UNIT OPERATIONS: SELECTED ISSUES RELATING TO LOUISIANA'S RISK FEE AND WELL COST REPORTING STATUTES

Presented by: **Dana E. Dupre**

GORDON ARATA MCCOLLAM DUPLANTIS & EAGAN LLC

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www.gordonarata.com

April 11, 2013

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In Louisiana, the Commissioner of Conservation (the "Commissioner") has the statutory authority to combine or "pool" mineral interests to create a drilling unit – the maximum area of land or deposit of minerals which may be efficiently and economically drained by one well.[1] All of the "owners"[2] in the unit have the right to a "just and equitable share of production from the unit."[3] While the Commissioner has broad discretion to allocate production in any equitable manner, owners typically share proceeds of the unit well on the basis of their pro-rata ownership of the minerals within the unit.

An owner's right to share in unit production reciprocally requires the owner to bear its proportionate share of the actual reasonable expenditures of the cost of drilling, testing, completing and equipping the unit well in addition to actual reasonable operating expenses, including a charge for supervision of the operations by the operator (collectively, the "Unit Well Costs").[4] The unit operator generally pays the Unit Well Costs and sells unit production on behalf of the non-operating owners.[5]

I. Recoupment of Unit Well Costs from Non-operating Owners, Generally.

Prior to beginning oil and gas operations in a unit, the owners will often enter into a joint operating agreement ("JOA") that provides for development of the property for the joint account. Under most JOAs, an owner that elects to participate in an operation must pay the operator its share of the estimated cost of the operation in advance or within a relatively short period of time after making the election to participate. If the non-operating owner elects not to participate in the operation or fails to timely submit payment, a non-consent penalty ranging from 100% to 500% of the well costs incurred will generally be imposed on the non-consenting owner pursuant to the terms of the JOA.

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1 *See* La. R.S. § 30:9(B) and generally, §§ 30:1-30:21.

2 Defined as persons with the right to drill, produce and appropriate production in the unit. *See infra* and La. R.S. § 30:3(8).

3 La. R.S. §§ 30:9 and 30:10(A)(1)(a).

4 La. R.S. § 30:10(A)(2).

5 The unit "operator" or "drilling owner" has the exclusive right to drill a unit well and sell unit production on behalf of the owners in the unit. The term "non-operating owners" refers to all owners in the well other than the operator. A "participating owner" is an owner that shares in the risk and expense of the unit operation. A "nonparticipating owner" or "non-participant" is an owner that does not share in the risk and expense of a unit operation.

In the absence of a JOA, the operator must look to statutory law and jurisprudence for available ways to recover Unit Well Costs allocable to tracts in the compulsory unit in which the operator does not have an interest.[6] If a non-operating owner does not agree to pay its share of the Unit Well Costs or otherwise consent to the unit operation, the general rule of law in Louisiana is that the operator may recoup that non-participating owner's share of Unit Well Costs but *only* from the non-participating owner's share of unit production (although additional protections exist for unleased owners under La. R.S. § 30:10(A)(3)).[7]

Thus, the operator (on behalf of all participating owners of a unit) becomes the owner of production from the unit well allocable to the non-participating owners until the Unit Well Costs have been recovered.[8] Once the operator has recovered the non-participant's share of Unit Well Costs from unit production, the non-participant may begin receiving its share of unit production subject to its obligation to pay certain operating expenses of the well and future well costs.[9]

As has been previously noted,[10] no Louisiana appellate court has addressed the liability of a non-participating owner for its share of the costs to plug and abandon the unit well and restore the surface of the drill-site. In situations where the unit well is a dry hole or revenue from the well is insufficient to cover Unit Well Costs, the participating owners must presumably bear the entire cost of plugging and abandoning the well and any associated costs to restore the surface of the property. Compare the situation where a non-participating owner has shared in production after the Unit Well Costs have been recovered – there, one could arguably claim that the operator should be able to recover from such non-participant, the "lesser of (i) its share of the cost to plug and abandon the unit well and restore the drill-site, or (2) the net income (revenues less Unit Well Costs) of the nonparticipating working interest owner or unleased landowner from the unit well … If this is not the rule adopted by the courts, nonparticipating working interest

6 *See e.g., Jones Energy Co., LLC v. Chesapeake Louisiana, L.P.*, 873 F. Supp. 2d 779, 783 (W.D. La. 2012)("When a Joint Operating Agreement does not exist, the Louisiana Mineral Code, the Louisiana Conservation Code, and the "Risk Fee Statute" set forth the parties' obligations to each other.").

7 *See e.g., id*. at 788; La. R.S. § 30:10(A)(2)(b)(i).

8 La. R.S. § 30:10(A)(2)(b)(i).

9 *Id*. Resolving what it saw as a question of "first impression", a federal district court recently concluded that any collection from a *participating owner* (for its pro-rata share or risk-fee charge if applicable) must also be taken *in rem* from production. It held that collection *in rem* should be credited to each well from the proceeds of that specific well, explaining that "[t]he statute refers to the drilling unit well in the singular form, and the Court does not interpret the statute to allow production revenues from one unit well to pay for the costs associated with a separate unit well." *Jones Energy*, 873 F. Supp. 2d at 788.

An in-depth analysis of what are proper Unit Well Costs is outside the scope of this presentation. *See* Blaise M. Sonnier, *Accounting for Well Costs and Well Cost Adjustments in Louisiana*, 55 Loy. L. Rev. 79 (2009) for excellent coverage.

10 *See e.g.,* Sonnier, 55 Loy. L. Rev. at 88.

owners and unleased landowners that have shared in production from a unit well will receive a windfall by escaping their proportionate share of the costs to plug and abandon the unit well."[11]

II. The Louisiana Risk Fee Statute: La. R.S. § 30:10(A)(2).

When there is no contractual relationship between an operator and non-operating owners in a compulsory unit – i.e. no JOA or other development agreement between the parties - the provisions contained in the La. R.S. § 30:10(A)(2) (the "Risk Fee Statute" or "Statute") allocate the risk and expense of drilling certain unit wells. The Risk Fee Statute provides a mechanism to compensate an operator (or "drilling owner") for advancing a non-participating owner's (or "non-drilling" owner's) share of the Unit Well Costs of a successful well.[12] Under the Risk Fee Statute, when a non-drilling owner has been sent a risk-fee notice by a drilling owner and has elected not to participate or has been deemed a non-participant in the risk and expense of drilling, the drilling owner may recoup the Unit Well Costs to be borne by the non-drilling owner from the non-drilling owner's share of unit production, plus a risk fee of 200% (or in some cases, 100%) of such tracts' allocated share of the cost of drilling, testing, and completing the well.

On June 6, 2012, the Louisiana legislature amended the Louisiana Conservation Act, including the Risk Fee Statute (the "Amendment")[13], to include the following key changes:

- making alternate unit wells and cross-unit wells subject to the Risk Fee Statute;
- requiring the notice contain a detailed AFE and estimate of a non-drilling owner's percentage interest in the unit;
- requiring that the notice be sent before "the actual spudding" of a well;
- allowing delivery of the notice and response by registered mail or other form of guaranteed delivery and notification method;
- requiring a participating party to pay Unit Well Costs within 60 days of spudding the well or within 60 days of receipt of detailed invoices, as applicable;

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[11] *Id.*

[12] The Risk Fee Statute uses the term "drilling owner." For ease of discussion and because it is more commonly used, I also refer to the "operator" or "unit operator." Similarly, non-participating owner or non-participant are synonymous with "non-operating owner" or "non-operator."

[13] A copy of the Amendment, as enrolled and showing red-lined changes, is attached hereto as **Exhibit A.** Act No. 743 also adds a new subsection to La. Rev. Stat. §30.5.1 authorizing the Commissioner of Conservation to create "ultra deep" units, defined as structures with a top at the depth below 22,000' TVD; this article only discusses the second part of the Amendment relating to the Risk Fee Statute.

- requiring a drilling owner to pay a non-participating party (even during the risk fee) a portion of the proceeds of production sufficient to cover any lease royalties or overriding royalties owed by the non-participants for that production, with some limitations; and

- providing for damages and attorneys fees in the event the drilling owner fails to pay non-participants the required royalties or overriding royalty burdens.

Because the legislature did not provide a specific effective date for the Amendment, the default effective date was August 1, 2012. It is unclear, however, whether the changes will apply retroactively. The Amendment does not expressly provide for retroactive application and the changes are substantive – as opposed to procedural or interpretive - and may affect vested rights; thus, it should arguably apply only to wells drilled after August 1, 2012.

The following is a more detailed examination of certain issues relating to the Risk Fee Statute and further discussion of the changes noted above.

<u>What wells are eligible under the Risk Fee Statute</u>?

The Risk Fee Statute applies to unit wells or substitute unit wells (which replace original unit wells), alternate wells (where more than one unit well is needed for efficient production) and cross-unit wells (when a unit well drains more than one unit) in Commissioner formed or compulsory units.[14] Whereas previously there was some question as to the whether the Statute applied to certain wells, the Amendment expressly makes alternate wells and cross-unit wells eligible.

<u>Who may utilize the Risk Fee Statute</u>?

Under the Statute, an "owner" may offer other "owners" the option to elect to participate in the cost, risk and expense of drilling a unit well. The term "owner" is broadly defined in the Conservation Act as "the person, including operators and producers acting on behalf of the person, who has or had the right to drill into and to produce from a pool and to appropriate the production either for himself or for others."[15]

Remember, the Statute only affects third parties with whom the drilling owner has no contractual relationship or other cost-sharing agreement in place, and it cannot modify or change the rights and obligations under any contract between or among owners. Additionally, the Risk Fee penalty provisions (described herein) do not apply to any owner not subject to an oil, gas and mineral lease.

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14 La. R.S. § 30:10(A)(2)(a)(i).

15 La. R.S. § 30:3(8).

<u>What is considered effective Notice</u>?

To trigger the Risk Fee Statute, the drilling owner must send notice, by registered mail, return receipt requested, or some "other form of guaranteed delivery and notification method" to all other owners in the unit of the drilling or the intent to drill and give each owner an opportunity to elect to participate in the risk and expense of the well (the "<u>Notice</u>").[16] The Amendment expanded delivery options to allow delivery by private carriers like FedEx or UPS, but expressly prohibits Notice by "electronic communication or mail."

A drilling owner must send Notice to all owners of record as of the date of Notice, meaning that the drilling owner has the obligation to perform at least some title work before spudding the well.[17] The Notice must contain:

- an AFE which shall include a detailed estimate of the cost of drilling, testing, completing, and equipping the proposed well;
  - the AFE should be dated within 120 days of the date of mailing of the Notice
- the proposed location of the well;
- the proposed objective depth of the well;
- an estimate of ownership as a percentage of expected unit size or approximate percentage of well participation; and
- if the well is being drilled or is drilled at the time of Notice, all logs, core analysis, production data, and well test data from the well which has not been made public.[18]

The Notice must be sent "prior to the actual spudding" of a well if the unit is in place on the spud date and within 60 days of the "date of the order" creating the unit if the unit is created during or after drilling.[19] Likewise, if the unit is revised to include an additional tract or tracts after drilling, then the Notice is required to be sent within 60 days of the "date of the order" revising the unit.[20] If drilling of the proposed well is not commenced within 90 days after receipt of the initial Notice, supplemental Notice is required, meaning a drilling owner must again comply with the full Notice requirements under the Statute.[21]

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16 La. R.S. § 30:10(A)(2)(a)(i).

17 La. R.S. § 30:10(A)(2)(h). Extent of this title examination obligation is vague, and it is unclear whether the formal survey of the unit must be done before Notice is sent or if a rough estimate of unit participation or ownership is sufficient.

18 La. R.S. § 30:10(A)(2)(a)(i).

19 La. R.S. § 30:10(A)(2)(c)(i).

20 La. R.S. § 30:10(A)(2)(d)(i).

21 La. R.S. § 30:10(A)(2)(a)(iii).

Some have questioned whether a drilling owner can send notice before the Commissioner has formally designated the well as a unit, substitute or alternate well or if it can be sent before the Commissioner has formally designated a party as the unit operator. While no appellate court has yet answered this question, a federal district court recently held the Risk Fee Statute is to be liberally construed in favor of the drilling owner/unit operator. In *Jones Energy Co., LLC v. Chesapeake Louisiana, L.P.*, Judge Walter found that a party who originally agreed to participate in the unit well but failed to timely pay its Unit Well Costs could not later claim the Notice was insufficient for failure to supply certain data.[22] It questioned whether an operator's Notice "is vitiated if the operator failed to include information or provided inaccurate information as to one of the enumerated categories." It answering, Judge Walter explained:

> The risk-fee statute is to be liberally construed in favor of the owner operator because it is the owner and operator who initially shoulders the expense and risk of drilling the unit well. The statute is not intended to allow an owner to … sit aside to discern whether a well is producing or not, and if so, attack the operator's notice with the hope that a Court will construe the statute so strictly that they will be deemed an "owner not notified". Such a holding would allow an owner to reap all of the lucrative benefits of drilling without any of the inherent risk of such a venture. In finding that Chesapeake's [the unit operator's] notice letters substantially complied with the language and spirit of 30:10, this Court noted that Jones Energy is a sophisticated owner who repeatedly elected to participate without seriously questioning the contents of the notice letters. The equities in this case lie with Chesapeake.[23]

In *Jones Energy*, the owner received most, if not all, of the information required under the Statute; thus, the court held that the unit operator had substantially complied with the notice requirements of the Risk Fee Statute.[24] Thus, it seems likely that a court could similarly find substantial compliance when an operator sends Notice before formal unit well or operator designations.

<u>What must an owner do to participate</u>?

An owner electing to participate in a unit well must notify the drilling owner in writing, by registered mail, return receipt requested, or some "other form of guaranteed delivery and notification method" within 30 days of its receipt of Notice. Failure to give timely written response shall be deemed an election not to participate.[25]

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[22] *Jones Energy*, 873 F. Supp. 2d at 785.

[23] *Id*. at 786.

[24] *Id*.

[25] La. R.S. § 30:10(A)(2)(a)(ii).

<u>What are a participating owner's obligations for Unit Well Costs</u>?

An owner who chooses to participate is obligated to pay his share of Unit Well Costs, as determined by the AFE, within 60 days of the spudding of the well.[26] Likewise, any "subsequent drilling, completion and operating expenses" have to be paid within 60 days of receipt of detailed invoices, to avoid being deemed a non-participating owner.[27] An owner who chooses to participate in the risk and expense of drilling a well is liable for cash payment for its proportionate share of Unit Well Costs, regardless of whether there is production.[28]

<u>What is the penalty for non-participation</u>?

If a non-drilling owner elects not to participate or is deemed a non-participant, he is subject to a risk fee penalty. The risk fee for a unit well, substitute unit well, or cross-unit well that will act as **the unit well or substitute well** for the unit is 200% of an owner's allocated share of the cost of drilling, testing, and completing the well, *exclusive of amounts the drilling owner remits to the nonparticipating owner for the benefit of the nonparticipating owner's royalty and overriding royalty owner* (explained in more detail below).[29] The risk charge for an alternate unit well or cross-unit well that will act as an **alternate unit well** for the unit is 100% of an owner's allocated share of the cost of drilling, testing, and completing such well, *exclusive of amounts the drilling owner remits to the nonparticipating owner for the benefit of the nonparticipating owner's royalty and overriding royalty owner.*[30] These charges supplement the right of the drilling party to recoup 100% of drilling, testing, completing, equipping and operating costs.

- Example calculation:
  - Assume (a) a drilling owner drills a ***unit well*** in the unit; (b) the owner of a mineral lease with 50% unit participation receives due Notice under the Statute but elects not participate; and (c) the drilling owner incurs total well costs of $525,000, broken down as follows: drilling costs of $200,000, testing costs of $50,000, completing costs of $150,000, equipping costs of $50,000, supervision charge of $50,000, and operating costs (until all of such costs had been recovered out of production) equaling $25,000.
    - In this example, the drilling owner would be entitled to recover production allocable to the non-participating owner in the sum of $662,500 as broken down below:

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26 La. R.S. § 30:10(A)(2)(b)(i).

27 *Id.*

28 *Shanks v. Exxon Corp.*, 07-0852 (La. App. 1 Cir. 12/21/07), 984 So. 2d 53, 59 n.8.

29 La. R.S. § 30:10(A)(2)(b)(i).

30 *Id*.

Costs to non-participating owner:

i.	Drilling costs - $200,000 x 50%	= $100,000
ii.	Testing costs– $50,000 x 50%	= $ 25,000
iii.	Completing costs -$150,000 x 50%	= $ 75,000
iv.	Equipping costs – $50,000 x 50%	= $ 25,000
v.	Supervision charge - $50,000 x 50%	= $ 25,000
vi.	Operating costs - $25,000 x 50%	= $ 12,500
vii.	Risk charge	= $ 400,000
	((total of i, ii & iii above x2) = $400,000)	
		$662,500

Note: The risk charge is 200% of the tract's allocated share of the cost of ***drilling, testing and completing the well***.

Who pays a non-participant's royalty and overriding royalty burdens during the recovery period?

Under the previous version of the Statute, a non-participant was at all times solely responsible for its lessors' royalties and any overriding royalties carved out of its working interest; a drilling owner had no responsibility for these burdens.[31]

With the Amendment, drilling owners are now required to give non-participants "that portion of production due to the lessor royalty owner under the terms of the contract or agreement creating the royalty between the royalty owner and the non-participating owner's reflected of record at the time of the well proposal" during the recovery period.[32] The Statute defines the recovery period as the time period for "the recovery of the actual reasonable expenditures incurred in drilling, testing, completing, equipping, and operating the well, the charge for supervision and the risk charge…"[33]

With respect to overriding royalties, a drilling owner must now provide to the non-participant during the recovery period (for the benefit of the overriding royalty holder), the lesser of: "(I) the non-participating owner's total percentage of actual overriding royalty burdens associated with the existing lease or leases which cover each tract attributed to the non-participating owner reflected of record at the time of the well proposal; or (II) the difference

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31 *See, e.g., Gulf Explorer, LLC v. Clayton Williams Energy, Inc.*, 06-1949 (La. App. 1 Cir. 6/8/07), 964 So. 2d 1042.

32 La. R.S. § 30:10(A)(2)(b)(ii)(aa). Note that a drilling owner is responsible for burdens "reflected of record at the time of the well proposal" which time is not defined in the Statute. Thus, it seems reasonable to assume that the time of the well proposal should mean the time when Notice is sent to all owners, but this is not entirely clear from the language of the Statute. And again, it is presumably, the obligation of the drilling owner to perform a minimal amount of leasehold title work before spudding (or proposing) a well.

33 *Id*.

between the weighted average percentage of the total actual royalty and overriding royalty burdens of the drilling owner's leasehold interest within the unit and the non-participating owner's actual leasehold royalty burdens reflected of record at the time of the well proposal."[34] Importantly, the overriding royalty calculation in II above incorporates only the "non-participating owner's actual leasehold royalty burdens", not his cumulative royalty and overriding royalty burdens. Note also, that if the overriding royalties attributable to a non-participant exceeds the lesser of the two calculation options noted in the Statute, the non-participant is responsible for that remainder override.[35]

<u>What types of production data must a drilling owner provide</u>?

A drilling owner must provide non-participants all of the information required under La. R.S. § 31:212.31 including:

- Lease identification number, if any, or reference to appropriate agreement with identification of the well or unit from which production is attributed;
- Month and year of sales or purchases included in the payment;
- Total barrels of crude oil or MCF of gas purchased;
- Owner's final realizable price per barrel or MCF;
- Total amount of severance and other production taxes, with the exception of windfall profit tax;
- Net value of total sales from the property after taxes are deducted;
- Interest owner's interest, expressed as a decimal fraction, in production from the check stub;
- Interest owner's share of the total value of sales prior to any tax deductions; and
- Interest owner's share of the sales value less his share of the production and severance taxes, as applicable.[36]

<u>What rights exist between the royalty and overriding royalty owners and the drilling owner during the recovery period</u>?

There is no contractual privity between the non-participating owner's royalty and overriding royalty holders and the drilling owner; however, the Amendment specifically provides these burden holders with special direct rights of action against the drilling owner. Specifically, royalty and overriding royalty owners may now seek remedies under Louisiana Mineral Code articles 133-144 (La. R.S. §§ 31:133-144) relating to termination of mineral leases and Articles 212.21-212.23 (La. R.S. §§ 31: 212.21-212.23) relating to royalty payments.[37] Such rights are triggered only upon written notice to both the non-participating owner and drilling owner, and a

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[34] La. R.S. § 30:10(A)(2)(b)(ii)(bb).

[35] *See* La. R.S. § 30:10(A)(2)(b)(ii)(dd).

[36] La. R.S. § 30:10(A)(2)(b)(ii)(cc).

[37] *See* § 30:10(A)(2)(b)(ii)(ee).

drilling owner will be insulated from liability upon sufficient proof that royalties and overriding royalties were paid to the non-participating owner.[38]

Notwithstanding these new rights of action, the non-participating owner remains directly responsible to its royalty and overriding royalty holders, and such holders may still seek recovery from the non-participating owner.[39] It is unclear how this new procedure will apply in practice or be interpreted by the courts.

<u>What rights exist between a non-participant and the drilling owner during the recovery period</u>?

The Amendment added a new provision permitting a non-participant a cause of action against a drilling owner for non-payment of royalty and overriding royalty burdens. In the event (i) the drilling owner fails to pay the burdens ***and*** (ii) the non-participant makes such payment ***and*** (iii) after written notice, the drilling owner either has not paid within 30 days after receipt of notice or responded with reasonable cause for nonpayment, the drilling owner will be subject to damages double the amount of royalties due, interest and reasonable attorney fees.[40]

<u>What is the relationship between a drilling owner and an owner not notified</u>?

A risk charge may not be assessed against an "un-notified owner", but the drilling owner can still recover from production the un-notified owner's allocated share of Unit Well Costs. A drilling owner cannot, however, avoid payment of an un-notified owner's royalty burdens by foregoing the risk fee charge. The Amendment requires that the "participating owner" (and uses this term instead of the term, "drilling owner") pay the un-notified owner "the proceeds attributable to his royalty and overriding royalty burdens as described in this Section."[41]

<u>What right does the drilling owner have for recovery of Unit Well Costs from an unleased owner</u>?

The drilling owner has the right to withhold all proceeds of production until payout[42] is achieved. As a corollary, after payout, the drilling owner is required to pay the unleased owner

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38 *Id*.

39 *See* La. R.S. § 30:10(A)(2)(b)(ii)(dd).

40 *See* La. R.S. § 30:10(A)(2)(b)(ii)(ff).

41 La. R.S. § 30:10(A)(2)(b)(iii).

42 There is not yet any statutory or jurisprudential guidance regarding the definition of payout in this situation. One case simply stated that the unleased owner is not entitled to production until "the cost of drilling and operating the well is paid for." *Willis v. Int'l Oil & Gas Corp.*, 541 So.2d 332 (La. App. 2 Cir. 1989). *See also* the Risk Fee Statute, which provides that a drilling owner is entitled to recover from a non-participating owner "the actual reasonable expenditures incurred in drilling, testing, completing, equipping and operating the unit well, including charge for supervision."

its pro rata share of the proceeds within 180 days of sale (since the operator is authorized to market the production and presuming the owner has made no arrangements to dispose of its share); this relationship has been described as quasi-contractual.[43] After payout, unleased owners, like other non-participating owners, are liable for their proportionate part of the unit operating expenses.

In response to the perceived lack of information available to unleased owners regarding payout and Unit Well Costs, the Louisiana legislature, in 1950, adopted La. R.S. § 30:103.1 *et seq* (the "Well Cost Reporting Statute").

III. The Well Cost Reporting Statute: La. R.S. § 30:103.1.

La. R.S. § 30:103.1 is a mechanism for an unleased owner in a compulsory unit to obtain information from the operator about the Unit Well Costs and revenue of a unit well (presumably, for all type of "unit wells" since it is not otherwise expressly limited). La. R.S. § 30.103.2 provides penalties for an operator's failure to timely provide such information. Because of the draconian consequences to the operator for failure to timely or sufficiently respond to a request, care should be taken to ensure strict compliance.

What is the scope of the operator's duty to report to unleased owners?

The Well Cost Reporting Statute sets out two separate reporting requirements:

- within 90 calendar days from completion of the unit well, an operator must send an initial report which must contain the costs of drilling, completing, and equipping the unit well; and
- after establishment of production from the unit well, an operator must send quarterly reports containing the following:
  - The total amount of oil, gas, and other hydrocarbons produced from the lands during the previous quarter.
  - The price received from any purchaser of unit production.
  - Quarterly operating costs and expenses.
  - Any additional funds expended to enhance or restore the production of the unit well.[44]

These reports must be sworn, detailed, itemized and must be sent via certified mail.[45] Reports shall be sent to each owner of an unleased oil or gas interest who has requested such reports in

[43] La. R.S. § 30:10(A)(3); *see Taylor v. Smith*, 619 So.2d 881, 887 (La. App. 3 Cir. 1993).

[44] La.R.S.. § 30:103.1 (A). Note that unlike the Risk Fee Statute, the Well Cost Reporting Statute has not been amended to expand delivery and response methods.

[45] La.R.S.. § 30:103.1 (A) and (C).

writing, by certified mail addressed to the operator or producer.[46] The written request shall contain the unleased owner's name and address.[47]

What is the penalty for failure to report to unleased owners?

La. R.S. § 30:103.2 provides that:

> Whenever the operator or producer permits ninety calendar days to elapse from completion of the well and thirty additional calendar days to elapse from date of receipt of written notice by certified mail from the owner or owners of unleased oil and gas interest calling attention to failure to comply with the provisions of La. R.S. 30:103.1 such operator or producer shall forfeit its right to demand contribution from the owner or owners of the unleased oil and gas interests for the costs of the drilling operations of the well.

Note that if the operator fails to timely or properly respond, it (only) forfeits its right to "demand contribution from the owner or owners of the unleased oil and gas interests for the costs of the ***drilling operations*** of the well." Ostensibly, then, an operator does not forfeit its right to recover costs associated with the ***completing and equipping*** of the unit well.

Recent Jurisprudence

There is little jurisprudence regarding the way these reporting statutes should be interpreted. Recently, however, Judge Hornsby in the Western District of Louisiana dissected the language of the statutes and held that an unleased owner must request reports in writing, as required under 103.1(C), before forfeiture under 103.2 is applicable.[48]

In *Adams v. Chesapeake Operating, Inc*, an unleased landowner sent a 103.2 non-compliance letter to Chesapeake; Chesapeake failed to timely respond. Although Chesapeake asserted numerous factual and equitable defenses, the court adopted a reading of the statues that pretermitted any of those defenses.[49] It held that 103.1(C) expressly requires the owner of an unleased interest to first request the Operator to furnish detailed reports; a 103.2 non-compliance alone is insufficient. Thus,

> In the court's view, Plaintiff's February 10 letter [a 103.2 non-compliance letter] could not have called to Chesapeake's attention any "failure to comply with"

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46 La.R.S.. § 30:103.1 (C).

47 *Id*.

48 *Adams v Chesapeake Operating, Inc*. 2013 WL 1193716, slip op. (J. Hornsby, W. D. La. 3/21/2013)

49 *Id.* at *2-3.

> Section 103. 1, because there would not have been any such failure (due to Plaintiff not making an earlier Section 103.1(C) request for reports).[50]

Adams is consistent with previous cases concluding that an operator will not forfeit its right to contribution for failure to provide an initial report until 30 days have elapsed from date of receipt of letter "calling attention" to such failure,[51] but adds an additional level of notice to the equation.

Pursuant to these older cases and the guidelines recently set forth in *Adams*, it can be argued that the forfeiture penalty arguably should be triggered **only** when the operator/ producer permits:

- an owner requests the reports via certified mail under § 103.1(C); and
- the operator does not timely respond to that request; and
- the owner sends the operator a § 103.2 non-compliance letter; and
- the operator does not respond with adequate reports within 30 calendar days after receipt of written notice by certified mail from the owner or owners of unleased oil and gas interests calling attention to failure to comply with the provisions of La. R.S. 30.103.1

Again, due to the serious adverse penalties, care should be taken to comply with all reporting requirements and timely respond as required under the Well Cost Reporting Statute.

Notwithstanding the above, the federal Fifth Circuit, in an unpublished opinion, also recently interpreted the level of "detail" required in an initial report required under 103.1(A). In *Brannon Properties*, an "owner of property" in Caddo Parish (Brannon) requested reports pursuant to §§ 30:103.1 and 103.2. [52] As unit operator, Chesapeake timely provided a report consisting of eighteen pages of itemized entries. Each entry gave the date and amount of the

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50 *Id*. at 4.

51 *See e.g., White v. Phillips Petroleum Co.*, 232 So. 2d 83 (La.App. 3d Cir. 1970) (refusing to apply the penal provisions, and explaining that Statute "expressly requires the owner of an unleased interest to request the Operator to furnish a sworn, detailed itemized statement showing the costs of drilling operations on the land and penalizes the Operator only when it has failed to furnish such information within (1) 90 days from the completion of the well, and (2) fifteen [now 30] additional calendar days from the date of receipt of written notice by registered mail [now certified mail] from the owner of the unleased interest calling the Operator's attention to the fact that it has failed to comply with the provisions of that statute."); *Scurlock Oil Co. v. Getty Oil Co.*, 324 So. 2d 870 (La.App. 3d Cir.1975)(strictly construing statute to deny forfeiture penalty where notice is not sent by owner calling attention to failure to comply with requirement that operator submit statement of costs of drilling operations).

52 *Brannon Properties, LLC v. Chesapeake Operating, Inc*., 2013 WL 657781, slip op. at *4 (5th Cir. 2/21/2013, *per curiam*) (holding that Chesapeake's initial report failed to comport with § 103.1, so Brannon "need not contribute to the costs of the drilling operations of Chesapeake's well for the period covered by the deficient report." There is no indication in the statute or in the jurisprudence otherwise limiting forfeiture to this restricted period of time.).

expenditure, as well as whether it was an "Intangible Drilling and Completion" cost or a "Tangible Drilling and Completion" cost, but no additional detail. Brannon brought suit against Chesapeake, seeking a court order that Chesapeake had forfeited its right to demand contribution for the well's drilling and operating costs because its report was insufficiently detailed to comply with the statute.[53] The court, after an extensive discussion of the definition of "detailed", reversed the district court's grant of summary judgment for the operator, finding "the 'detailed' requirement … mean[s] that the report has to relate the cost to the benefit: it must tell the unleased mineral owner what it is getting for its money," which Chesapeake's reports did not provide.[54]

Note, however, that various other courts (both federal and state court) have stated that the Well Cost Reporting Statute, being penal in nature, "should be construed strictly against the party seeking to impose the penalty."[55]

<u>Is the Well Cost Reporting Statute applicable to a tract which is leased to a party who is not the unit operator</u>?

By its terms, the Well Cost Reporting Statute seems applicable only to the "owner of an ***unleased*** oil or gas interest" - versus an interest subject to a third party oil and gas lease. The statutes consistently refer to and use the term "unleased" or "owner of unleased oil and gas interest." Furthermore, 103.1(A) specifically provides that: "[w]henever there is included within a drilling unit, as authorized by the commissioner of conservation, ***lands producing oil or gas***, or both, upon which the operator or producer has no valid oil, gas, or mineral lease…." Arguably, this language could be read to restrict the reporting requirement to unleased **<u>land</u>**owners.

However, some have emphasized the importance of the clause "upon which the operator…has no valid oil, gas and mineral lease" in 103.1(A) to show that that the term "unleased" includes owners over which the operator has not valid lease. Moreover, some argue that the statutes incorporate the more expansive definition of "owner" as that term is defined in La. R.S. § 30:3(8). This issue has been the subject of various district court decisions but no Louisiana appellate court has yet directly addressed it.[56]

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[53] *See also Brannon*, 2013 WL 657781 at * 1.

[54] *Id*. at *3-4.

[55] *See e.g., Scurlock Oil Company v. Getty Oil Co.,* 324 So.2d 870, 877 (La.App. 3 Cir. 1976); *Browning v. Exxon Corp.,* 848 F. Supp. 1241, 1246 (M.D. La. 1994), *affirmed without reasons,* 43 F.3d 668 (5th Cir. 1994).

[56] *Cf. Adams v. Chesapeake Operating, Inc*., 2011 WL 6370512, slip op. at * 2-3 (W.D.La. 12/20/11)(distinguishing an unleased owner from a leased owner and holding that an owner of an unleased oil and gas interest does not have a remedy under La. R.S. §§ 31:212.21-23 because this mineral code article expressly "applies to parties connected, in some form, whether directly or indirectly, by a mineral lease or some type of contract or agreement.").