

HOLDING ONTO LEGACY LEASEHOLD: CESSATION OF PRODUCTION AND PRODUCTION IN PAYING QUANTITIES ISSUES IN THE PERMIAN

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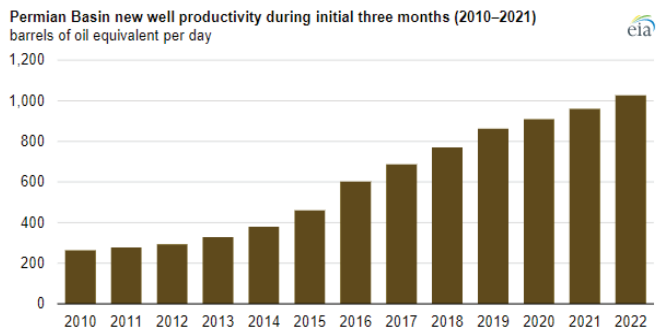
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LAND CONTINUES TO BE KING.

Permian Basin oil and gas output reaches new stage of maturity

Pioneer CEO Scott Sheffield said companies are running out of inventory and are now looking at their inventory of Tier 2 and Tier 3 drilling locations.

Melisa McEwen, MRT.com/Midland Reporter-Telegram
Jan. 17, 2023



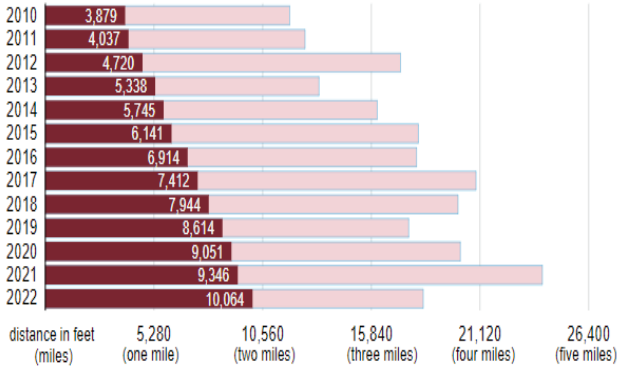
- I. Minimal Open Oil & Gas Leases
- II. Lease Termination Suits Prevail over last 10 years.
- III. Shifting nature of lease termination suits, particularly in Midland Basin.
- IV. Horizontal World

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*PRODUCTION IN PAYING
QUANTITIES:*

Permian Basin annual average and maximum lateral length per well (2010–2022)
year



Data source: Enverus
Note: 2022 values reflect data between January and September.

I. The Beginning

II. The BP Cases

III. Frequent Prong 1 Issues

IV. What about Prong 2?

V. Practical Considerations

I. THE BEGINNING - *GARCIA*

139 Tex. 578
Supreme Court of Texas.

GARCIA et al.
v.
KING et al.

“[C]onsider the objects and purposes intended to be accomplished . . .”

Oil and Gas Lease – “secure development of the property for mutual benefits of the parties.”

- (1) Lessors shouldn't suffer continuation after expiration merely for speculation BUT
- (2) Lessees should be permitted to continue their lease to reap the “full fruits” of their investments made by them in developing the property.”

I. THE BEGINNING - *GARCIA*

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In defining the term 'paying quantities' the court said: 'It has been generally held that 'paying quantities,' when used in this connection, means paying quantities to the lessee. If a well pays a profit, even small, over operating expenses, it produces in paying quantities, though it may never repay its costs, and the enterprise as a whole may prove unprofitable. Ordinarily, the phrase is to be construed with reference to ****512** the operator, and by his judgment when exercised in good faith.'

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I. THE BEGINNING CONT'D – *CLIFTON'S TWO-PRONG TEST*

Prong One: Whether paying production has ceased – has the well paid a profit, however small, over operating and marketing expenses.

Prong Two: If so, whether under all of the relevant circumstances, a reasonably prudent operator would continue to operate . . . In order to make a profit and not merely for speculation.

Prong Two Non-Exhaustive Factors: (1) Depletion of Reservoir; (2) Price; (3) Relative Profitableness of Area Wells; (4) the leases' operating and marketing expenses; (5) net profit; (6) lease provisions; and (7) a reasonable period of time under the circumstances

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