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Holding onto Legacy Leasehold: Cessation of Production and Production in Paying Quantities Issues in the Permian

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I. INTRODUCTION

For more than a decade, land and available leases have been scarce in the most desirable areas of the Permian Basin. As a result, the competition for those leases and the creative ways to assert that prior leases have terminated has continued. From retained acreage fights to claimed lapses in continuous development to disputes over the meaning of various lease provisions, there has been no shortage of lease termination lawsuits, either in terms of quantity or variety. While claims that leases have either completely ceased production or ceased producing in paying quantities are not new, the volume of those claims has increased, particularly in locations where decades of vertical well production has occurred under 1960s and 1970s (and sometimes 1980s) oil and gas leases, some still waiting their turn for horizontal development. With that increase, the issues that arise with production in paying quantities have increased, too.

II. WHERE DID WE START: PRODUCTION MEANS "PRODUCTION IN PAYING QUANTITIES" UNLESS THE LEASE SAYS OTHERWISE

Texas courts have long held that when "production" is used in an oil and gas lease's habendum clause, that production must be in "paying quantities" to perpetuate the oil and gas lease. In *Garcia v. King*, the Texas Supreme Court reasoned that it "must consider the objects and purposes intended to be accomplished by them in entering the contract" in order to interpret the habendum clause's language at issue. 164 S.W.2d 509, 512 (Tex. 1942). There, when first confronted with the issue, the court further stated that the lease's purpose was to "secure development of the property for the mutual benefits of the parties." *Id.* It followed then that (1) Lessors shouldn't suffer a continuation of an oil and gas lease after expiration of the lease's primary term "merely for speculation purposed on the part of the lessees" but that lessees should also be permitted to continue their lease "to allow the lessees to reap the full fruits of their investments made by them in developing the property." *Id.* at 512-13.

The Court then concluded that "if the lease could no longer be operated at a profit, there were no fruits for them to reap, and the object sought to be accomplished by the continuation thereof had ceased," resulting in lease termination. *Id.* at 513. It is this competing tension that the courts, as well as parties, to production-in-paying-quantities disputes have continued to wrestle with—determining whether (& how) a lease has been "operated profitability," "developed for the mutual benefit of both parties," and "operated for purposes other than speculation."

But before continuing on that path, the courts have repeatedly allowed parties to an oil and gas lease to agree to terms that vary from the principle of "production" equals "production in paying quantities" in drafting habendum clauses. For example, the Houston Court of Appeals recently addressed a dispute in which the oil and gas lease's habendum clause (a form frequently encountered in West Texas) provided that it would remain in effect for a three-year primary term and "as long thereafter as operations, as hereinafter defined, are conducted upon said land with no cessation of more than ninety (90) consecutive days." *Thistle Creek Ranch, LLC v. Ironroc Energy Partners*, No. 14-20-0347-CV, 2022 WL 1310957 (Tex. App.—Houston [14th Dist.] May 3, 2022, no pet.). It then defined "operations" as including "production of oil, gas, sulphur, or other minerals, whether or not in paying quantities." The lessee introduced evidence of continuous gas production but conceded that the production had not been profitable. The lessor contended that "production" meant "production in paying quantities." The court of appeals affirmed the trial court and restated the well-known contract and lease principle—a court cannot rewrite the contract to ignore the lease's definition of "operations," which expressly provided that production in paying quantities was not required to perpetuate the lease. As a result, the standard two-prong test was not applicable. Only continuous production was at issue.

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