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Haynesville Lease Rescission Decisions

A string of decisions involving landowners seeking rescission of mineral leases covering lands in the Haynesville Shale have recently been handed down by the Second Circuit Court of Appeal of Louisiana and the United States District Court for the Western District of Louisiana. For the most part, the Courts have refused to grant rescission of these leases and have adhered to the holding of *Thomas v. Pride Oil & Gas Properties, Inc.*, 633 F.Supp.2d 238 (W.D.La. 2009), wherein the United States District Court for the Western District of Louisiana dismissed the lessor's claim that his lease should be rescinded on the grounds of error, among other things, noting the "particularly speculative nature of mineral exploration and production." The Second Circuit *has* granted rescission to one Haynesville lessor, where the Court found actual evidence of mutual error concerning lease terms, in the form of a signed affidavit from the landman who took the lease. An examination of these cases reveals that Haynesville leases will generally not be subject to claims seeking rescission of the lease based on the lessor's lack of knowledge about the value of lands in the Haynesville Shale, but that circumstances out of the ordinary must exist for a court to rescind such a lease.

In *Cascio v. Twin Cities Development, LLC*, 45,634 (La.App. 2 Cir. 9/22/10), --- So.3d --, the Second Circuit refused to rescind an April 15, 2008 mineral lease covering a 76-acre tract in Bossier Parish taken from the landowners by Twin Cities. The lessors filed suit against Twin Cities for rescission of the lease based on error concerning a substantial quality of the object of the contract, claiming that the object of the mineral lease was the land and mineral formations, and the substantial quality of that object was the Haynesville Shale. The lessors' main argument was that because they did not know that they were leasing "land with exceptional qualities (namely the existence of the Haynesville Shale)," this constituted error that vitiated consent, which is required in order to have a valid and binding contract. Twin Cities moved for partial summary judgment on this claim. In analyzing the lessors' claim, the Court cited the *Thomas* case, stating that as in *Thomas*, it would accept as true that the lessors did not have knowledge of the existence of the Haynesville Shale deposit under the leased premises and that Twin Cities, the lessee, did have such knowledge. However, this lack of knowledge did not rise to the level needed in order to constitute error that vitiated consent to the lease because (i) the lessors should

have been aware that Twin Cities entered into a lease agreement in order to explore for and hopefully produce minerals from the leased premises, and (ii) Twin Cities assumed the risk and expenses involved with leasing, exploration, production and sales in accordance with “unstable market conditions.” The Court noted that the “ease and success of such an exploration as well as the potential profit to be made could not have been assumed at such an early stage.” Although Twin Cities was aware of the potential existence of the Haynesville Shale below the leased premises, there were other uncertainties that remained, which, the court stated, “encompass the nature of mineral exploration.”

In a similar case involving a class of Haynesville lessors, the United States District Court for the Western District of Louisiana recently dismissed the lessors’ claims with prejudice in *HMB Interests, LLC v. Chesapeake Louisiana LP*, 2010 WL 3604008 (W.D. La. 2010). In this case, the plaintiffs filed suit in DeSoto Parish, individually and on behalf of “all persons and entities who signed mineral leases, or extensions of pre-existing mineral leases, with any of the defendants, or which mineral leases have been assigned to any of the defendants, affecting land within Bienville, Bossier, Caddo, Claiborne, DeSoto, Jackson, Lincoln, Natchitoches, Red River, Sabine, Webster or Winn Parishes, in Louisiana from July 1, 2006 through June 30, 2008 without knowledge of the presence under their lands of the Haynesville Shale natural gas formation.” As in *Cascio* and *Thomas*, the plaintiffs in *HMB Interests* alleged lack of knowledge of the Haynesville Shale formation, and that the defendants had “long known of the presence and commercial exploitability of the Haynesville Shale and had taken steps to ensure that this information did not become public.” Like the plaintiffs in the *Thomas* and *Cascio* cases, the plaintiffs in *HMB Interests* sought rescission of the leases arguing error as to the substantial quality of the object of the leases, i.e., the Haynesville Shale formation under the leased premises, alleging that they would not have executed the leases if it had not been for their error as to the mineral formations within the leased premises, which concerned a cause without which the leases would not have been entered, and that this cause was known or should have been known to the defendants.

In addressing the plaintiffs’ claims in *HMB Interests*, Judge Walter first noted that under Louisiana law, consent is required in order to form a valid contract, and that consent can be vitiated by error, but “only when it concerns a cause without which the obligation would not have been incurred and that cause was known or should have been known to the other party.” Error concerns a cause when it, among other things, bears on the nature of the contract, or the thing that is the contractual object or a substantial quality of that thing. After setting forth the plaintiffs’ arguments concerning error as to the substantial quality of the minerals under the leased premises and concerning the substantial quality of the Haynesville shale being different from an ordinary reservoir of hydrocarbons in the way that a “shotgun style house” is different from Buckingham Palace and other such comparisons, Judge Walter discussed the holdings of the Second Circuit in the recent *Cascio* decision as well as Judge Hicks’ opinion in *Thomas*. Judge Walter stated that “Plaintiffs are attempting to characterize the Haynesville Shale as something different than what it is—a mineral formation containing natural gas.” Even assuming the plaintiffs were unaware of the existence of the Haynesville Shale when the leases were signed, this was not error concerning “a cause without which the obligation would not have occurred.” Judge Walter also held that the leases could not be rescinded on the grounds that the value paid to the plaintiffs was deficient because of Louisiana Revised Statute 31:17, which prevents a mineral right from being subject to rescission for lesion beyond moiety.

In *Adams v. JPD Energy, Inc.*, 45,420 (La.App. 2 Cir. 8/11/10), --- So.3d ---, the Second Circuit was asked to rescind a 2008 lease taken by JPD Energy covering a seven acre tract in Caddo Parish. Unlike the fact scenario in *Thomas, Cascio, and HMB*, in this case, as opposed to merely asking the Court to rescind the Lease based on error because of lack of knowledge of the Haynesville Shale formation, the plaintiffs claimed mutual error with respect to the terms of the lease. According to the plaintiffs, the Lease was supposed to have a depth limitation provision and was supposed to be subject to a one-fourth royalty. The executed lease, however, was subject to a one-eighth royalty. The landman who took the lease, in a signed affidavit, stated that the parties had agreed to a one-fifth royalty, and that the lease “incorrectly stated that the royalty ... was a one-eighth ... [but] should have provided instead for the one-fifth royalty that had been agreed upon.” The plaintiffs filed suit to rescind the lease on the grounds of fraud, error and failure of cause. In response, JPD admitted the royalty provision was incorrectly stated, but alleged that the lease was supposed to be subject to a one-fifth royalty. JPD also admitted that the lease was supposed to exclude surface operations, but denied that it was to also include a depth limitation. The trial court rendered judgment in favor of the plaintiffs, finding the lease “null, void and cancelled,” and from this judgment JPD appealed. On appeal, the Second Circuit discussed the law of contracts, noting that in order to form a valid contract, Louisiana law requires capacity, consent, a certain object and lawful cause. In order to constitute consent, the Court must find that there was a “meeting of the minds.” Because of the discrepancy with regard to the royalty provision of the lease, the Court found that there was no “meeting of the minds” or mutual consent between the parties and declared the lease null and void.

In another lease rescission case, the Second Circuit held that the plaintiff’s action was premature where the lease included a provision requiring that the lessor provide notice of any breach of the lease. *Lucky v. Encana Oil & Gas (USA), Inc.*, 45,413 (La.App. 2 Cir. 8/11/10), --- So.3d ---. The lease at subject here was a 2005 lease covering property in Bossier Parish, which included various provisions regarding maintenance of the premises, and which also included a provision which stated that “*in the event the Lessor considers that operations are not being conducted in compliance with this contract, Lessee shall be notified in writing of the facts relied upon as constituting a breach and Lessee shall have sixty (60) days after receipt of such notice to comply with the obligations imposed by virtue of this instrument.*” The plaintiff argued that its claims against the lessee were related to the destruction of property, not a breach related to operations under the lease, and that therefore it was not required to put the lessee in default under La. R.S. 31:136. However, the Court found that the plaintiff’s suit was filed prematurely because it was contractually bound to first notify the lessee of any breach of the lease, due to the inclusion of the above-quoted provision, and dismissed the plaintiff’s claims without prejudice.

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