



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

smartt@onebane.com
bertrandj@onebane.com
www.onebane.com

Second Circuit Reverses Trial Court’s Grant of Partial Dissolution of Lease

In *Ferrara v. Questar Exploration & Production Co.*, 46,357 (La. App. 2d Cir. 6/29/2011), 2011 WL 2555794, the Second Circuit examined plaintiff-lessor Ferrara’s (“*Ferrara*”) claim that their mineral lessee failed to explore or develop the Haynesville Shale formation. The Lease at issue was a 1988 mineral lease which was held by production from the Hosston and Glen Rose formations on lands unitized with the leased premises. In this case, lessee Questar Exploration & Production Co. (“*Questar*”) appealed the judgment of the trial court that partially dissolved the Lease and awarded the Ferraras damages. The Louisiana Oil & Gas Association (“*LOGA*”) filed an *amicus curiae* brief in the case, seeking reversal of the trial court’s judgment.

In relating the facts of the case, the Second Circuit noted that: there were no active wells on the leased premises; there had been no drilling on the leased premises since 1990; the Ferraras had received royalties from three wells on unitized lands since 1989; and no further demand for exploration or development had been made by the Ferraras, until 2008, after the public announcement by Chesapeake Energy of the discovery of the Haynesville Shale formation. One week after the Commissioner of Conservation issued a memorandum pertaining to the extensive and productive nature of the Haynesville Shale zone, the Ferraras sent a certified letter to Questar demanding that it release the lease below the Hosston Formation, or alternatively, explore and develop deeper zones. Forty-six days later, after having gotten no response from Questar, the Ferraras filed suit demanding dissolution of the Lease, damages and attorney fees, or in the alternative, a partial release below the Hosston formation. The case went to trial, with Questar providing no evidence on its own behalf. The trial court dissolved the lease as to all depths below the Hosston formation for Questar’s failure to act as a reasonably prudent operator pursuant to La. R.S. 31:122, finding that Questar knew of the Haynesville Shale’s economic viability yet had no intention to develop deep rights on the Ferraras’ land. Moreover, the court found Questar’s conduct toward the Ferraras “troubling.”

In its appeal to the Second Circuit, Questar urged that the district court erred in finding that it breached its obligation to explore and/or develop the lease as a reasonably prudent operator and therefore erred in canceling the Lease. The Court began its analysis by a discussion of Louisiana Mineral Code Article 122, which provides that “[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 reasonably prudent operator for the mutual benefit of himself and his lessee. Parties may stipulate what shall constitute reasonably prudent conduct on the part of the lessee.” The Court noted that in order to determine whether Questar breached its obligation to the Ferraras, the totality of the circumstances bearing on the lessee’s overall operations and measures taken for future development must be considered, examining factors such as (1) geological data, (2) number and location of wells drilled, (3) productive capacity of wells, (4) cost of drilling operations compared to profits, (5) time intervals between completion of the last well and the demand for additional operations, and (6) acreage involved in the disputed lease. After applying the factors to the facts at hand, the Court found that the evidence did not support the trial court’s conclusions. The Ferrara’s expert was not a geologist and did not offer any opinion as to whether placing a new well on their property was prudent. The Court sympathized with the trial court’s sense of awe at the potential of the Haynesville Shale, but found inadequate support for “a blanket finding of ‘plans to drill wells in every section or every square mile.’” Most importantly, the Court noted that there was no evidence that a prudent operator using geological data would have drilled on the Ferrara’s property to the Haynesville Shale depth by the date of trial. The Court found the time frame to be significant to its inquiry, pointing out that by the time of trial it had been almost 20 years since any exploration occurred on the leased premises and noting the short period of time between the submission of the demand letter and the filing of suit by the Ferraras. The Court stated that it understood the Ferraras’ and the trial court’s “impatience and indignation” at Questar’s unresponsiveness with respect to the demand letter, its conduct after suit was filed, and its strategy of putting on no evidence at trial. However, the Court found the record to be “utterly devoid of evidence that any reasonably prudent operator could have begun exploration, much less drilled a well to the deep Haynesville Shale stratum, within this remarkably short time. The evidence falls far short of proving that Questar *persistently failed* to reasonably investigate the leased premises for potentially profitable oil and gas deposits.” It should be noted that this opinion is not final and may be subject to an appeal.

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