contamination. Damages awarded for the restoration of any other part of the property — such as soil, surface water or groundwater that is not "usable" — are to be paid directly to the landowner rather than into the registry of the court and do not have to be expended on cleanup.

Additional legislation to address *Corbello* may be proposed by the industry in the upcoming session of the Louisiana legislature which convenes in April 2005.[5]

Recent Judicial Developments

Corbello's application in differing factual scenarios is being worked out in the courts. Notably, a non-operating working interest owner has been held to be solidarily liable with the operator for restoration damages.[6] On the other hand, at least two trial courts have dismissed suits for restoration costs as premature on grounds that the mineral lease had not yet terminated.[7] In January 2005, a federal district court dismissed a suit by summary judgment on grounds that the plaintiff landowner, who purchased the property *after* the alleged oil and gas contamination occurred, lacked standing to sue for its restoration.[8]

Could the Court Have Required Actual Restoration?

Perhaps the most controversial aspect of *Corbello* is the fact that no one was required to actually restore the property. It is one thing to award a landowner damages many times the value of his property in order to address contamination. It is another thing entirely to allow the landowner to keep the money and leave the property in a contaminated state, at risk to the public and the environment and exposing the payer to continuing potential liability to other parties for the same damages.

There are several legal theories that, given the appropriate facts, would support a judgment requiring restoration rather than a payment of money to the landowner with no strings attached. For instance, the *Corbello* court could have ordered specific performance of the restoration by Shell,[9] based on the contract language. After all, the lease required Shell to "reasonably restore the premises as nearly as possible to their present condition," not to write the landowner a check in the amount of the cost of restoration.[10] Also, under Louisiana law, specific performance is the preferred remedy for breach of a contract.[11]

In addition, a landowner that has recovered the money necessary to restore his property, and fails or refuses to do so, may have statutory liability for the restoration. Restoration suit plaintiffs were recently successful in requiring the Louisiana Department of Environmental Quality to take action with respect to an oilfield site under the remediation sections of the Louisiana Environmental Quality Act.[12] Implicit in that decision (but not actually decided by the court) is that oilfield wastes are "hazardous substances" as defined by the statute.[13] If that is the case, then a landowner — particularly one who has received the money to address an environmental problem on his property and fails to do so — should also be liable for the cleanup under the statute.[14] This statutory liability should provide the court with authority to order the landowner to spend the money on the restoration.[15]

As a final point, a careful reading of *Corbello* indicates that the court did not hold that it lacked the authority to order the landowner to spend the damages on restoration. Shell did not ask the court to order the landowner to do

so. Instead, Shell argued that the damage award should be vacated because the landowner had no legal duty to use the damage award for restoration.[16] The court simply held that Shell's argument did not justify modification of the damage award.[17] In conclusion, despite *Corbello*, a sound argument can be made, in appropriate circumstances, that the court has the authority to order the landowner to spend the money on restoration.

The Castex Decision: When the Lease is Silent as to Restoration

Corbello turned on a lease provision that expressly required restoration. In contrast, the mineral lease in *Castex* was silent as to restoration. In the absence of controlling lease provisions, the *Castex* court looked to the Louisiana Mineral Code, Civil Code, and case law for the guiding principles for its decision. And the lower court decisions suggest that the courts were searching for a way to avoid one of the most problematic aspects of *Corbello*, the award of money damages with no corresponding obligation to restore that property.

The Trial Court Decision

Castex involved a 1963 mineral lease granted by the Terrebonne Parish School Board to Shell Oil Company. The lease covered a section of coastal marshland, and granted Shell broad rights to explore and drill for oil and gas and to store minerals and fluids, lay pipe lines, dredge canals, build roads and conduct other activities necessary for its oil and gas operations. The lease did not include any provision relating to restoration of the property. Various assignees of the lease dredged canals and a slip on the property, and five wells were drilled, one of which was converted to a saltwater disposal well. The lease terminated in late 1996 or early 1997 when production ceased.

The school board sued the assignees of the lease in 1999. It alleged that prior to the assignees' oil and gas activities, the property consisted of coastal wetlands with consistent vegetation and almost no surface ponds or streams, and that the assignees' activities had

caused and were continuing to cause damage by altering and eroding the natural hydrology of the marsh. Despite the absence of an express lease provision, the school board asserted that the assignees had an implied duty under the Louisiana Mineral Code to restore the surface of the property, as near as practicable, to its original condition, by backfilling of the canals.

The school board did not dispute that fact that the assignees had complied with all regulations of the Louisiana Commissioner of Conservation governing plugging and abandonment of the wells, closing of the oilfield pits and cleaning the area around the abandoned wells upon cessation of their operations. Also uncontested was a real estate appraisal submitted by the assignees showing that the estimated value of the 27.74 acres that had been dredged for canals was between $4,161 and $6,935.

After trial, the court concluded that that the assignees owed an implied duty under Louisiana Mineral Code article 122[18] to restore the surface of the property to its pre-lease condition by backfilling the canals. Following *Corbello*, it rejected the assignees' argument that the restoration award should not exceed the fair market value of the property. The court held that certain assignees were solidarily liable to the school board for restoration of the property in an amount not to exceed $1.1 million.

Significantly, however, the trial court did not order the assignees to pay the $1.1 million to the school board. Instead, perhaps in an attempt to avoid a windfall to the landowner as occurred in *Corbello*, it ordered that the assignees deposit the funds into the registry of the court, with any amounts not actually used to restore the canals to be refunded to the assignees. The court also appointed a special master to design and oversee the restoration plan which required backfilling of the canals.

The Court of Appeal Decision

The school board and the assignees all appealed the trial court's decision.[19] The school board contended it was entitled to a judgment unconditionally awarding it $1.1 million. It also chal-

lenged the appointment of a special master. The assignees joined in the objection to the special master and asserted several more substantive arguments, all of which were rejected by the appellate court.

The assignees first argued that under *Rohner v. Austral Oil Exploration Co.*,[20] they did not owe a duty to restore the surface absent a showing that they negligently or unreasonably exercised their rights under the lease. And because the lease granted the right to dredge canals, nothing in the lease required restoration by filling the canals or otherwise, and they had complied with all of the state's regulatory requirements upon cessation of operations. They had not acted negligently or unreasonably. The appellate court disagreed. Relying on the "reasonable, prudent operator" standard in Mineral Code article 122 and the comments to that article,[21] former Louisiana Civil Code articles 2719 and 2720,[22] and pre-Mineral Code jurisprudence,[23] the court concluded that "where an oil and gas lease lacks an express provision articulating the lessee's obligation to restore the surface at cessation of the lease term, a lessee is implicitly obligated to perform that duty."[24] The assignees, therefore, were obligated to restore the property as near as practicable to its pre-lease condition.

The assignees next asserted that even if they did have an obligation to restore the property, that obligation was limited by the "reasonably prudent operator" standard, and because industry custom did not require backfilling of canals, the remedy fashioned by the trial court exceeded that standard. Despite evidence confirming that the custom in the industry is that dredged canals are not backfilled at termination of a lease, the court affirmed the trial court's decision ordering the filling of the canals. It observed that in deciding on the scope of restoration, 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 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."[25] And "mindful of the non-pecuniary, aesthetic, and far-reaching benefits this State's wetlands provide to the entire ecosystem,"[26] the trial court's remedy was considered to be within the ambit of the requirements of article 122.

The appellate court also rejected the assignees' argument that the restoration obligation should be limited to the fair market value of the property, following the *Corbello* decision on that issue.

Most importantly, the court vacated the award of $1.1 million to the school board and instead ordered the assignees to specifically perform the restoration. It explained that "because the implied covenant that the assignees . . . are bound to perform is one *to actually restore* the surface (not simply to tender an amount sufficient to accomplish restoration),"[27] the award of money to the school board was inappropriate. The judgment was amended to require the assignees to restore the canals in

accordance with the methodology fashioned by the trial court, i.e. by backfilling the canals.

The Louisiana Supreme Court Decision

On appeal to the Louisiana Supreme Court, the assignees asserted essentially the same arguments as were previously made in the lower appellate court. The court identified the initial issue as being whether article 122 of the Mineral Code compels a lessee to restore the surface of the land to its pre-lease condition, where the lease terms do not so require and there is no evidence that the lessee excessively or unreasonably exercised its rights under the lease.

Addressing this issue, the court first noted that the text of Mineral Code article 122 does not expressly impose a duty to restore the surface. It acknowledged the comment to article 122 which states, "there appears no reason whatsoever to exclude [the duty to restore] as being a specification of the prudent operator standard," and that "it is established that the mineral lessee must restore the surface even though the lease contract is silent."[28] It explained, however, that the official comments to a statute, although not discounted entirely, are not binding on the court.

The court agreed with the assignees that *Rohner v. Austral Oil Exploration Co.* properly articulated the rule concerning the implied duty to restore the surface, by negating such a duty unless provided in the lease or based on proof of unreasonable or negligent operations. Further, the court found that former Civil Code articles 2719 and 2720 allow for deterioration of leased property because of necessary "wear and tear," and because the lease in *Castex* expressly granted the right to dredge canals, "the marshland was 'worn' and 'torn' in precisely the manner the parties contemplated."[29]

Ultimately, the court concluded that, in the absence of an express lease provision, Mineral Code article 122 does not impose an implied duty to restore the surface to its original, pre-lease condition absent proof that the lessee has exercised his rights under the lease unreasonably or excessively. The school board had not presented any such evidence. To the contrary, the assignees had shown that they had complied with all relevant regulations of the Louisiana Commissioner of Conservation, and that their decision not to backfill the canals was entirely consistent with industry custom. Accordingly, the court reversed the lower court's judgment and vacated its order compelling the assignees to specifically perform the backfilling of the canals.

Conclusion

Although the *Corbello* and *Castex* courts resolved some of the most important issues in oilfield site restoration litigation, certain questions remain unanswered. For example, in cases where the lease is silent as to restoration, what actions will constitute unreasonable or excessive exercise of the lease rights so as to give rise to an implied obligation to restore? And if in such a case the lessee has exercised its lease rights unreasonably or excessively, or in a case where the lease expressly requires restoration, can the court order specific performance rather than money damages, or order the landowner to spend the money on restoration if damages are awarded?

The general trend, both legislatively and judicially, since the *Corbello* decision appears to be favorable to the oil and gas industry. Time will tell whether the trend will continue.

Endnotes

[1] 2004-C-0968 (La. 1/19/05), — So.2d — 2005 WL 106482, 2005 La. LEXIS 141, rehearing denied (La. 2/25/05), 2005 La. LEXIS 573.

[2] 2002-C-0826 (La. 2/25/03), 850 So.2d 686.

[3] 2002-266 (La. App. 3d Cir. 4/2/03), 844 So.2d 380, writ denied 2003-1585 and 2003-1624 (La. 10/31/03), 857 So.2d 2d 476.

[4] A.J. Mistretta, Poll shows oil execs are fed up with lawsuits, BizNewOrleans.com (March 11, 2005), available at http://bizneworleans.com/109+M5b7416e4559.html. See also, Louisiana Oil and Gas Drilling Activity Feeling Impact of Legacy Lawsuits, LIOGA News, Newsletter of the Louisiana Independent Oil & Gas Association, January 2005, at 17.

[5] See Louisiana Oil and Gas Drilling Activity Feeling Impact of Legacy Lawsuits, LIOGA News, Newsletter of the Louisiana Independent Oil & Gas Association, January 2005, at 17.

[6] Simoneaux v. Amoco Production Co., 2002-1050 (La. App. 1st Cir. 9/26/03), 860 So.2d 560.

[7] Grand Lake Hunting Club v. BP America Production Co., Docket No. 2002-4112, 12th Judicial District Court, Avoyelles Parish, Louisiana, Judgment on Exceptions dated November 6, 2003; Doré Energy Corp. v. Carter-Langham, Inc., Docket No. 10-16202, 38th Judicial District Court, Cameron Parish, Louisiana, by Judgment dated January 29, 2004, appeal pending, Appeal No. 2004-01373-CA, Louisiana Third Circuit Court of Appeal.

[8] Frank C. Minvielle, L.L.C. v. IMC Global Operations, Inc., Civil Action No. 03-1908 (W.D. La., Lafayette-Opelousas Division 1/12/05).

[9] See La. Civ. Code art. 1986.

[10] Cf. Terrebonne Parish School Board v. Castex Energy, Inc., 2001 2634 (La. App. 1st Cir. 3/19/04), 878 So.2d 522, 536-37, reversed on other grounds, 04-0968 (La. 1/19/05), — So.2d — 2005 WL 106482, 2005 La. LEXIS 141.

[11] J. Weingarten, Inc. v. Northgate Mall, Inc., 80-C-2991 (La. 9/8/81), 404 So.2d 896, 897, 901 (specific performance is the preferred remedy for breach of a contract, but may be withheld by the court when specific performance is impossible, when the inconvenience or cost of performing is greatly disproportionate to the damages caused, when the obligee has no real interest in receiving performance, or when it would have a substantial negative effect on the interests of third parties); Dunham v. Dunham, 84-CA-0237 (La. App. 1st Cir. 2/15/85), 467 So.2d 555, 563, writ denied, 85-C-0898 (La. 5/31/85), 469 So.2d 989 (specific performance granted).

[12] Dore Energy Corp. v. Bohlinger, 2003-2768 (La. App. 1st Cir. 10/29/04), 889 So.2d 295, rehearing denied (12/29/04). The remediation sections of the Louisiana Environmental Quality Act are found at La. R.S. 30:2271, et seq.

[13] La. R.S. 30:2272(4).

[14] See La. R.S. 30:2273(1) and 2276.A.(5), which impose cleanup liability on the owner of the contaminated property.

[15] For sound policy reasons, Louisiana law provides some liability protection to landowners that lease the property for oil and gas activities. See, e.g., La. R.S. 30:91.C, which protects most owners of property on which an orphaned oilfield site is located from liability for its restoration under the Louisiana Oilfield Site Restoration Law, La. R.S. 30:80, et seq. The policies are not served, however, when a landowner that has recovered the money to restore his property fails to do so, at potential risk to health or the environment.

[16] 850 So.2d at 698.

[17] Id. at 699. The court framed the issue as follows: "The question for this court then becomes whether this court has authority to modify a breach of contract damage award to a private landowner because the landowner has no duty to actually use the money to clean or restore the land where the legislature has not chosen to mandate remediation or restoration."

[18] La. R.S. 31:122 , which states: "A mineral lessee is not under a fiduciary obligation to his lessor, but he is bound to perform the contract in good faith and to develop and operate the property leased as a reasonable prudent operator for the mutual benefit of himself and his lessor. Parties may stipulate what shall constitute reasonably prudent conduct on the part of the lessee."

[19] Terrebonne Parish School Board v. Castex Energy, Inc., 2001 2634 (La. App. 1st Cir. 3/19/04), 878 So.2d 522.

[20] 104 So.2d 253 (La. App. 1st Cir. 1958).

[21] Comment, La. R.S. 30:122.

[22] Former Louisiana Civil Code article 2719 stated: "If an inventory has been made of the premises in which the situation, at the time of the lease, has been stated, it shall be the duty of the lessee to deliver back everything in the same state in which it was when taken possession of by him, making, however, the necessary allowance for wear and tear and unavoidable accidents." Former Louisiana Civil Code article 2720 stated: "If no inventory has been made, the lessee is presumed to have received the thing in good order, and he must return it in the same state, with the exceptions exceptions contained in [article 2719]." These articles were deleted, and the lessee's obligations at the end of the lease are defined further and modified, in the revision of the Louisiana Civil Code effective January 1, 2005. See Comment to new Louisiana Civil Code article 2683.

[23] The court cited Smith v. Schuster, 66 So.2d 430, 431-32 (La. App. 2d Cir. 1953) for the proposition that: "A mineral lessee must restore the surface even in instances where the lease contract is silent."

[24] 878 So.2d at 529.

[25] Id. at 534.

[26] Id.

[27] Id. at 536 (italics in original).

[28] Comment, La. R.S. 30:122.

[29] 2005 WL 106482, at 16; 2005 La. LEXIS 141, at 27.