SUPREME COURT OF LOUISIANA

DOCKET NO.: 2017-C-1519

A CIVIL ACTION

GLORIA'S RANCH, L.L.C.,
Plaintiff-Respondent

VERSUS

TAUREN EXPLORATION, INC., CUBIC ENERGY, INC.,
WELLS FARGO ENERGY CAPITAL, INC., AND EXCO USA ASSET, INC.,
Defendants-Applicants

On Application for Writ of *Certiorari* from the
Court of Appeal, Second Circuit, State of Louisiana,
Docket No. 51,077-CA, On Appeal from the
First Judicial District Court, Parish of Caddo,
Docket No. 541,768-A (Civil Action),
Hon. Ramon Lafitte, Presiding

AMICI CURIAE **BRIEF ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION, THE LOUISIANA BANKERS ASSOCIATION AND THE TEXAS BANKERS ASSOCIATION IN SUPPORT OF APPLICATION FOR WRIT OF** ***CERTIORARI*** **BY APPLICANT, WELLS FARGO ENERGY CAPITAL, INC.**

By Attorneys,

Patrick S. Ottinger
Bar Roll No. 8727
OTTINGER HEBERT, L.L.C.
Post Office Drawer 52606
1313 West Pinhook Road (70503)
Lafayette, Louisiana 70505-2606
(337) 232-2606
(337) 232-9867 (fax)
Attorneys for the American Bankers Association
and the Texas Bankers Association, *Amici Curiae*

David J. Boneno
Bar Roll No. 22956
LOUISIANA BANKERS ASSOCIATION
5555 Bankers Avenue
Baton Rouge, Louisiana 70808
(225) 387-3282
(225) 343-3159 (fax)
Attorney for Louisiana Bankers Association, *Amicus Curiae*

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

LOUISIANA CIVIL CODE

SUPREME COURT OF LOUISIANA

DOCKET NO.: 2017-C-1519

A CIVIL ACTION

GLORIA'S RANCH, L.L.C.,
Plaintiff-Respondent

VERSUS

TAUREN EXPLORATION, INC., CUBIC ENERGY, INC.,
WELLS FARGO ENERGY CAPITAL, INC., AND EXCO USA ASSET, INC.,
Defendants-Applicants

AMICI CURIAE BRIEF ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION, THE LOUISIANA BANKERS ASSOCIATION AND THE TEXAS BANKERS ASSOCIATION IN SUPPORT OF APPLICATION FOR WRIT OF _CERTIORARI_ BY APPLICANT, WELLS FARGO ENERGY CAPITAL, INC.

MAY IT PLEASE THE COURT:

I. INTRODUCTION

The oil and gas industry is one of the most significant economic drivers in Louisiana. There are, of course, distinct sectors comprising the oil and gas industry, including the service, drilling, exploration or production sectors, all of which are dependent upon the drilling of wells. The exploration for oil and gas, along with the mining for minerals and support sectors, constituted approximately 6.7% of the State's real gross domestic product in 2015.[1] In fiscal year 2016, considering only revenue to the State of Louisiana (and not considering revenue in the private sector) in the "upstream" sector of the oil and gas industry, receipts from bonus, rentals and royalties totaled $157.2 million, while severance taxes totaled $429.6 million.[2] Thus, it is indisputable that the drilling of oil and gas wells is an extremely important activity that funds governmental functions, services and operations.

---

1 Source: U.S. Department of Commerce, Bureau of Economic Analysis Website downloaded August 16, 2017; Prepared by Louisiana Department of Revenue, Policy Services Division.

2 Revenue Estimating Conference, Actual Collections FY 16.

At the same time, access to capital on commercially reasonable terms is an essential lifeline for the drilling of oil and gas wells, both in the State of Louisiana and elsewhere. From the viewpoint of the lender, predictability, certainty and security are indispensable preconditions to the loan of money for these purposes.

By its very nature, the oil and gas business has an insatiable appetite for capital. As has been said, "[t]he oil and gas business is always out of money. It just inhales capital."[3] This critical need is met by banks and other financial institutions, including many of the constituent members of *Amici Curiae*, who lend money to oil and gas companies.

The importance of oil and gas lending has been explained, as follows:

> Oil and gas exploration and production (E&P) is a capital-intensive business. Global upstream investments may require up to $15 trillion over the next two decades, with the U.S. shale revolution accounting for as much as one-third of this total. In 2013 alone, global E&P expenditures hit a record $678 billion. Although producers expend the bulk of this capital up front to drill wells, they recoup costs only gradually as they prove up and sell off production. Large International Oil Companies (IOCs) have the balance sheets to finance such expenditures internally or turn to public debt and equity markets. Most small to midcap companies, however, lack this flexibility and will look to external sources for financing.[4]

In the instant case, the Court of Appeal, Second Circuit (the "Second Circuit") affirmed the district court's judgment finding that a mineral lease granted by Plaintiff-Respondent had expired as a consequence of the failure of the mineral lessee to produce in "paying quantities," and further finding that the Defendants-Applicants were solidarily liable for various damages and costs resulting therefrom, including, specifically, for purposes hereof, the coextensive liability of Wells Fargo Energy Capital, Inc. ("Wells Fargo"), for the failure of Cubic Energy, Inc. ("Cubic") to provide a release of its interest in such mineral lease. Simply stated, this decision of the Second Circuit places the indispensible secured lending industry in significant peril, and creates unnecessary confusion and uncertainty among lenders and borrowers alike.

The Second Circuit ultimately concluded—erroneously, *Amici Curiae* respectfully submit—that the mortgaging of a borrower-lessee's rights under a mineral lease imposes solidary liability upon its mortgagee for the contractual

---

[3] Bernard F. Clark, Jr., OIL CAPITAL—THE HISTORY OF AMERICAN OIL, WILDCATTERS, INDEPENDENTS AND THEIR BANKERS, p. i (2016), attributed to Joe Bridges.

[4] Michael P. Marek & Robert A. Wilson, *A Future For Reserve-Based Lending in Emerging Markets? Limitations on the Traditional Model*, 10 TEX. OIL & GAS L.J. 150 (2014).

and statutory obligations owed by the mortgagor to its lessor. As a consequence of various contractual provisions between Wells Fargo and Cubic relative to the mortgage loan, intending only to provide certain safeguards to protect the collateral and manage the lender's risk of loan loss, the Second Circuit reasoned the existence of such special provisions resulted in the lender having "controlled" the ability of the borrower-lessee to execute a release of the mineral lease, and therefore, served as the basis for the imposition of solidary liability upon the non-possessory lender.

In doing so, the Second Circuit fundamentally and drastically altered the traditional understanding of the relationships between, not only mortgagors and mortgagees, but also mineral lessors and lessees, including both the correlative obligations and liabilities inherent in such relationships. By ignoring the fundamental principles of the law of mortgage, and the fact that no case has ever previously held otherwise, the expansiveness of the Second Circuit's decision threatens to cause significant upheaval to the stable understandings of mortgage lending, and in particular reserve-based lending ("RBL") secured by mortgages of mineral leases, as well as to the participants in other commercial transactions. Consequently, the Second Circuit created considerable uncertainty with respect to financing structures already in place, as well as all future negotiations between lenders and borrowers throughout this State in an array of industries.

The lending and banking industries represented herein by *Amici Curiae,* including their many constituent members, must be able to rely upon well-settled and consistently applied legal principles of Louisiana security rights in order to continue to justify the massive investment in not only the business of oil and gas exploration and production, but also a myriad of other commercial and industrial activities within this State. Without a stable, predictable body of law, there is a chilling effect upon the ability of both banks and borrowers to manage and administer their commercial affairs. When Louisiana courts create instability in areas of the law that were previously thought to be well settled, such industries are directly and adversely affected.

Unless rectified by this Honorable Court, the uncertainty of the exposure to claims for damages by financial institutions, including their inability to continue to rely upon the mortgage of leases as a vital source of collateral without being held solidarily liable with its borrower, will discourage commercial relationships by banks in the context of such secured transactions, out of a concern for increased risk of liability as a consequence thereof. Hence, it is appropriate to give detailed consideration to the customary interpretation of the nature of mortgage as a security right pursuant to Louisiana law.

II. STATEMENT OF THE CASE

The Statement of the Case has been aptly summarized by Wells Fargo in its Memorandum of Law in Support of Application for Writ of *Certiorari*, and accordingly, *Amici Curiae* adopt and incorporate its Statement of the Case into this brief *in extenso. Amici Curiae* do not wish to burden this Honorable Court with a recitation of such facts, and will therefore, limit its argument to the relevant legal issue of whether a secured creditor can be held to be solidarily liable for the obligations of its debtor, the resolution of which is of great importance to the banking industries represented herein by *Amici Curiae* because of its profound impact on the lending industry in Louisiana and elsewhere.

III. LEGAL PRINCIPLES

A. The Law of Mortgage:

Mortgage is, quite simply, the perfect form of security right. In helping to aid a creditor to collect upon an obligation, the contract of mortgage creates for the lender a security interest over property belonging either to its borrower or another third person based upon the contractual commitment effective between the parties thereto. Although it is a nonpossessory[5] real right over the property mortgaged, also being accessorial[6] in character to the principal obligation, it is indisputable that the substantive nature of a mortgage is the creation of certain rights in favor of the mortgagee when its mortgagor fails to perform the principal obligation that the mortgage secures. The mortgagee is provided the right to have the mortgaged property seized and sold to satisfy the outstanding debt owed, and to further use such proceeds in debt satisfaction in preference to other claims.[7] This, in turn, provides the creditor with greater security that the principal obligation (typically a money debt arising from a loan for a commercial purpose) will be fulfilled because the mortgage allows the lender access to another source of value to compensate for an unfulfilled obligation in the event its borrower fails to pay the debt. In the context of a mortgage of a mineral lease, the mortgagee is provided the right to have the lease seized and assigned to

---

5 LA. CIV. CODE ANN. art. 3278.

6 *Id*. at art. 3282.

7 *Id*. at art. 3279.

satisfy the outstanding debt owed. This action does not extinguish the lease and the mineral lease assignee assumes the obligations of the mineral lease.

The sole formality for the establishment of a conventional mortgage[8] is the contract of mortgage must be in writing.[9] Although no special words are necessary for its establishment,[10] the mortgagor must have rights in the collateral in order to encumber his right in the property by mortgage.[11] Further, it is required that the contract of mortgage sufficiently and adequately describe or otherwise identify the property to be mortgaged; declare the maximum amount of the secured obligation, and be signed by the mortgagor to be valid.[12]

A mortgage can attach only to immovable property and certain related rights, including the lessee's rights in a lease or other kinds of property authorized by law.[13] The conventional mortgaging of leasehold rights in mineral leases is authorized pursuant to article 203 of the Louisiana Mineral Code. As explained in *In the Matter of Senior-G&A Operating Co., Inc.*,[14] the mineral lessee's right in a mineral lease is susceptible of mortgage. However, the mortgage of its "working interest"[15] under the lease does not result in a transfer of such right to its secured creditor under Louisiana law.[16]

---

[8] *Id.* at art. 3283.

[9] *Id.* at art. 3287.

[10] *Id.*

[11] *Id.* at art. 3290.

[12] *Id.* at art. 3288.

[13] *Id.* at art. 3286.

[14] 957 F.2d 1290 (5th Cir. 1992).

[15] "The term 'working interest' is synonymous with the extent of a lessee's 'leasehold interest' in a tract or subsurface geological strata thereunder." *Pinnacle Operating Co., Inc. v. ETTCO Enterprises, Inc.*, 40,367 (La. App. 2d Cir. 10/26/05); 914 So.2d 1144, 1145, n. 1.

[16] "It is, therefore, clear that Senior mortgaged-it did not transfer-its mineral interest in the well to PSI (and also pledged its production), and under Louisiana law, PSI must be classified as a secured creditor as opposed to a royalty owner." 957 F.2d at 1296-97.

Notably, a mortgage is only the encumbrance of a right in the property that is the subject of the mortgage, and, consequently, conveys neither title nor the right of possession to the actual property.[17] The creditor's only recourse for the satisfaction of a debt secured by a mortgage is limited to the right to seize and sell the property (or in the case of a mineral lease, assign the lease to a new mineral lessee) through government action over which the mortgage has been established.[18] As a result, the right of mortgage does not give rise to personal liability on the part of the mortgagee in any case or under any circumstances for the obligations of its mortgagor.

Additionally, a mortgage also affords the lender a means to reduce its risk of loss on loans. Because of this, lenders are then able to take certain loan risks by having confidence in the law that, by taking a mortgage, they are granted certain rights over a borrower's assets in the event of default. However, a lender needs to have certainty that the mortgage rights over the collateral can be relied upon in the event of default.

Here, the basis of the contractual relationship between Wells Fargo and Cubic is one of a lender and borrower created by mortgage, wherein the bank has lent Cubic money for the purposes of oil and gas exploration and production. As part of the relationship, and as collateral to secure the repayment of the loan, Cubic granted a mortgage on its interest in and to a mineral lease covering and affecting certain property owned by Plaintiff-Respondent. The mortgage granted by Cubic is a nominate contract,[19] regulated by codal rules and principles pertaining thereto. The "cause" of the mortgage[20] is to grant to a lender real security over property of the borrower such as, in this case, mineral leases owned by the mortgagor.[21]

---

[17] "Perfect ownership becomes imperfect when the property is mortgaged, by the alienation of that real right; *but the title and the possession still remain in the owner*." *Duclaud v. Rousseau*, 2 La. Ann. 168, 173 (La. 1847) (Emphasis added.).

[18] Of course, in such event, the lease would continue in force and effect.

[19] "Nominate contracts are those given a special designation such as sale, lease, loan, or insurance." LA. CIV. CODE ANN. art. 1914.

[20] "Cause is the reason why a party obligates himself." *Id*. at art. 1967.

[21] "Mortgage is a nonpossessory right created over property to secure the performance of an obligation." *Id*. at art. 3278.

B. Financing in Reserve-Based Lending:

When making a loan, a financial institution takes on the risk of repayment, and wants to ensure that it is repaid. In order to increase the likelihood of repayment, a lender will take a mortgage on the borrower's property. In connection therewith, the lender has an interest in making sure that the borrower maintains its rights in the collateral throughout the life of the loan to prevent the loan from becoming unsecured or undersecured. A loss of the collateral would increase the lender's risk of not being repaid. While the interests of the borrower and lender may be somewhat aligned in that both parties want to see the borrower's business succeed, the lender's primary focus is always having its loan repaid.

1. The Precarious Nature of Mineral Leases as the Source of Collateral for Loan Security:

In the "upstream" sector of the oil and gas industry,[22] the participants are so-called "E&P" companies.[23] The principal form of collateral for an oil and gas loan are the mineral leases held by such a borrower. A loan of this type is called a "reserved-based" loan.[24]

When mineral leases constitute the collateral to secure a loan in a RBL loan transaction, it is important to recognize the unique issues thereby presented. Consider two loans—one secured by raw land to be developed for a commercial purpose, and the other secured by mineral leases. The principal indebtedness of each borrower is $10 million.

In the former case, the collateral is essentially "dirt" or "land," the classic immovable.[25] That lender can actually see and walk on the collateral securing its loan via a mortgage. That collateral "is not going anywhere." There is absolutedly no fear that lender's collateral will disappear. In contrast, in the instance where the collateral is composed of

---

[22] "Upstream companies—also known as E&P companies—find, develop, and produce oil, natural gas, and natural gas liquids (NGL). The upstream business model is analogous to mining for raw materials. Upstream companies manage their development and production costs and emphasize production volume to generate profit margins, which are sensitive to commodities market prices. This price risk can cause volatility in company cash flow and the value of O&G reserves." Comptroller's Handbook on Safety and Soundness, Oil and Gas Exploration and Production Lending, issued by the Office of the Comptroller of the Currency (March 2016), pp. 1-2 ("OCC Lending Manual").

[23] "E&P" means "exploration and production." These are companies that drill and produce oil and gas.

[24] "At its core, the traditional reserve-based loan is little more than an asset-backed loan, a mortgage secured by oilfield reserves rather than a home." Michael P. Marek & Robert A. Wilson, *A Future For Reserve-Based Lending in Emerging Markets? Limitations on the Traditional Model*, *supra* note 4.

[25] *See* LA. CIV. CODE ANN. art. 462 ("Tracts of land, . . ., are immovables.").

mineral leases, the lender can see and hold the written contract evidencing the lessee-borrower's rights under the mineral lease, but, by its nature, such collateral is "perishable" or "precarious" in the sense that the collateralized mineral leases must be maintained in force and effect by the taking of actions prescribed therein. In other words, mineral leases serving as collateral for this secured loan have—in contrast to the land itself—the potential to expire and terminate,[26] in which case, the collateral ceases to exist, and the lender becomes unsecured or undersecured.

Both loans for $10 million will be documented by a credit agreement and an array of security interests, principally a mortgage describing the collateral, coupled with a security interest in the revenue generated by any lease on the land or in the oil and gas produced by the mortgagor. However, the loan to the E&P borrower will typically have significantly more and different clauses, conditions, requirements and covenants, than the loan secured by the raw land. Again, this is in order that the lender has the highest level of comfort and assurance that its collateral will not "perish," or become extinguished, essentially leaving that bank unsecured or undersecured.

Moreover, yet even when the mineral leases are being properly maintained in force and effect, the volatility in commodity prices can quickly exacerbate the status of the loan, in comparison to the raw land.[27] So clearly, the terms and provisions pursuant to which a bank might be willing to loan money to the E&P company are carefully negotiated so as to ensure that the unique collateral on which the bank relies for repayment, continues to exist for the life of the loan. Given the precarious nature of mineral leases, it is both reasonable and understandable that a bank would want to have additional safeguards in place in order to protect against the lapse or extinction of such leases, and accordingly, the loss of its collateral.

2. The Absolute Necessity of Mortgage Lenders to Safeguard the Collateral Securing Their Loans in Order to Manage Their Risk and Protect Against Loss:

It is a foundational principle of banking that a lender should be able to rely upon the existence of the collateral throughout the life of a loan. The continued existence and availability of collateral during the life of a proposed loan

[26] LA. REV. STAT. ANN. § 31:133 ("A mineral lease terminates at the expiration of the agreed term or upon the occurrence of an express resolutory condition.").

[27] For example, a sharp decline in oil prices could cause the value of the reserves to decline below the value of the loan causing the lender to be undersecured. Conversely, land typically has a more stable valuation.

is a risk factor considered at the time a loan is made. When a lender makes a secured loan, it is vital that the collateral is safeguarded so as to manage the risk of loss by mortgage lenders.

To this end, it is customary for a credit agreement or the mortgage (or both) to include an array of unique covenants to allow the lender to monitor the activities of the borrower, and to inform itself as to the operations, plans and projections of the borrower. These types of safeguards are widely used in both commercial and residential mortgage loans, and are intended to protect and preserve the property mortgaged, including requiring the perpetuation of the mineral leases by the mortgagor debtor.[28]

Commentators have recognized the propriety of including an array of covenants in a credit agreement or mortgage executed by a company such as Cubic. For example, in an article entitled "Some Aspects of Financing Oil and Gas Transaction," the author explained, as follows:

> The instrument creating the pledge of an oil and gas property to secure payment of a loan is customarily in the form of a . . . mortgage which, together with the note, is the most important document to the banker. . . . In a few brief words, the special provisions we like are as follows:
>
> (1) That the mortgagor will comply with all State and Federal Regulations regarding the production of oil and gas.
>
> (2) That he will keep his leases and mineral rights in full force and effect.
>
> (3) That he will comply with and fulfill all his obligations under the leases.
>
> (4) That he will operate his leases in a good and workmanlike manner and in accordance with best engineering practices.
>
> (5) That he will permit the mortgagee or its representatives to inspect the properties at all reasonable times.
>
> (6) That he will furnish the mortgagee with a monthly report of his operations, if requested.

---

28 Protections widely included in mortgage loan documentation include the following requirements of the borrower: to maintain property insurance, repair any damage, maintain the property to prevent it from deteriorating or decreasing in value due to its condition, refrain from any major alterations to the property without the lender's knowledge, and pay taxes promptly to prevent loss of property at tax sale.

(7) That the mortgage not only secures the note described therein, but also any and all renewals, extensions and rearrangements of the debt.

(8) That the mortgage secures the payment of all future advances and loans as well as other obligations to the bank, whether fixed or contingent, primary or secondary, express or implied, or past, present or future, and whether created or not under the terms and provisions of the mortgage.[29]

3. The Sole Purpose of Covenants is to Ensure the Collateral Continues to Exist for the Life of the Loan and to Prevent Against the Loan Becoming Unsecured or Undersecured:

Neither the mortgage nor credit agreement entered into between Cubic and Wells Fargo is unique or extraordinary. Rather, both are typical of transactions of this type—a RBL loan to an E&P company. Unfortunately, however, the Second Circuit misinterpreted the special provisions contained therein as a way for Wells Fargo to "control" or "dictate" the operations of Cubic's business, and failed to recognize their principal purpose of protecting not only Cubic's collateral as a source of repayment, but also minimizing Wells Fargo's risk of loss on the Cubic loan.

The Second Circuit seemed to have placed particular emphasis on a typical clause that requires the mortgagor-lessee to obtain the bank's consent to release an item of collateral.[30] Given the nature of the collateral securing the loan—mineral leases (the status of which becomes much more tenuous and precarious), this clause is nothing more than provision to ensure that the loan remains secured at all times. Unlike a mortgage in which land, for example, is the collateral (remember, the land will always be there), the unilateral release of a mineral lease by the lessee-borrower results in turning the secured loan into an unsecured or undersecured loan.[31] Consequently, this would greatly impair a bank's ability to rely upon such type of collateral due to its increased risk of loss on the loan.

---

[29] John R. Scott, *Some Aspects of Oil and Gas Financing*, 5 INST. ON OIL AND GAS LAW AND TAX'N 325, at 330-31 (1954). *See also* Hubert Dee Johnson, *Legal Aspects of Oil and Gas Financing*, 9 INST. ON OIL AND GAS LAW AND TAX'N 141, at 157(1958), for a similar list of typical covenants.

[30] "Notably, Wells Fargo controlled Cubic's ability to alienate its interest in the lease by requiring Cubic to obtain its written consent to release the lease." Opinion, p. 32 (Appendix E, Volume I of Application for Writ of *Certiorari* by Wells Fargo).

[31] The sale by the mortgagor of the mortgaged land does not diminish the rights of the secured lender as the mortgagor's vendee takes the land subject to the recorded mortgage. *See* LA. CIV. CODE ANN. art. 3280. However, if the mortgagor *releases* (and thereby terminates) a mortgaged mineral lease, the lender is, to that extent, unsecured as to its loan.

Such a clause, typical in most documentation utilized in an RBL financing, might be likened to the *pact de non alienando* appearing in virtually all mortgages,[32] and actually provided by law.[33] This "consent-to-release" clause is not intended, and is not understood, to regulate the necessity to release back to a lessor an expired mineral lease, a matter addressed by article 206 of the Mineral Code, or restrict the power or ability of the lessee-borrower to perform its obligations due under the mineral lease, including any actions required thereby.

4. <u>Federal Law Encourages the Use of Covenants in RBL Financing Structures</u>:

Not only are clauses of the type contained in the mortgage and credit agreement, customary and typical as a matter of affording security to the lender, they are actually encouraged, if not mandated, by Federal law. In March of 2016, the Office of the Comptroller of the Currency issued its OCC Lending Manual.[34] As explained in the preamble of this Manual:

> This booklet addresses only E&P lending to upstream companies because their financing structures are more specialized than financing structures used by midstream, down-stream, and service companies. Loan policies and underwriting standards applied to midstream, downstream, and service companies are similar to traditional commercial and industrial loans.[35]

The OCC Lending Manual noted the following with respect to the management of risk in a RBL transaction, to-wit:

> Underwriting standards and approval requirements that are specific to lending to the E&P industry and provide appropriate lender controls, including measurement of O&G reserve and production history; financial analysis expectations; realistic repayment terms consistent with the use of proceeds; advance rates and risk adjustments on various reserve types; pricing parameters; stress or sensitivity analysis of cash flow; covenant and structure expectations; *approval authority*; and policy exception authority.[36]

---

32 *Avegno v. Schmidt & Ziegler*, 35 La. Ann. 585 (La. 1883), *aff'd*, 113 U.S. 293, 5 S. Ct. 487 (1885); *Lotz v. Iberville Bank and Trust Co.*, 146 So. 155 (La. 1933).

33 *See* LA. CODE CIV. PROC. art. 3701.

34 *Supra* note 5, and available for review: https://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/pub-ch-og.pdf.

35 *Id.*, at p. 3.

36 *Id.*, at p. 18. (Emphasis added.).

Thus, the Second Circuit's decision, finding liability on the part of a lending bank that utilizes these unique and vital covenants, necessarily means that compliance with the OCC Lending Manual (Federal law) will lead to a new species of financial exposure and, hence, risk to a bank—precisely the state of affairs sought to be avoided by this regulatory Manual.

Instead, the covenants were a set of provisions that Cubic agreed to follow to remain in good standing with its mortgage loan. Regardless of the covenants, Cubic always retained the power and ability to terminate its mineral lease, and this right was in no manner ceded to its mortgagee, Wells Fargo. However, by releasing an item of collateral, and without making some other financial accommodation with Wells Fargo, Cubic would have been in default of the terms of its mortgage loan. This, however, is a matter strictly between Wells Fargo and Cubic.

If a bank is unable to rely upon the continued existence of its collateral, then a lender will not be able to make certain loans where the collateral is subject to such a risk of loss. This will have devastating effects on banks and other lenders as well as all Louisiana industries that borrow money. Consequently, it is an absolute necessity for Louisiana lenders to contractually safeguard and protect against their collateral being alienated, extinguished, diminished or destroyed, thereby finding itself either unsecured or undersecured. Lenders must know that their borrowers will not terminate, damage, sell, transfer, or otherwise alienate their collateral without their knowledge, and without first making other accommodations to protect the lender from loss. Protective contractual provisions requiring the borrower to communicate with the lender and to address the outstanding loan, before it alienates or terminates the lender's collateral, are important protections to the lender. Such protections, however, should neither cause the nature of a debtor-creditor relationship to change; impose upon lenders the underlying obligations of an owner of mortgaged assets; nor be misconstrued as "control" over the borrower to give rise to any sort of liability upon the lender *vis-à-vis* third persons.

Unfortunately, the Second Circuit seemingly placed great significance on the notion that Wells Fargo exercised "control" over Cubic, its borrower. This case, unless rectified, would stand for the proposition that a mortgagee can be held liable for the actions or inactions of its borrower if the secured creditor retains the right to monitor and to be informed as to its borrower's activities and operations. Such a ruling would be extreme and catastrophic to the lending industry in a variety of industries (certainly not limited to the upstream E&P space).

C. *In Solido* Liability:

The Second Circuit committed legal error by imposing solidary liability on the mortgagee in the present case, and its decision is legally insupportable, and subject to numerous flaws as will be demonstrated. Any determination of the obligations owed to the Plaintiff-Respondent pursuant to the mineral lease should be determined either by the Louisiana Mineral Code or the law of contract between lessors and lessees.

Cubic is in the E&P business, and it had entered into a mineral lease with a landowner, Plaintiff-Respondent. Wells Fargo, however, was not party to the mineral lease. As such, the mineral lease did not set forth any rights and obligations owed by Wells Fargo to Plaintiff-Respondent. Instead, with respect to Wells Fargo, the mineral lease was only an asset that Wells Fargo took as collateral to secure the repayment of Cubic's loan.

Notably, there exists no contractual relationship or agreement, written or otherwise, by and between Wells Fargo and the Plaintiff-Respondent to form the basis for holding Wells Fargo solidarily liable for the obligations due by Cubic under the mineral lease or the law of Louisiana. Since Wells Fargo was not a party to the mineral lease, it had neither the authority nor the power to release the collateralized mineral lease. In fact, the contract of mortgage explicitly provides that Wells Fargo "shall not be liable in any respect for the performance of any covenant or obligation of Mortgagor in respect of the Mortgaged Property."[37] Further, yet another provision specifically states that the security interest granted therein by Cubic imposes no liability upon Wells Fargo in any way for any obligations or liabilities relative to the collateral or the mortgage transaction.[38]

Most importantly, however, with respect to Wells Fargo, there is no basis in law to hold it solidarily liable with Cubic for damages assessed against Cubic for non-compliance with article 206 of the Louisiana Mineral Code—failure to release an expired mineral lease. Additionally, it was error to hold Wells Fargo responsible for unpaid royalties and damages associated therewith, in the total amount of $726,087.78 as, even under the erroneous standard applied to find liability for not granting a release, there is absolutely no connexity to assign liability to the bank for non-payment of royalties.

---

[37] Plaintiff Exhibit 7, § 2.01 (Appendix H, Volume II of Application for Writ of *Certiorari* by Wells Fargo).

[38] *Id.* at § 2.12.

Under article 207 of the Louisiana Mineral Code, damages may be assessed for failing to release an expired lease. Notably, the person who might be cast for liability under this article is the "*former owner* of the . . . expired mineral [lease] [who] fails to furnish the required act within thirty days of receipt of the demand."[39] Wells Fargo is not the "former owner" of the Gloria's Ranch lease, a matter properly determined by the Second Circuit in reversing a contrary holding of the trial court. A secured creditor simply is not within the ambit of persons who might be cast for damages under that article.

Tellingly, the law of Louisiana pertaining to mineral leases granted by the State of Louisiana recognizes that a mortgage of a mineral lease does not constitute a "transfer" of the lease, and is not a matter of concern to the State, as lessor. Thus, although Louisiana Revised Statutes section 30:128 requires that the consent of the State Mineral and Energy Board be obtained prior to the "transfer" of a mineral lease granted by that agency, Section C of that statute provides an exception, as follows:

> A transfer for purposes of this Section shall not be deemed to occur by the granting of a mortgage in, collateral assignment of production from, or other security interest in a mineral lease or sublease or the transfer of an overriding royalty interest, production, payment, net profits interest, or similar interest in a mineral lease or sublease.[40]

The very purpose of this statute is to create a mechanism whereby the State Mineral and Energy Board will know with certainty, at any point in time, who are the owners of the working interest in a state lease so that the mineral lease can be property administered, and the proper parties may be called upon to release the mineral lease. A mortgagee is explicitly excluded from this group of owners of the mineral lease.

This decision of the Second Circuit, unless rectified, will cause significant harm to the oil and gas industry, and to bankers who finance E&P activities. It is important to the banking industry in Louisiana and elsewhere that obligations and liabilities not be created simply because a lender takes a mortgage where no relationship exists between a lender and a third party landowner. To do so would be a significant and unwarranted expansion of lender liability in Louisiana law.

---

39 LA. REV. STAT. ANN. § 31:207.

40 *Id.* at § 30:128C.

IV. CONSIDERATIONS OF PUBLIC POLICY AFFECTING COMMERICAL TRANSACTIONS

When a financial institution makes a loan, it not only puts its depositors' money at risk, but the financial institution also takes a measured risk. In doing so, it will assess the financial strength of the borrower, whether the purpose for which the loan funds will be used will be successful, and whether there is any collateral available that can be seized and sold in the event that the borrower is unable to repay the loan. The seizure and sale of collateral is a last resort for a lender when a borrower is unable to repay its loan. Foreclosure takes time and is expensive, but its availability as a remedy gives a lender some opportunity to recoup some or all of its loan funds in the event of default.

Lenders look to collateral as a source of repayment when the borrower is unable to repay the loan. It serves as a safety net. Hence, this is the very reason why covenants to safeguard collateral are widely used. As a consequence of the Second Circuit's reliance upon these special provisions as the basis for their holding the secured creditor coextensively liable, there is great concern of the many unintended consequences resulting therefrom. The significance of this decision is that it jeopardizes a lender's ability to make loans because it creates too great a risk of solidary liability for financial institutions. Consequently, lenders will no longer be able to rely upon this source of collateral to secure the repayment of its loan.

A. The Repercussions of Reductions to the Availability of Credit and More Restrictive Banking Regulations to the Lending Industry:

Unless this decision is reversed, lenders will need to manage this increased risk of liability resulting from loans secured by a lease, whether mineral or commercial. Consequently, this will likely result in fewer loans being made as some borrowers will have no other assets to use as loan collateral. It further presents a particular hardship on small businesses who also do not have other resources to provide additional collateral because the mortgage of a lease will no longer be sufficient. Similarly, various community banks operate in many small towns throughout Louisiana and, due to their size and risk tolerance, make a significant number of loans to small and medium sized businesses. They too may be particularly harmed.

This decision will also require lenders to reevaluate their existing loans and determine whether they can continue to hold such loans or no longer be able to do so. Lenders may ultimately end up requiring additional collateral; insisting loans be paid off; declining to renew existing loans; or only offering the option for loan renewal with increased interest rates. This could potentially cause a great disruption to financial institutions as well as to the industries that need capital and routinely use valuable leases as loan collateral.

Moreover, financial institutions are regulated entities.[41] As the risk of loss becomes greater, so does the risk of the solvency of financial institutions and the public's deposits. This will also pose a greater risk to the FDIC insurance fund that insures citizens' money deposited in banks, savings banks, and savings and loans operating in Louisiana and elsewhere. If the regulators perceive that loans secured by mortgages on leases pose too high a risk to the financial health of financial institutions, then they will impose significant restrictions limiting this type of lending.

Regulated financial institutions generally each undergo a full-scope on-site safety and soundness examination at least once during each 12-month period.[42] The bank regulator will look at the financial institution's asset quality, which includes the quantity of existing and potential credit risk associated with the loan portfolio,[43] including a review of a bank's loan policies and loan portfolio to determine whether the lending practices of the financial institution are exposing the institution to excess risk.

Based on the holding at issue in this case, if a financial institution can be held solidarily liable with its borrower for millions of dollars in damages, then the capital of a financial institution could be rapidly depleted causing its insolvency and eventual failure. If a federally insured financial institution fails, then there could be claims by depositors of the failed institution to the FDIC insurance fund. In order to prevent such heightened risks to both the FDIC insurance fund and the solvency of regulated financial institutions, regulators could decide to place restrictions on certain types of loans deemed too

---

[41] Banks, savings associations, and savings and loan associations, depending on the type of charter they hold, are regulated by state and federal regulatory agencies such as the Federal Deposit Insurance Corporation ("FDIC"), Office of the Comptroller of the Currency ("OCC"), Federal Reserve Board of Governors, Consumer Financial Protection Bureau and the Louisiana Office of Financial Institutions.

[42] 12 C.F.R. 337.12 of the FDIC Rules and Regulations requires a full-scope, on-site examination of every insured state nonmember bank and state savings association at least once during each 12-month period. Annual examination intervals may be extended to 18 months under certain conditions. Similarly, the OCC examines national banks once every "supervisory cycle" (generally, every 12-18 months). 12 U.S.C. 1820d.

[43] *See* FDIC RMS Manual of Examination Policies, Basic Examination Concepts and Guidelines, Section 1.1, page 22, and available for review: https://www.fdic.gov/regulations/safety/manual/section1-1.pdf.

risky because of the risk of solidary liability, or ultimately decide that insured institutions can no longer make loans secured by such type of collateral.

The present case imposes solidary liability on financial institutions who take leases as mortgage collateral, and has greatly expanded the risk and uncertainty for those regulated institutions. This holding, if left to stand, could cause regulators to restrict regulated financial institutions from making mortgage loans secured by any type of lease. If this happens, Louisiana businesses' access to capital will be reduced, leading to fewer projects being funded, fewer tax dollars generated to fund government, and fewer jobs available for Louisiana citizens.

These results will be devastating to the banking industry in Louisiana and elsewhere. The ability to safely secure a loan with mortgage collateral is vital to the health of our State's banking industry. Uncertainty and increased risk of liability leads to more cautious and tighter lending activity. The mortgage and lending laws of our State are written to promote stable lending activity, which, in turn, will stimulate the economy and foster growth in Louisiana.

B. The Ensuing Impact Resulting from the Instant Ruling Reaches Far Beyond the Oil and Gas Industry:

The foreseeable implications of this decision were correctly noted by Judge Bleich, sitting *pro tempore*, and joined by Chief Judge Brown, who "strongly agreed" with the dissenting reasons of Judge Bleich on rehearing denial. As cogently recognized by Judge Bleich:

> Devastating economic repercussions might possibly develop throughout the lending industry if the original opinion of this court is maintained. Serious and harmful impact on the oil and gas industry is foreseeable. At a minimum, confusion will develop inside the legal community, as well as to other advisors to the respective companies within those industries if the original pronouncement of this court is maintained. Notwithstanding a generally well written and analyzed original opinion and the instructive language therein that this is a somewhat isolated fact setting, cautious managers and decision makers within those industries will incur a most chilling effect on their businesses. All of these developments can be potentially harmful in a broader sense; e.g. the potential impact on the financial condition of this state resulting from lost revenue.[44]

---

[44] Dissent in the Denial of Rehearing, p. 1 (Appendix G, Volume I of Application for Writ of *Certiorari* by Wells Fargo).

It is difficult to overstate how catastrophic the Second Circuit decision could be to the lending industry and, concomitantly, the oil and gas industry. But it is not limited solely to the industry in which Cubic operates. If such decision is left to stand, any industry in which money is loaned, secured by a sophisticated mortgage of leases (whether mineral or commercial) with credit agreements containing customary loan covenants, could face all manner of exposure for the faults or inactions of the borrower. The Second Circuit seemed to recognize this possibility when it attempted to limit its decision in its penultimate sentence.[45] However, that seeming limitation will in no manner prevent future litigants in a variety of contexts from arguing the same rationale should apply in all types of secured transactions, citing this case as precedent.

The mere possibility of these types of unanticipated liability will, at a minimum, result in greater scrutiny in potential lending transactions. Even when a decision is made to loan money to an E&P company, or other commercial borrower, it is a certainty that lending costs will increase. Additionally, in the current environment of depressed prices for oil and gas, many E&P companies operating under a commercial line of credit will more frequently face the certainty of a redetermination of their borrowing base by their lender.[46] This, in turn, will result in fewer wells being drilled, and, hence, less production being obtained, to the obvious detriment of Louisiana's economy. Highly regarded commentators have already criticized the potentially significant adverse consequences of this case, including the many considerations with which lenders are now faced as a result thereof.[47]

Moreover, this decision also serves to greatly expand the risk of exposure to solidary liability to claims for damages brought in other matters in reliance thereon. In connection therewith, where a borrower enters into a commercial lease with a landowner and the lessee borrows money to build a shopping center or office building and the lender takes a

---

[45] "We note this case is highly fact-intensive and should not be construed as governing other cases that may follow unless the same facts exist." Opinion, p. 35 (Appendix E, Volume I of Application for Writ of *Certiorari* by Wells Fargo).

[46]. "The borrowing base for E&P loans represents the lending commitment established from the engineering valuation of the borrower's proved O&G reserves, subject to limitations and adjustments. The borrowing base is determined by analyzing previous production reports and independent engineering evaluations." OCC Lending Manual, p. 23.

[47] "In the name of public policy alone, this aberration needs to be corrected." *A New Day for Louisiana Oil and Gas Lenders?*, available at http://www.energyandthelaw.com/2017/08/29/a-new-day-for-louisiana-oil-and-gas-lenders/#more-10059.

mortgage on the lease and improvements, the lender will likely require protective covenants in the mortgage loan documents safeguarding the lease and improvements. In the event the landowner believes the lease has terminated or otherwise has a dispute with its lessee, the landowner could simply rely upon the covenants in the lender's mortgage, and seek to hold it solidarily liable for any damages imposed on the borrower-lessee.

Going forward, the threat or concern is these implications in the lending industry will further reach to various types of transactions within other industries, including, but not limited to, loans to real estate developers involving long-term leases of land or energy companies for the construction of pipelines or electrical transmission lines. It is common for shopping centers and office buildings to be constructed on land upon which the developer holds a long-term lease.[48]

As is evident by the facts in the present case, mineral leases are often relied upon as loan collateral, and financial institutions will undoubtedly no longer accept mineral leases as collateral for mortgages. Similarly, and as a result of this decision, mortgage lenders might also no longer be able to rely upon the mortgage of leased property as its collateral for fear of solidary liability. Both the real estate development and energy industries have a large impact on the Louisiana economy. Many citizens are employed in these industries as well as by the Louisiana financial industry.

V. CONCLUSION

Amici Curiae, the American Bankers Association, the Louisiana Bankers Association and the Texas Bankers Association, respectfully submit the above and foregoing authorities and arguments for the Court's consideration. Further, *Amici Curiae* urge this Honorable Court to grant the writ application and reverse the errors committed in the Second Circuit's decision.

---

[48] *See*, *e.g*., *Carriere v. Bank of Louisiana*, 95-3058 (La. 12/13/96); 702 So. 2d 648.

Respectfully submitted,

/s/ Patrick S. Ottinger
Patrick S. Ottinger
Bar Roll No. 8727
OTTINGER HEBERT, L.L.C.
Post Office Drawer 52606
1313 West Pinhook Road (70503)
Lafayette, Louisiana 70505-2606
(337) 232-2606
(337) 232-9867 (fax)

Attorneys for the American Bankers Association and the Texas Bankers Association, *Amici Curiae*

David J. Boneno
Bar Roll No. 22956
LOUISIANA BANKERS ASSOCIATION
5555 Bankers Avenue
Baton Rouge, Louisiana 70808
(225) 387-3282
(225) 343-3159 (fax)

Attorney for Louisiana Bankers Association, *Amicus Curiae*

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the above and foregoing *Amici Curiae* Brief on Behalf of the American Bankers Association, the Louisiana Bankers Association and the Texas Bankers Association in Support of Application for Writ of *Certiorari* by Applicant, Wells Fargo Energy Capital, Inc., has been served upon the respondent judge and all counsel of record, all of whom are identified, as follows:

1. Honorable Ramon Lafitte
   District Judge
   1st Judicial District Court
   501 Texas Street
   Shreveport, Louisiana 71101

2. Clerk of Court
   Court of Appeal, Second Circuit
   430 Fannin Street
   Shreveport, Louisiana 71101

3. Guy E. Wall, Esq.
   Paul E. Bullington, Esq.
   Philip M. Wood, Esq.
   540 Elmwood Park Boulevard
   New Orleans, Louisiana 70123
   Counsel for Plaintiff-Respondent,
   Gloria's Ranch, L.L.C.

4. Linda S. Akchin, Esq.
   Richard D. McConnell, Jr., Esq.
   Samuel O. Lumpkin, Esq.
   Kean Miller LLP
   400 Convention Street, Suite 700
   P. O. Box 3513 (70821-3513)
   Baton Rouge, Louisiana 70802
   Counsel for Defendant-Applicant,
   Wells Fargo Energy Capital, Inc.

5. Kelly B. Becker, Esq.
   Kathryn Z. Gonski, Esq.
   Michael D. Rubenstein, Esq.
   Liskow & Lewis, PLC
   701 Poydras Street, Suite 5000
   New Orleans, Louisiana 70139
   Counsel for Defendant-Applicant,
   Cubic Energy, Inc.

6. Kevin W. Hammond, Esq.
333 Texas Street, Suite 1401
Shreveport, Louisiana 71101
Counsel for Defendant-Applicant,
Tauren Exploration, Inc.

7. Gerald F. Slattery, Jr., Esq.
Slattery, Marino & Roberts
1100 Poydras Street, Suite 1800
New Orleans, Louisiana 70163
Counsel for Defendant-Applicant,
Tauren Exploration, Inc.

by placing a copy of same in the United States Mail, properly addressed and postage pre-paid, on this 8th day of September, 2017.

/s/ PATRICK S. OTTINGER
PATRICK S. OTTINGER

In compliance with Part P., Rule XLII, Section 5(b), of the Rules of the Louisiana Supreme Court, the Registered User filing this pleading hereby states and certifies that he has been authorized to submit this pleading on behalf of those appearers other than the Registered User.

/s/ PATRICK S. OTTINGER
PATRICK S. OTTINGER