PRESENTED AT

43rd Annual Ernest E. Smith
OIL, GAS AND MINERAL LAW INSTITUTE

April 14, 2017
Houston, Texas

Production in Paying Quantities

Charles R. "Skip" Watson

Charles R. "Skip" Watson
Davis, Gerald & Cremer, P.C.
Austin, TX

crwatson@dgclaw.com
512.493-9615

PRODUCTION IN PAYING QUANTITIES

BP v. Laddex

The Supreme Court Revisits the Doctrine It Created

By Charles R. "Skip" Watson

[Lead Counsel to BP America Production Co. in the *Laddex* appeal,
through oral argument in the Texas Supreme Court.]

The problem with legal fictions is that they develop a life of their own. Legal fictions can defeat their intended purpose when we forget they are fictions created to accomplish a specific, limited purpose. That was the analysis employed by BP in *BP America Production Co. v. Laddex, Ltd.,* No. 15-0248, 2017 WL 889920 (Tex. March 3, 2017) to request the Supreme Court of Texas to reexamine the doctrine that it created and implied into oil and gas lease habendum clauses to require that for production to extend a lease beyond its primary term, the production must be in paying quantities.

BACKGROUND

Laddex, a top lessee, had obtained a judgment terminating BP's lease based on jury findings that: (1) The lease "failed to produce in paying quantities" during a 15-month period "from August 1, 2005 to October 31, 2006," and (2) "a reasonably prudent operator would not continue to operate" the only producing well "for the purpose of making a profit" "in the manner in which it was operated" during the same 15-month period. *Id.* at *2.

The Amarillo Court of Appeals had reversed and remanded for a new trial because the jury had been restricted to determining whether the well had "failed" to produce in paying quantities during a period when production had unexpectedly slowed to the point that Laddex's experts, using expenses that were subject to BP's *Robinson* Motion and running objection, opined that the well was unprofitable for those 15 months. *See BP America Prod. Co. v. Laddex*, *Ltd.*, 458 S.W.3d 683 (Tex. App.—Amarillo 2015), *aff'd*, *BP America Prod. Co. v. Laddex, Ltd.* No. 15-0248, 2017 WL 889920 (Tex. Mar. 3, 2017). The problem was that the well's production returned to near normal levels after 15 months. Thus, the well was profitable both before and after the period the jury was required to use to determine production in paying quantities. The court of appeals held that the jury should not have been restricted to considering the period when the well was arguably unprofitable without considering its return to profitability. *Id.* at 688. But in holding the 15-month period "was not reasonable," the court of appeals offered no guidance as to what "reasonable period" should be used upon retrial to determine whether the lease was profitable. BP was therefore forced to look to the Supreme Court for guidance concerning whether any specific period should be used upon retrial.

I assumed that Laddex would be filing a Petition for Review in the Supreme Court seeking reversal and rendition of the trial court's judgment under its theory of the case—that (i) production is a special limitation on the title granted by the lessor, and (ii) because "production" means production in paying quantities, (iii) therefore, only "failure" to produce in paying quantities triggers automatic lease termination if the lease's 60-day temporary cessation clause is not activated. Mindful of Justice Willett's statement that "it falls squarely on this court's shoulders to decide what is actionable in a "court-defined doctrine,'" s*ee Coastal Oil & Gas Corp. v. Garza Energy Trust*, 268 S.W.3d 1, 27 (Tex. 2008) (Willett, J. concurring), BP's Petition for Review contrasted Laddex's theory against the Supreme Court's pronouncements defining and limiting the implied doctrine of production in paying quantities when it was created.

The analysis began with:

(i) Isolating the stated purpose for implying the doctrine's requirements into oil and gas leases;

(ii) Determining how the doctrine was originally applied; and

(iii) Contrasting the purpose and original application with the application in the jury charge in this case.

I. THE PURPOSE OF THE DOCTRINE

In *Garcia v. King*, 164 S.W.2d 509 (Tex. 1942), the Court explained why it created and implied the requirement that to perpetuate a lease upon expiration of its primary term, "production" must be in paying quantities "under normal conditions." *Id.* at 512.

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First appeared as part of the conference materials for the
43rd Annual Ernest E. Smith Oil, Gas and Mineral Law Institute session
"Production In Paying Quantities (PPQ)"