



**Thomas G. Smart**  
**Jasmine B. Bertrand**  
Onebane Law Firm  
P. O. Box 3507  
Lafayette, Louisiana 70502  
337-237-2660

[smartt@onebane.com](mailto:smartt@onebane.com)  
[bertrandj@onebane.com](mailto:bertrandj@onebane.com)  
[www.onebane.com](http://www.onebane.com)

### **Second Circuit Examines Most Favored Nations Clause; Sublease/Assignment Issues**

In *Hoover Tree Farm, LLC v. Goodrich Petroleum Company, LLC*, 46,153 (La.App. 2 Cir. 3/23/11), 63 So.3d 159, the Second Circuit examined the distinction between a sublease or assignment, in determining whether the trial court correctly applied the following lease provision, a “most favored nations” clause (“*MFNC*”), which provided, in pertinent part, as follows:

*Lessee [Petroleo Properties, LLC] and Goodrich Petroleum Company, LLC, which joins herein, each guarantee that no lessor of either Lessee or Goodrich Petroleum or their successors and assigns shall receive a higher royalty and/or bonus than the Lessor under this Lease. Should any lessor receive such higher bonus and/or royalty, the Lessor under this Lease shall receive from Goodrich Petroleum Company, LLC the difference between the higher bonus and the bonus paid to Lessor at the inception of this Lease, and the difference between the higher royalty and the royalty paid to Lessor under this Lease. ... This clause covers every lease which may be made by Lessee, Goodrich Petroleum Company, LLC, Sendero Resources Incorporated and/or Caddo Resources LP, as Lessee, and their respective successors and assigns, in any section in any of the following townships and ranges in Caddo Parish, Louisiana: (19N-16W), (19N-15W), (18N-16W), and (18N-15W).*

The Lease at issue was subject to an assignment effective June 6, 2008, by and between Goodrich Petroleum Company, LLC (“*Goodrich*”), the then-lessee thereof, and Chesapeake Louisiana, LP (“*Chesapeake*”), through which Goodrich transferred an undivided 50% interest in and to the Lease and various other leases as to all depths below the Cotton Valley Formation (the “*2008 Transfer*”). Thereafter, Chesapeake obtained third party leases which paid higher lease bonuses and royalties on property located within the area established by the MFNC, upon which the lessor of the Lease, Hoover Tree Farm (“*Hoover*”), instituted suit. Hoover claimed that by virtue of the 2008 Transfer, Chesapeake was a successor and assign of Goodrich, such that when it entered into the third party leases, it triggered the MFNC, and that therefore Hoover

was entitled to \$7.6 million for an increase in lease bonus as well as a 30% lessor's royalty. In response, Goodrich and Chesapeake argued that the 2008 Transfer was a sublease and not an assignment. Chesapeake alternatively argued that if the MFNC was triggered, only Goodrich was liable because the terms of the Lease provided for recovery from Goodrich alone. The trial court found in favor of Hoover, finding that the Transfer was an assignment sufficient to allow application of the MFNC, but also found that Goodrich was the sole party responsible for the higher bonus under the terms of the Lease. Both parties appealed the judgment of the trial court.

The first issue addressed by the Second Circuit was Hoover's argument that Chesapeake was obligated along with Goodrich to satisfy the higher bonus under the MFNC. The Court first discussed the classification of a mineral lease as a real right, and the obligations created by the mineral lease as real obligations, as opposed to personal obligations. The Court cited Mineral Code Article 128, which provides that "to the extent of the interest acquired, an assignee or sublessee acquires the rights and powers of the lessee and becomes responsible directly to the original lessor for performance of the lessee's obligations." The Court rejected Chesapeake's argument that the MFNC imposed a personal obligation upon Goodrich, finding instead that application of Mineral Code Article 128 made performance of the higher royalty and bonus payment obligations the responsibility of Chesapeake as well because of its acquisition of interest in the Lease.

The second issue addressed by the Court was Goodrich and Chesapeake's argument that the Transfer was a sublease and not an assignment, and that the MFNC was applicable only in the event third party leases were acquired by Goodrich and its "successors and assigns", not by those acquired by its sublessee. The Court first looked at the use of the terms "successor," "assigns" and "sublessee (sublease)" in other parts of the Lease and the definition of such terms in the Louisiana Civil Code. The Court then entered into an intense discussion of the Louisiana jurisprudence regarding the sublease of a mineral lease, finding that none of the cases which raised the issue of sublease involved a transfer of an undivided interest in a mineral lease. Thereafter, the Court examined the jurisprudence with respect to transfers of an undivided interest in the leasehold which were found not to be subleases. It read the relationship created between Goodrich and Chesapeake by the Transfer, which was a conveyance of an undivided 50% of 8/8ths interest in and to the Lease, save and except the shallow rights, as defined therein, as falling "squarely within the Louisiana law of co-ownership". The Court read Mineral Code Articles 127<sup>1</sup>, 128 and 168<sup>2</sup> as broad authority for the lessee to create co-ownership of the entire lease by an assignment of an undivided interest in the entirety of the lease to another, and found that this was recognized by the jurisprudence. The allowance of a transfer of leasehold ownership "in part" under Article 127, the Court stated, is "the codal power for a conveyance of an undivided interest to a portion of the leased premises or to a geological zone or zones of the lease." The Court noted that there was no joint operating agreement governing the relationship of the parties, and that therefore the Civil Code and the Mineral Code governed same. In finding that the Transfer was not a sublease, the Court pointed out that (1) "Goodrich did not lease the deep rights to Chesapeake and provide it the exclusive use and enjoyment of that portion of the Lease"; (2) "Chesapeake owed no rent or overriding royalty to Goodrich for the rights acquired"; and (3) "the right of the sublessor to demand further development of the mineral lease by his sublessee" was not present in the relationship of the parties. As a co-owner in indivision,

---

<sup>1</sup> Article 127 provides that "the lessee's interest in a mineral lease may be assigned or subleased in whole or in part."

<sup>2</sup> Article 168 provides that "mineral rights are susceptible of ownership in indivision."

Goodrich did not retain a right of control over Chesapeake and therefore both parties were on equal footing for the use, control and development of the working interest rights covered by the transfer. The Court found the Transfer to be an assignment of an undivided interest in the Lease, and therefore Chesapeake was directly responsible to the original lessor for performance of obligations under the Lease, including payment of the increase in bonus attributable to application of the MFNC. This case emphasizes the importance of considering the implications of a MFNC to future transactions, highlighting how important it is to carefully consider the language included in any such lease provision.

**DISCLAIMER**

The information contained herein presents general information about a legal issue and should not be considered legal advice. Before acting on any of the materials presented here, we advise you to seek legal counsel. We welcome your calls, letters, and e-mail; however, contacting us does not create an attorney-client relationship. Please refrain from sending any confidential information to us until such time as an attorney-client relationship has been established.