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November 5, 2020

Senator Patrick Page Cortez  
President of the Senate  
P.O. Box 94183  
Baton Rouge, Louisiana 70804

**RE: SENATE RESOLUTION NO. 159 OF THE 2017 REGULAR SESSION**

Dear Mr. President:

The Louisiana State Law Institute respectfully submits its report to the legislature relative to the classification of mineral royalties for bankruptcy proceedings.

Sincerely,

A handwritten signature in blue ink, appearing to read "Guy Holdridge".

Guy Holdridge  
Director

cc: Senator R. L. "Bret" Allain, II

email cc: David R. Poynter Legislative Research Library  
[drplibrary@legis.la.gov](mailto:drplibrary@legis.la.gov)  
Secretary of State, Mr. R. Kyle Ardoin  
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**LOUISIANA STATE LAW INSTITUTE  
MINERAL LAW COMMITTEE**

**REPORT TO THE LEGISLATURE IN RESPONSE TO  
SR NO. 159 OF THE 2017 REGULAR SESSION**

**Relative to the classification of mineral royalties for bankruptcy proceedings**

Prepared for the  
Louisiana Legislature on

**November 5, 2020**

Baton Rouge, Louisiana

# LOUISIANA STATE LAW INSTITUTE MINERAL LAW COMMITTEE

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Patrick S. Ottinger, Reporter

Nick Kunkel, Staff Attorney

SENATE RESOLUTION NO. 159

BY SENATOR ALLAIN

A RESOLUTION

To urge and request that the Louisiana State Law Institute study the classification of mineral royalties under Louisiana law for the purposes of bankruptcy proceedings.

WHEREAS, the legal classification of certain debts and monies owed has implications for priority of treatment of those debts and monies in bankruptcy proceedings; and

WHEREAS, Louisiana is unique in the United States in its classification of mineral royalties as "rent", and the reason for the classification is unclear; and

WHEREAS, pursuant to R.S. 30:127, mineral leases of state-owned property contain a provision permitting the state, at its option, to take in-kind the portion due it as royalty of any minerals produced and saved from leased premises; and

WHEREAS, certain mineral leases of privately owned property reserve to the lessor a fraction of the oil in-kind with the right to sell, dispose, or take it as he sees fit; and

WHEREAS, under federal bankruptcy law, the classification of a debt as "rent" affects the priority that the debt has compared to other competing claims and limits the remedies available to collect the debt; and

WHEREAS, this classification has led to mineral royalties owed to landowners in Louisiana being given no priority in bankruptcy proceedings.

THEREFORE, BE IT RESOLVED that the Senate of the Legislature of Louisiana does hereby request that the Louisiana State Law Institute study the history and reasoning for the classification of mineral royalties as "rent" in La. R.S. 31:123, and consider whether the law should be revised to reflect that royalties are properly classified as the property of the landowner or mineral owner at the moment of severance, rather than rent or any other type of debt, and report its findings and recommendations for any changes to laws which would protect the rights of public and private landowners or mineral owners to the Louisiana Legislature no later than sixty days prior to the convening of the 2018 Regular Session.

BE IT FURTHER RESOLVED that during the study of these issues and prior to submitting any recommendations to the legislature, the Louisiana State Law Institute shall include in its research information from the following:

(1) The State Mineral and Energy Board.

(2) The Louisiana Landowner's Association.

(3) Legal counsel with experience in bankruptcy matters involving oil and gas production company debtors.

(4) The Louisiana Midcontinent Oil and Gas Association.

BE IT FURTHER RESOLVED that a copy of this Resolution be transmitted to the director of the Louisiana State Law Institute, the secretary of the Department of Natural Resources, the chairman of the Louisiana State Mineral and Energy Board, the executive director of the Louisiana Landowners Association, and the president of the Louisiana Midcontinent Oil and Gas Association.

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PRESIDENT OF THE SENATE

November 5, 2020

To: Senator Patrick Page Cortez  
President of the Senate  
P.O. Box 94183  
Baton Rouge, Louisiana 70804

**REPORT TO THE LEGISLATURE  
IN RESPONSE TO SR NO. 159 OF THE 2017 REGULAR SESSION**

Senate Resolution No. 159 of the 2017 Regular Session urged and requested the Louisiana State Law Institute to “study the classification of mineral royalties under Louisiana law for the purposes of bankruptcy proceedings.” In fulfillment of this request, the Law Institute created the Mineral Law Committee, which consists of mineral law practitioners, law professors, and judges and operates under the direction of Reporter Patrick S. Ottinger, a practicing attorney and adjunct professor at the LSU Paul M. Hebert Law Center.

After conducting research and compiling background information, the Committee first met in February of 2018. The Committee identified that the issue the resolution sought to address was the state’s status as an unsecured creditor in bankruptcy proceedings pertaining to state mineral leases. In particular, this issue arose from the U.S. Bankruptcy Code’s negation of enforcement in bankruptcy of statutory liens securing a lessee’s obligation to pay rent to a lessor. Because, under the Louisiana Mineral Code, “royalties paid to the lessor [under a mineral lease] on production are rent[,]” the state had been left as an unsecured creditor in bankruptcy proceedings, leaving collection of the lessor’s royalties it was owed by bankruptcy debtors unlikely. The Mineral Law Committee ultimately decided to form a Subcommittee to further research potential solutions to this issue.

The Subcommittee, chaired by Professor Keith Hall of the LSU Paul M. Hebert Law Center, met several times to discuss how best to overcome the state’s unsecured creditor problem. The Subcommittee quickly concluded that adding a simple statement to R.S. 31:123 to the effect that “mineral royalties do not constitute rent” would not be advisable for multiple reasons.

First, such a course of action would not likely even solve the problem, as bankruptcy courts’ interpretative process focuses on substance, as opposed to label. Importantly, the characterization of royalty under a mineral lease as “rent” has been long recognized by the Louisiana Supreme Court and is deeply engrained in Louisiana law.<sup>1</sup> Indeed, the courts have recognized that it “is well established that the payment of a royalty, under a mineral lease, is the

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<sup>1</sup> See *Logan v. State Gravel Co.*, 103 So. 526 (La. 1925) (finding that “plaintiff [was] entitled to a lessor’s privilege [for rent] on the property situated on the leased premises” in one of the earliest cases to embrace this characterization); *Board of Commissioners of Caddo Levee District v. Pure Oil Co.*, 120 So. 373 (La. 1929) (citing *Logan* in holding that the prescriptive period applicable to a suit for unpaid mineral royalties “[wa]s governed by the prescription applicable to arrearages of rent”); *Roberson v. Pioneer Gas Co.*, 137 So. 46 (La. 1931) (providing a seminal articulation of the matter); *Hatch v. Morgan*, 12 So. 2d 476 (La. App. Ct. 2d 1942) (“It is now beyond dispute that the royalty under [a mineral lease] is in reality rent”).

paying of rent[.]”<sup>2</sup> This proposition is not only so well settled as to have been expressly codified in the Mineral Code,<sup>3</sup> but it is intertwined in a number of areas of mineral law generally.<sup>4</sup> Thus, Bankruptcy Courts would likely ignore such a statement as a plain attempt to circumvent 11 U.S.C. 545 and instead look to the nature of the obligation.

Second, for a century and a half, the courts of Louisiana have recognized that, “. . . to the contract of lease, as to that of sale, ‘three things are *absolutely necessary*, to wit: the thing, the price, and the consent.’”<sup>5</sup> Under the Louisiana Civil Code, three things must exist and coincide for a contract to be considered and characterized as a “lease,” *viz.*, the thing made subject to the lease, the consent of the parties, and rent.<sup>6</sup> Indeed, this definitional article provides that the “consent of the parties as to the thing and the *rent is essential* but not necessarily sufficient for a contract of lease.”<sup>7</sup> In other words, the fact that “rent is essential” means that, if there is no rent, there no lease. Hence, because rent is an essential element of any lease under Louisiana law, stating that royalties do not constitute rent under a mineral lease would risk transforming mineral leases into innominate contracts, in which case they potentially would no longer be subject to the Mineral Code or to the Civil Code provisions governing leases.

The Subcommittee additionally considered a number of alternative approaches, including providing for direct payments to the state by each first purchaser of minerals produced pursuant to a state mineral lease, providing for the state to acquire a contractual – as opposed to a statutory – security interest by way of an amendment to the state lease form, and taking the royalty in-kind, with the lessee acting as an agent.

The Mineral Law Committee met again in April of 2019 so that the Subcommittee could report on its progress. After weighing the relative merits of each of the alternatives presented and agreeing that a simple statement attempting to reclassify royalty payments would be inadvisable, the Committee ultimately determined that the best course of action would be to authorize the state to acquire a contractual security interest via changes to the state lease form. To accomplish this goal legislatively, the Committee approved recommendation of the following amendment to R.S. 30:127:

### **§ 127. Opening bids; minimum royalties; terms of lease; deposit**

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H. Each contract of lease entered into by the Board after [effective date of legislation] shall contain a clause whereby the lessee grants to the lessor a continuing security interest in and to all

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<sup>2</sup> *Shell Petroleum Corp. v. Calcasieu Real Estate & Oil Co.*, 170 So. 785, 791 (La. 1936).

<sup>3</sup> See La. R.S. 31:123 (providing, in relevant part, that “royalties paid to the lessor on production [under a mineral lease] are rent”).

<sup>4</sup> See, e.g., La. R.S. 31:146 (setting out that the “lessor of a mineral lease has, for the payment of his rent, and other obligations of the lease, a right of pledge on all equipment, machinery, and other property of the lessee on or attached to the property leased.”); La. Civ. Code art. 3494(5) (listing, as an action with a prescriptive period of three years, “an action to recover underpayments or overpayments of royalties from the production of minerals”).

<sup>5</sup> *Jordan v. Mead*, 19 La. Ann. 101, 102 (La. 1867). (Emphasis in original).

<sup>6</sup> LA. CIV. CODE ANN. art. 2668.

<sup>7</sup> *Id.*

of the lessee's right, title and interest in and to all as-extracted collateral attributable to, produced, or to be produced, from the leased premises or from lands pooled or unitized therewith, as security for the prompt and complete payment and performance of the lessee's obligation to pay royalties under the lease, as contemplated by the Uniform Commercial Code-Secured Transactions.

As the security interest contemplated by the suggested language is one contemplated by the Uniform Commercial Code, the Board would need to satisfy the requirements of that law in order to perfect the security interest, including the filing of a financing statement.

Subsequent to this April meeting, the Legislature passed Senate Bill No. 242 of the 2019 Regular Session, which added a substantially similar provision to R.S. 30:127 as approved by the Mineral Law Committee. The Reporter provided input to legislative staff in the drafting of this bill, and at the request of legislators, testified before the House Natural Resources Committee. The bill, which was enacted as Acts 2019, No. 403, did, however, differ from the recommendation approved by the Committee in several ways: First, the Committee's proposal uses mandatory language – namely, "Each contract of lease ... *shall* contain a clause ..." – whereas this Act's amendment is merely permissive. Second, the scope of the security interest authorized by the Act goes beyond the scope of the Committee's approved amendment, covering "other sums of money that may become due under the lease" in addition to unpaid royalties. Finally, the Act contains language granting the Mineral Board permission to subordinate the state's security interest in any amounts exceeding the sums due to the state, as well as requiring that the State Mineral and Energy Board allow the House Committee on Natural Resources and Environment and the Senate Committee on Natural Resources thirty days' notice to review the new clause before its use in a contract. Nevertheless, because the Act accomplishes essentially the same objective as the proposal approved by the Mineral Law Committee, the Law Institute has no further recommendation with respect to Senate Resolution No. 159 of the 2017 Regular Session.