PERPETUATING OIL AND GAS LEASES IN THE PERMIAN BASIN

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I. INTRODUCTION

The Permian Basin in western Texas and eastern New Mexico has long been one of the world's most prolific unconventional oil and gas producing regions. And, due to technological advancements in drilling and completion techniques allowing operators to economically extract hydrocarbons from its low permeability reservoirs, the Permian Basin is currently producing at unprecedented levels.[1] Unsurprisingly, organic oil and gas leases on productive lands have been increasingly difficult to come by in the most desirable regions of the Permian Basin. As competition for sought-after oil and gas leases in this region continues, there has been no shortage of actual and threatened lease termination litigation in Texas, making it more important than ever for operators to be proactive in protecting and maintaining their valuable leasehold interests. The goal of this Article is to identify key concepts and points for operators to evaluate when faced with challenges to the ongoing validity of their oil and gas leases.

This Article starts with a brief discussion of the beginning of the typical oil and gas lease and the nature of interests created thereunder in Part II. Part III examines when and how oil and gas leases terminate, both during and beyond the primary term, with an emphasis on the two-prong production in paying quantities test set forth in *Clifton v. Koontz* and lease termination in the event of a total cessation of production. Part III also discusses the application and effect of certain lease savings clause provisions that operators can utilize to perpetuate their leases in the absence of production or production in paying quantities. Part IV examines legal issues implicated by the practice of "top leasing." Finally, Part V addresses various defenses potentially available to operators faced with lease termination disputes.

II. BEGINNING OF AN OIL AND GAS LEASE

In states like Texas that follow the ownership-in-place theory, courts generally view the lessee's interest under an oil and gas lease as a fee

1. Stephanie Kelly, *U.S. Permian oil output to hit record in December, but gains are slow*, REUTERS (Nov. 14, 2022, 4:18 PM), https://www.reuters.com/business/energy/us-permian-oil-production-due-rise-dec-record-eia-2022-11-14/.

simple determinable estate in the oil and gas in place.[2] Meanwhile, the lessor retains a possibility of reverter.[3] Oil and gas leases almost always contain a habendum clause, which is used to create the property interests owned by the parties to the lease.[4] The habendum or term clause of an oil and gas lease sets the lease's duration.[5] The primary term is a fixed term of years, generally ranging from one to five years, during which the lessee has the right, without the obligation, to explore for oil and gas on the leased premises.[6] The secondary term is an extended period of time the lease is maintained if the lessee develops the leased premises.[7] As typically drafted, an oil and gas lease terminates at the end of its primary term unless the lessee is engaged in operations on, or is producing oil and gas from, the leased premises:

> Subject to the other provisions herein contained this Lease shall be for a term of _____ years from this date (called "primary term") and as long thereafter as oil and gas or other hydrocarbons are being produced from said land or land with which said land is pooled hereunder.[8]

The "thereafter" or "production" language in the habendum clause operates as a special limitation upon the lessee's estate.[9] Production, therefore, is a condition precedent to the extension of the lease beyond the primary term.[10] Consequently, once production ceases in the secondary term (absent an express or implied savings provision), the leasehold estate terminates and the lessor is once again the owner of the fee simple absolute.[11] Texas courts have long held that the meaning of "production" in the habendum clause is synonymous with "production in paying quantities," a concept discussed extensively in Section III.B.1.[12] As outlined below in Section III.B.2 and Section III.C, several exceptions to this general rule exist to rescue a lease from termination, which would otherwise occur upon a cessation of production or failure to produce in paying quantities.

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2. *See, e.g.*, Cherokee Water Co. v. Forderhause, 641 S.W.2d 522, 525 (Tex. 1982).
3. *See, e.g.*, *Nat.* Gas Pipeline Co. of Am. v. Pool, 124 S.W.3d 188, 192 (Tex. 2003).
4. *See* ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 4.3[A] (2d. ed. 2010) [hereinafter SMITH & WEAVER].
5. *Id.*
6. *Id.*
7. *Id.*
8. *Id.*
9. *See, e.g.*, Joshua L. Baker et al., *Everything Old is New Again: Lease Maintenance Issues that Arise When Oil Prices Drop*, 62 ROCKY MOUNTAIN MINERAL L. INST. 20-1, 20-3 (2016).
10. *See id.*
11. Bruce Kramer, *The Temporary Cessation Doctrine: A Practical Response to an Ideological Dilemma*, 43 BAYLOR L. REV. 519, 522–25 (1991).
12. *See, e.g.*, Garcia v. King, 164 S.W.2d 509, 512–13 (Tex. 1942).

III. TERMINATION OF AN OIL AND GAS LEASE

A. Termination During the Primary Term

An oil and gas lease may terminate prior to the end of the primary term if the lease requires that the lessee commence drilling operations within a certain time after the effective date of the lease.[13] The typical form leases used in Texas throughout the twentieth century contained operations and delay rental clauses which required the lessee to commence operations within a certain period, or, alternatively, pay the lessor annual delay rentals for the right to maintain the lease throughout the primary term.[14]

1. Payment of Delay Rentals

Though most oil and gas leases do not expressly obligate the lessee to drill, there are several instances in which the lessee may have an implied duty to do so.[15] Historically, one such duty has been called the implied covenant to drill an initial test well.[16] Because a central goal of the lessee is to have the option, without the obligation, to drill, the implied covenant to drill an initial test well was problematic for lessees.[17] To avoid the implied covenant, some oil and gas leases contain a delay rental clause that expressly provides that the lessee may maintain the lease throughout the primary term, without drilling, by paying periodic delay rentals.[18] The delay rental clause allows the lessee to extend the lease from period to period during the primary term without drilling by paying delay rentals that are usually nominal—often $1.00 per net mineral acre.[19] In general, there are two different types of delay rental clauses: (1) the "unless" clause and (2) the "or" clause.

The "unless" delay rental clause, which was once the most widely used type of delay rental clause in Texas, creates a special limitation whereby the lease will automatically terminate unless a well is commenced or delay rentals are paid.[20] The lessee typically has three options under an "unless" delay rental clause: it can maintain the lease by commencing drilling operations, it can maintain the lease by paying delay rentals, or it can let the lease expire by doing neither.[21]

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13. EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 27.1 (Matthew Bender rev. ed. 1989) [hereinafter KUNTZ, OIL & GAS LAW].
14. *See* SMITH & WEAVER, *supra* note 4, § 4.3[A].
15. KUNTZ, OIL & GAS LAW, *supra* note 13, § 27.1.
16. *See id.*
17. *See* SMITH & WEAVER, *supra* note 4, § 4.3[A].
18. *Id.*
19. *Id.*
20. *Id.* § 4.3[A][1].
21. *Id.*

An alternative to the "unless" delay rental clause is the "or" delay rental clause.[22] Unlike the "unless" clause, an "or" clause does not result in automatic termination upon a failure to commence drilling operations and failure to pay rentals properly.[23] Instead, the "or" clause simply imposes an affirmative duty upon the lessee to either commence drilling, pay rentals, or surrender the lease before the anniversary date.[24] If the lessee does not drill, the lessor is entitled to recover the delay rentals if they have not been paid.[25]

Beginning in the 1980s and commensurate with shorter primary terms, use of the delay rental clause declined in favor of paid up leases, which, if properly drafted, expressly allow the lessee to maintain the lease for the full primary term without being obligated to drill a test well.[26] A well-drafted paid up lease will recite that no rentals are due (or have been pre-paid as part of the lease bonus) and will disclaim the implied covenant to drill an initial test well.[27]

2. Commencement of Drilling

Most leases provide that a lessee may maintain its rights throughout the primary term by commencing a well.[28] Consider the following language contained within an "unless" delay rental clause:

> If operations for drilling are not commenced on said land, or on acreage pooled therewith as above provided for, on or before one year from the date hereof, the Lease shall terminate as to both parties, unless on or before such anniversary date Lessee shall pay . . . the sum of ($___), herein called rentals, which shall cover the privilege of deferring commencement of drilling operations for a period of twelve (12) months.[29]

The majority rule is that the phrases "operations," "operations for drilling," "engaged in drilling operations," and the like, when used in this context, do not require actual drilling.[30] Rather, preparatory activities such as building access roads to the drill site, moving tools and equipment onto the drill site, providing a water supply, and similar activities are generally sufficient so long as they are performed with the bona fide intention to proceed with diligence to the completion of the

22. *Id.* § 4.3[A][2].
23. *Id.*
24. *Id.*
25. *Id.*
26. *Id.* § 4.3[A][3].
27. *Id.*
28. KUNTZ, OIL & GAS LAW, *supra* note 13, § 27.3.
29. SMITH & WEAVER, *supra* note 4, § 4.3[A][1].
30. KUNTZ, OIL & GAS LAW, *supra* note 13, § 32.3[a].

well.[31] Though determining whether the lessee commenced drilling activities during the primary term may be a question of fact, at least one Texas court has ruled on this issue as a matter of law where the lessee selected the location of an oil well, hauled equipment to the drilling site, and provided a water supply for drilling purposes.[32]

B. Termination at the End of the Primary Term or During the Secondary Term

A lease will typically terminate at the end of the primary term if the lessee is not producing oil or gas or has not utilized one of the savings provisions in the lease that excuses or serves as a substitute for lack of production.[33] Even if a lease is held by production into the secondary term, the lease is nevertheless susceptible to termination where a special limitation is implicated.[34] A special limitation terminating the lease will occur if there is a lack of production in paying quantities or if production permanently ceases, i.e., a total cessation of production.[35]

1. Production in Paying Quantities

In states like Texas that require actual production prior to the end of the primary term, a question arose early in the history of the oil and gas industry concerning the amount of production that was required to continue the lease into the secondary term. At the time, the habendum clauses contained in most leases stated that the lease would continue for "so long as oil and gas, or either of them, is produced . . . ."[36] Qualifying words were usually absent. Should any amount of production satisfy the habendum clause and perpetuate the lease? Nearly all jurisdictions, including Texas, have since adopted the rule that production must be "in paying quantities," even where the lease habendum clause does not state as much.[37] The evolution of the production in paying quantities framework in Texas, as well as the two-prong test set forth in *Clifton v. Koontz*, are discussed in turn below.

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31. *Id.* § 32.3[b].

32. McCallister v. Tex. Co., 223 S.W. 859, 861–62 (Tex. App.—Fort Worth 1920, writ ref'd) (holding that drilling operations had started where the lessee selected the location of an oil well, hauled derrick timbers to the site, and selected and provided a water supply for drilling purposes; holding that starting, but not completing, a well constitutes drilling operations); *see also* Petersen v. Robinson Oil & Gas Co., 356 S.W.2d 217, 220 (Tex. App.—Houston 1962, no writ); Terry v. Tex. Co., 228 S.W. 1019, 1019 (Tex. App.—Fort Worth 1920, no writ).

33. *See, e.g.*, BP Am. Prod. Co. v. Red Deer Res., LLC, 526 S.W.3d 389, 394 (Tex. 2017).

34. Kramer, *supra* note 11, at 527–28.

35. *See id.*

36. *See, e.g.*, Garcia v. King, 164 S.W.2d 509, 512–13 (Tex. 1942).

37. *Id.*

a. Beginning of the Modern Standard

Aycock v. Parraffine Oil Co., a 1919 case decided by the Beaumont Court of Appeals, offers one of the first definitions of "paying quantities" in Texas.[38] In *Aycock*, the court held the following:

> The term 'paying quantities,' as used in an oil lease for a given term and as much longer as oil can be produced in paying quantities, means paying quantity to the lessee. If the well pays a profit, even small, over operating expenses, it produces in paying quantities, though it may never repay its cost, and the operation as a whole may result in a loss.[39]

In reaching this decision, the *Aycock* court cited language from the Indiana Supreme Court's 1905 holding in *Manhattan Oil Co. v. Carrell*, declaring that "whether oil was found in paying quantities is to be exclusively determined by the operator, acting in good faith."[40]

Twenty-three years later, the Supreme Court of Texas built upon the production in paying quantities standard in *Garcia v. King*.[41] There, the plaintiff-lessor and defendant-lessees entered into an oil and gas lease that was to last for a period of ten years and "so long thereafter as oil, gas, and other minerals is produced from said land."[42] The central issue was whether the phrase "produced," in fact, meant "produced in paying quantities."[43] At the expiration of the primary term, only twenty-four barrels of oil per month were being produced.[44] The revenue the defendant-lessees received from this production was insufficient to yield a profit over and above their operating and marketing expenses.[45] The court reasoned that "all of the producing wells on the lease in question at the time of the termination of the primary term were not producing enough oil or gas to pay a profit over and above the cost of operating the wells."[46] It then stated that:

> So far as the lessees were concerned, the object in providing for a continuation of the lease for an indefinite time after the expiration of the primary period, was to allow the lessees to reap the full fruits of the investments made by them in developing the property.

38. Aycock v. Parraffine Oil Co., 210 S.W. 851, 852 (Tex. App.—Beaumont 1919, no writ).
39. *Id.* at 852–53 (citations omitted).
40. *Id.* at 853 (citing Manhattan Oil Co. v. Carrell, 73 N.E. 1048, 1048 (Ind. 1905)).
41. *Garcia*, 164 S.W.2d at 509.
42. *Id.* at 510.
43. *Id.*
44. *Id.*
45. *Id.*
46. *Id.* at 512.

> Obviously, if the lease could no longer be operated at a profit, there were no fruits for them to reap. The lessors should not be required to suffer a continuation of the lease after the expiration of the primary period merely for speculation purposes on the part of the lessees.[47]

Because none of the wells were yielding a profit to the lessees at the expiration of the primary term "under normal conditions," the court held that "the object sought to be accomplished by the continuation [of the lease] had ceased," and that the lease therefore terminated.[48] In the Court's view, the small amount of revenue the lessees could expect to earn in the future could not perpetuate the lease, and instead suggested that the lessees were attempting to hold the lease for speculative purposes only.[49] *Garcia* therefore stands for the proposition that production in paying quantities from a well is required to maintain an oil and gas lease; production alone—without a profit—is insufficient.[50]

b. The Two-Pronged Test: *Clifton v. Koontz*

In 1959, the Supreme Court of Texas expanded the production in paying quantities doctrine to its modern-day application, adopting a two-prong approach in *Clifton v. Koontz* to determine whether the lessee has maintained production in paying quantities sufficient to perpetuate its lease.[51] The *Clifton* two-prong approach—discussed in detail below—is still recognized today as the applicable standard for resolving production in paying quantities disputes in Texas.[52]

i. Prong One

The first step in the *Clifton* approach requires a determination of whether a well on the lease generated a profit over a reasonable period of time.[53] If the well turns a profit over a reasonable time period, the well is producing in paying quantities, even if it could never repay the initial capital costs or make the entire enterprise profitable.[54] In articulating this first prong, the *Clifton* court followed the holding in *Aycock* and held that profit or loss should be determined by deducting operating and marketing costs and excluding initial capital costs.[55] The court recognized that "[t]he underlying reason for this definition

47. *Id.* at 512–13.
48. *Id.* at 513.
49. *Id.* at 512–13.
50. *See id.*
51. Clifton v. Koontz, 325 S.W.2d 684, 688–92 (Tex. 1959).
52. *See, e.g.*, BP Am. Prod. Co. v. Red Deer Res., LLC, 526 S.W.3d 389, 394 (Tex. 2017).
53. *Clifton*, 325 S.W.2d at 690–91.
54. *Id.*
55. *Id.* at 692.

appears to be that when a lessee is making a profit over the actual cash he must expend to produce the lease, he is entitled to continue operating in order to recover the expense of drilling and equipping, although he may never make a profit on the over-all operation."[56] The Court also made clear that the party seeking to terminate the lease (i.e., not the lessee) bears the burden of proof on prong one of the *Clifton* analysis.[57]

1. Revenue

The revenue component under the first prong of the *Clifton* test is relatively straightforward. As *Clifton* indicates, all income, including any overriding royalties, attributable to the lessee's working interest as established by the lease is included in the calculation.[58] Thus, only income attributable to the lessor's mineral royalty is excluded.[59]

2. Expenses

As *Clifton* states, it is well-settled that capital costs incurred in the acquisition of the lease, as well as the initial costs of drilling and equipping the well, are not considered in determining whether the lease is producing in paying quantities.[60] These expenses are irrelevant because they have already been incurred before the time that the lessee decides to produce. In assessing whether a lessee is acting as a reasonable prudent operator in continuing to operate the lease, sunk expenses are not instructive. Even though such expenses may never be recovered, the prudent operator will continue to operate so long as operating revenues exceed regular, recurring operating costs because operating will reduce the ultimate loss on the venture.

Only regular, recurring direct costs of continued production, i.e., operating and marketing expenses, are considered under prong one of the paying-quantities test.[61] But what are operating and marketing costs? An expenditure's classification as a capital or operating/marketing expense is generally determined by whether it is ordinary and recurring, in which case the expense is a lease operating expense, or largely nonrecurring in nature, in which case the expense is ordinarily considered to be a capital cost.[62] Operating and marketing expenses generally include ordinary labor, trucking, transportation expenses, minor repairs, production taxes, and license and permit fees.[63] These are direct costs

56. *Id.*
57. *Id.* at 690.
58. *Id.* at 692–93.
59. *Id.* at 693.
60. *Id.*
61. SMITH & WEAVER, *supra* note 4, § 4.4[A][2][a].
62. *Id.*
63. *See, e.g.*, Skelly Oil Co. v. Archer, 356 S.W.2d 774, 781–82 (Tex. 1961).

of producing a well, which generally involves the actual taking of oil or gas from a well in a captive state for either storing or marketing the product for sale.

Reworking costs, on the other hand, do not constitute expenses under the first prong of the *Clifton* test.[64] The term "reworking" has been described as those types of activities that are designed and conducted on a well in an effort to restore production or to enhance production in paying quantities from an existing well.[65] These are one-time expenditures and are treated as capital expenditures to be recouped over time, if ever.[66] In *Pshigoda v. Texaco, Inc.*, for example, the Amarillo Court of Appeals held that an expenditure to plug a leak in a well's casing was an expense analogous to initial drilling and, therefore, a capital expense, not an operating expense.[67]

Overhead charges and depreciations on salvageable equipment may in certain situations also be taken into account, yet the challenge of the lessor accurately establishing and allocating such expenses will often make them impractical to consider.[68] Overhead expenses must be directly and accurately allocated to the specific well or wells at issue.[69] In *Ladd Petroleum Corp. v. Eagle Oil & Gas*, the Fort Worth Court of Appeals suggested that such expenses may only be allocated to a well to the extent they would actually be reduced by the elimination of the well.[70] Similarly, although depreciation of pumps and other salvageable equipment may, in some circumstances, be treated as operating costs, the Supreme Court of Texas has noted that the "proof may be difficult and the reduction in value [of salvageable equipment] may be slight."[71] The Corpus Christi-Edinburg Court of Appeals has construed this language to mean that, in order for depreciation to be considered as part of the production in paying quantities analysis, the depreciation must be based on the actual cost of the equipment rather than its replacement cost or market value, and the cost must be spread out over its years of service.[72]

64. *See, e.g.*, Pshigoda v. Texaco, Inc., 703 S.W.2d 416, 417 (Tex. App.—Amarillo 1986, writ ref'd).
65. 31 TEX. ADMIN. CODE ANN. § 9.31(b)(8) (West 2018).
66. *See Pshigoda*, 703 S.W.2d at 417; SMITH & WEAVER, *supra* note 4, § 4.4[A][2][a].
67. *Pshigoda*, 703 S.W.2d at 417.
68. *See Skelly Oil Co.*, 356 S.W.2d at 781; SMITH & WEAVER, *supra* note 4, § 4.4[A][2][a].
69. *See Skelly Oil Co.*, 356 S.W.2d at 781.
70. Ladd Petroleum Corp. v. Eagle Oil & Gas Co., 695 S.W.2d 99, 108–09 (Tex. App.—Fort Worth 1985, writ ref'd n.r.e.).
71. *See Skelly Oil Co.*, 356 S.W.2d at 781; SMITH & WEAVER, *supra* note 4, § 4.4[A][2][a].
72. Evans v. Gulf Oil Corp., 840 S.W.2d 500, 504-05 (Tex. App.—Corpus Christi-Edinburg 1992, pet. denied).

3. Reasonable Time Period

As discussed, prong one of the *Clifton* analysis must be considered over a reasonable period of time.[73] The reasonable period of time inquiry is one of the more contested issues in production in paying quantities disputes. Unless the lease defines the period for which production in paying quantities is to be measured, there can be no arbitrary limit on the time period considered and the unique circumstances of each case often dictate what is, or is not, a reasonable period of time.[74] While the issue must necessarily be decided by the fact finder on a case-by-case basis, Texas courts have found periods of eight,[75] twelve,[76] thirteen,[77] and fourteen months[78] to be reasonable under the circumstances.

One of the shortest periods of time found to be reasonable by a Texas court was the eight-month period at issue in *Garcia v. King*.[79] The Court noted that it was "dealing with a situation in which under normal conditions, all of the producing wells on the lease in question at the time of the termination of the primary period were not producing enough oil or gas to pay a profit over and above the cost of operating the wells."[80] The Court held that the eight-month period covering the months where operations were conducted by a contractor being paid the working interest share of production was reasonable.[81] Under the circumstances presented in that case, nothing was going to make the lease more profitable because the contract price for operation was 100 percent of the working interest revenue even before ad valorem taxes were paid.[82]

In *BP America Production Co. v. Laddex, Ltd.*, the Supreme Court of Texas addressed challenges to a jury charge concerning the reasonable period of time question in a dispute over production in paying quantities.[83] The lease in *Laddex* had a five-year primary term and a secondary term continuing thereafter so long as oil and gas was being produced.[84] The lessee drilled a single well on the lease.[85] In 2005,

73. Clifton v. Koontz, 325 S.W.2d 684, 690–92 (Tex. 1959).
74. *Id.*; *see also* Ridenour v. Herrington, 47 S.W.3d 117, 121–22 (Tex. App.—Waco 2001, pet. denied); Peacock v. Schroeder, 846 S.W.2d 905, 908–09 (Tex. App.—San Antonio 1993, no writ); Fick v. Wilson, 349 S.W.2d 622, 625 (Tex. App.—Texarkana 1961, writ ref'd n.r.e.).
75. Garcia v. King, 164 S.W.2d 509, 510 (Tex. 1942).
76. *Peacock*, 846 S.W.2d at 909–10.
77. Ballafonte v. Kimbell, 373 S.W.2d 119, 121 (Tex. App.—Fort Worth 1963, writ ref'd n.r.e.).
78. Pshigoda v. Texaco, Inc., 703 S.W.2d 416, 419 (Tex. App.—Amarillo 1986, writ ref'd).
79. *Garcia*, 164 S.W.2d at 510.
80. *Id.* at 512.
81. *Id.* at 510.
82. *Id.* at 511–13.
83. BP Am. Prod. Co. v. Laddex, Ltd., 513 S.W.3d, 476, 485–86 (Tex. 2017).
84. *Id.* at 477–78.
85. *Id.* at 478.

production from the well began to decline.[86] In 2006, after fifteen months of decline, production from the well was restored to its pre-slowdown levels.[87] In 2007, Laddex entered into a top lease with the lessors and filed suit, claiming that the well ceased to produce in paying quantities during the production decline and that the original lease had therefore terminated.[88] The jury found in favor of Laddex, and the court held that the lease had terminated.[89] BP appealed.[90] The Supreme Court of Texas considered whether the trial court erred by limiting the jury's inquiry to a specific fifteen-month period from August 1, 2005 to October 31, 2006.[91] BP objected to this question at trial, claiming that the fifteen-month period did not allow the jury to consider profitability over a "reasonable time."[92] The Supreme Court of Texas agreed with BP and remanded for a new trial, concluding that "narrowing the question on paying production to any particular period is necessarily 'arbitrary.'"[93] Consistent with *Laddex*, there are no bright-line tests for what constitutes a reasonable period of time over which a well's profits are to be measured under the first prong of the *Clifton* analysis. Rather, this issue must necessarily be decided on a case-by-case basis under the unique facts and circumstances presented.

ii. Prong Two

The *Clifton* court's second prong, which is only reached after a finding that the well failed to return a profit over a reasonable period of time, requires the fact finder to determine if a reasonable and prudent operator would continue to operate the well under the circumstances presented.[94] In articulating this second prong, the *Clifton* court expanded upon the rationale in *Aycock*, affording discretion to the lessee in assessing whether or not the well is profitable.[95]

The *Clifton* court identified several factors that may be considered in addressing prong two. These factors include:

> The depletion of the reservoir and the price for which the lessee is able to sell his product, the relative profitableness of other wells in the area, the operating and marketing costs of the lease, his net profit, the lease provisions, a reasonable period of time under the

86. *Id.*
87. *Id.*
88. *Id.*
89. *Id.* at 478–79.
90. *Id.* at 484–85.
91. *Id.*
92. *Id.* at 486.
93. *Id.* at 485–86 (citations omitted).
94. *See, e.g.*, Clifton v. Koontz, 325 S.W.2d 684, 690–92 (Tex. 1959).
95. *See id.*

> circumstances, and whether or not the lessee is holding the lease merely for speculative purposes.[96]

Critically, this list is non-exhaustive, and nothing in *Clifton* supports the conclusion that these factors are exclusive. Indeed, the Court noted that these are just "some of the factors" to be considered in the analysis.[97] Like the first prong, the second prong is also measured over a reasonable period of time presented by the evidence, which cannot, as a matter of law, be restricted to an arbitrary period of time without violating *Clifton* and *Laddex*.[98] The party seeking lease termination also bears the burden of proof on prong two.

If the answer to the second prong is "yes," then the lessee may continue operating the well in the manner in which it has previously been operated without risking lease termination.[99] If the answer is "no," however, the lessee must commence drilling or re-working operations as contemplated in any lease savings clause in order to restore production from the lease, or else risk having the lease terminate under its terms.[100]

c. Proper Unit of Measurement

Disagreement sometimes arises regarding the proper unit of measurement for performing the production in paying quantities analysis. For example, must the lessee produce both oil *and* gas in paying quantities to perpetuate the leasehold, or is the production of either substance, considered alone, sufficient? Relatedly, where there is more than one well situated on the lease, must the entire lease be profitable in the aggregate, or will the lease be extended so long as there is at least one profitable well on the lease?

As to the oil *or* gas issue, all of the commentators that have addressed the issue unanimously agree that the production of either oil *or* gas in paying quantities should perpetuate the typical oil and gas lease beyond the primary term.[101] As the authors of the Kuntz Oil and Gas Law treatise point out, the typical habendum clause references oil and gas in the disjunctive.[102] Under such a clause, the lessee is not required to produce both oil and gas in order to perpetuate the lease as to both substances.[103] It would therefore be illogical to require that both

96. *Id.* at 691.
97. *Id.*
98. *Id.* at 690–91.
99. SMITH & WEAVER, *supra* note 4, § 4.4[A][1].
100. *Id.*
101. KUNTZ, OIL & GAS LAW, *supra* note 13, § 26.7[t]; 3 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW § 604.6(g) (2023) [hereinafter 3 WILLIAMS & MEYERS].
102. KUNTZ, OIL & GAS LAW, *supra* note 13, § 26.7[t].
103. *Id.*

oil and gas be produced in paying quantities in order to perpetuate the typical oil and gas lease:

> In most oil and gas leases, the habendum clause refers to oil and gas in the disjunctive in connection with the requirement of production, and it is not necessary that both oil and gas be found and produced under such a clause in order to extend the lease as to both substances. If production of oil in paying quantities will satisfy the habendum clause as to both oil and gas if no gas is produced, it should necessarily follow that the production of oil in paying quantities will satisfy the habendum clause even though gas is also produced but in quantities less than paying quantities. Conversely, it should also necessarily follow that the production of gas in paying quantities will satisfy the habendum clause of the lease even though oil is produced but in quantities less than paying quantities. In such a situation it would be nothing short of ridiculous to require the lessee to forego producing the substance which is produced unprofitably in order to hold the lease.[104]

The authors of the Kramer and Martin Oil and Gas Law treatise share this same understanding, agreeing that where a lease calls for production of "oil *or* gas, the leasehold should not be held to terminate so long as production of either oil *or* gas is at a profit."[105] Drawing on "strong policy reasons," the treatise authors suggest that this same rule should apply even in cases where the habendum clause reads "oil *and* gas."[106] The authors of this Article agree that, absent express lease language to the contrary, the production of either oil or gas in paying quantities will perpetuate the entire lease as to all leased substances. A different rule would effectively require lessees to cease producing whichever mineral is being produced at a loss to maintain their leases, which would run counter to Texas's longstanding policy of encouraging the maximum recovery of minerals.

These same commentators also agree that the production in paying quantities test should be conducted on a well-by-well basis rather than a summed lease-wide basis.[107] That is, so long as there is at least one well on the lease that is producing oil or gas in paying quantities, the

104. *Id.*

105. 3 WILLIAMS & MEYERS, *supra* note 101, § 604.6(g) (emphasis in original).

106. *Id.* (emphasis in original).

107. KUNTZ, OIL & GAS LAW, *supra* note 13, § 26.7[t]; 3 WILLIAMS & MEYERS, *supra* note 101, § 604.6(g).

lease should remain in full force and effect even if the presence of one or more unprofitable wells renders the lease unprofitable as a summed whole. As the authors of the Kramer and Martin Oil and Gas Law treatise put it:

> [S]o long as any well on the premises operates at a profit, the lease should not be held to terminate automatically, even if operations on the entire leasehold are at a loss, since a contrary holding occasions economic waste to our society by placing a premium on the closing down of wells which by reason of factors believed by the lessee to be temporary in character are operating at a loss.[108]

The authors of the Kuntz Oil and Gas Law treatise also write that a well-by-well approach is appropriate:

> [I]t would appear to be immaterial that the entire operation is unprofitable . . . if one well is producing in paying quantities although another well or wells may be operating at a loss. If the lessee chooses, for reasons of his own, to engage in a concurrent losing operation on the lease which cancel out his profit . . . from any well or wells, it should be his privilege to do so.[109]

The authors of this Article likewise agree that only one well, if producing in paying quantities, is needed to perpetuate the typical oil and gas lease. A rule requiring courts to decide the production in paying quantities question on a summed lease-wide basis rather than a well-by-well basis would discourage successful operators from expending resources to make additional wells productive after obtaining production in paying quantities from a single well—lest their actual production in paying quantities be rendered "unproductive" by activity on *other* wells. Such a result would be especially egregious in states like Texas that impose an implied obligation on operators to continue to develop the leasehold and produce oil or gas with reasonable diligence.[110] Moreover, where more than one lessee is operating on the same lease, utilizing a lease-basis approach would improperly hold every lessee responsible for the actions of other lessees over which they have no control—and who may have competing leasehold interests.[111] It would also have the absurd effect of punishing a lessee that

108. 3 WILLIAMS & MEYERS, *supra* note 101, § 604.6(g).

109. KUNTZ, OIL & GAS LAW, *supra* note 13, § 26.7[t].

110. *See, e.g.*, W.T. Waggoner Est. v. Sigler Oil Co., 19 S.W.2d 27, 29 (Tex. 1929).

111. *See* Cox v. Sinclair Gulf Oil Co., 265 S.W. 196, 201 (Tex. App.—Austin 1924, writ ref'd n.r.e.) ("The issue of whether one assignee failed to properly and reasonably develop his portion of the lease

drills and operates multiple wells, even though operating multiple wells on a single leasehold benefits the royalty-collecting lessor, as well as the tax-collecting State of Texas.

d. Capable of Producing in Paying Quantities

Earlier oil and gas leases sometimes provided that the lease "shall remain in force for a term of (1) year and as long thereafter as gas is or can be produced."[112] Under such a habendum clause, it was unclear whether actual production was required to perpetuate the lease, or whether the discovery of gas with the capability of producing gas was sufficient.[113] The Supreme Court of Texas analyzed a lease with identical language in *Anadarko Petroleum Corp. v. Thompson*, and, utilizing a plain-meaning approach to the construction of the habendum clause, concluded that actual production in paying quantities was not required.[114] In addition to the language quoted above, the lease also provided that, "if production ceases for any reason, the lease 'shall not terminate provided lessee resumes operations for drilling a well within sixty (60) days from such cessation.'"[115] Production from a gas well began in 1936, but it completely ceased for sixty-one days in 1981 and ninety-one days in 1985 while the gas purchasers conducted pipeline repairs.[116] The lessor filed suit, insisting that the lease expired due to a cessation of production.[117] According to the Court, the "is or can be produced" language evidenced the parties' intention to allow the lease to be maintained for as long as the well was capable of producing in paying quantities.[118] In siding with the lessee, the Court defined the phrase "capable of production" as "a well that will produce . . . if the well is turned 'on,' and it begins flowing, without additional equipment or repair."[119] Consistent with *Thompson*, a well is therefore capable of production if it will produce in paying quantities, if it does not need additional equipment or repairs to begin flowing, and if it is located sufficiently close to transportation or storage facilities that it will be economically feasible to market production.[120]

The Waco Court of Appeals applied the *Thompson* rationale in *Blackmon v. XTO Energy, Inc*, holding that the absence of processing

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cannot as a rule affect the other assignees or the lease as whole, after title and the right to develop has been vested in them.").

112. 3 WILLIAMS & MEYERS, *supra* note 101, § 603.3(g).

113. *See id.*

114. Anadarko Petroleum Corp. v. Thompson, 94 S.W.3d 550, 554, 558 (Tex. 2002).

115. *Id.* at 553.

116. *Id.*

117. *See id.*

118. *Id.* at 555.

119. *Id.* at 558.

120. *See id.* at 557–58.

facilities necessary to improve the quality of gas and make it marketable does not render a well incapable of production in paying quantities if the well is connected to a pipeline and can produce gas merely by being turned on.[121] There, the lessor argued that the well was not capable of producing because it needed additional equipment and repairs before it could produce marketable gas.[122] In rejecting this proposition, the appellate court reasoned that the *Thompson* Court's reference to additional equipment or repairs concerned equipment or repairs needed to bring raw gas to the wellhead—not equipment installed downstream to refine the gas into a marketable product.[123]

2. Total Cessation of Production

The production in paying quantities test only applies in instances where there is at least some production on the lease.[124] But what if the lease ceases producing entirely? Does the lease terminate automatically for lack of production? This issue is particularly important in states like Texas that treat the leasehold interest as a determinable interest, which terminates when production stops during the secondary term.[125] The reality is that oil and gas wells, by their nature, do not produce constantly. Inevitably, there are cessations of production from time to time due to mechanical breakdowns, market conditions, reworking operations, formation particularities, or other problems.

Acting on the premise that the parties must have contemplated that production interruptions would occur from time to time, courts in several states, including Texas, generally recognize an implied lease term, the temporary cessation of production doctrine, which applies when a lease completely ceases production.[126] In determining whether to utilize the temporary cessation of production doctrine, Texas courts have historically considered the following three factors: (1) the cause of the cessation, (2) the duration of the cessation, and (3) whether the lessee exercised diligence in restoring production.[127]

a. Cause of the Cessation

Historically, Texas courts reserved the temporary cessation of production doctrine for instances in which the cause of the cessation was sudden or unavoidable.[128] In *Scarborough v. New Domain Oil and Gas*

121. Blackmon v. XTO Energy, Inc., 276 S.W.3d 600, 603 (Tex. App.—Waco 2008, no pet.).
122. *Id.*
123. *Id.*
124. BP Am. Prod. Co. v. Red Deer Res., LLC, 526 S.W.3d 389, 395-96 (Tex. 2017).
125. *See, e.g.*, *Anadarko Petroleum Corp.*, 94 S.W.3d at 554.
126. SMITH & WEAVER, *supra* note 4, § 4.4[B][1].
127. Kramer, *supra* note 11, at 549.
128. *Id.* at 531; *see also* Watson v. Rochmill, 155 S.W.2d 783, 784 (Tex. 1941); Scarborough v. New Domain Oil & Gas Co., 276 S.W. 331, 335-36 (Tex. App.—El Paso 1925, writ dism'd w.o.j.).

Co., for example, one of the earliest Texas cases where a court applied the temporary cessation of production doctrine, the court reasoned that the cause of the cessation—collapsed casing resulting in the loss of the well—was "unforeseen and unavoidable."[129] Sixteen years later in *Watson v. Rochmill*, the Supreme Court of Texas, citing *Scarborough*, held that the doctrine applies where the cessation is "due to sudden stoppage of the well or some mechanical breakdown of the equipment used therewith, or the like."[130] The lease at issue in *Watson* terminated because the stoppage was not temporary in nature and was not brought about by mechanical breakdowns or other conditions in connection with the well or associated equipment.[131] Rather, no oil or gas was produced because, according to the lessee, there was no market for production.[132] Over time, Texas courts slowly expanded application of the doctrine beyond the sudden and unavoidable breakdowns envisioned in *Scarborough* and *Watson*. Indeed, voluntary cessations based on maintenance, reworking, and even litigation have since been found to satisfy the "cause" requirement.[133]

The Supreme Court of Texas's 2004 decision in *Ridge Oil Co., Inc. v. Guinn Investments, Inc.* casts doubt on the ongoing relevance of the "cause" requirement in the temporary cessation of production analysis.[134] In that case, a lessee who had acquired an assignment of a portion of a lease where there were no producing wells attempted to utilize the temporary cessation of production doctrine against the lessee of the other portion of the leasehold.[135] The production that perpetuated the lease was from wells on this second portion, and the lessee of this second portion turned off the pumps in order to wash out the other lessee's interest by terminating the lease.[136] The Court ruled that the temporary cessation of production doctrine did not apply because cessation of production under the old lease became permanent after the new leases took effect.[137] Specifically, the Court stated that the doctrine had not been limited to situations in which there was a "sudden stoppage of the well," such as an equipment breakdown, and agreed with the lower court that "foreseeability and avoidability are not essential elements" of the temporary cessation of production doctrine.[138] Following *Ridge*

129. *Scarborough*, 276 S.W. at 336.
130. *Watson*, 155 S.W.2d at 784.
131. *Id.*
132. *Id.*
133. *See* Amoco Prod. Co. v. Braslau, 561 S.W.2d 805, 809–10 (Tex. 1978); Midwest Oil Corp. v. Winsauer, 323 S.W.2d 944, 946 (Tex. 1959); Stuart v. Pundt, 338 S.W.2d 167, 167 (Tex. App.—San Antonio 1960, writ ref'd).
134. *See* Ridge Oil Co., Inc. v. Guinn Inv., Inc., 148 S.W.3d 143, 150–51 (Tex. 2004).
135. *Id.* at 148–49.
136. *Id.* at 147–48.
137. *Id.* at 151–53.
138. *Id.* at 152.

Oil Co., at least one Texas commentator has questioned whether the "cause" requirement still exists at all or whether lessees will be precluded from relying on the doctrine if they cannot establish why production ceased.[139]

b. Duration of the Cessation

As the name implies, the temporary cessation of production doctrine does not apply unless the cessation is, in fact, temporary in nature—meaning there must eventually be production again.[140] As it stands, the lessee must remedy the problem and otherwise obtain renewed production within a reasonable time.[141] What constitutes a "reasonable time" is a fact-intensive inquiry that depends, in part, on the reason for the stoppage.[142] In *Cobb v. Natural Gas Pipeline Co.*, the United States Court of Appeals for the Fifth Circuit, applying Texas law, held that the doctrine applied where there was a nine-month cessation of production and then a two-month delay in reworking operations.[143] And in *Midwest Oil Corp. v. Winsauer*, the Supreme Court of Texas applied the doctrine even though there was a cessation totaling 174 days.[144] On the other hand, periods as short as two months and as long as five months have been deemed impermissible and resulted in lease termination where the cessation was not the result of a mechanical breakdown or similar event.[145]

c. Diligence in Restoring Production

The lessee's diligence in working to regain production is another important factor courts consider in determining whether the lessee can utilize the temporary cessation of production doctrine.[146] Where the lessee proceeds expeditiously and in good faith to restore production, courts will likely hold that the doctrine applies.[147] *Amoco Production Co. v. Braslau*, a 1978 Supreme Court of Texas case, demonstrates the point.[148] In *Braslau*, a multiple completion well had exhausted two of the four potential producing reserves.[149] Production ceased and work

139. *See* Mitchell E. Ayer et. al., *Recent Case Summaries*, 29 TEX. STATE BAR SEC., OIL, GAS, & ENERGY RES. REP. 70, 71–72 (2004) (explaining that the court's decision turned not on the issues of habendum clauses in leases covering separate tracts or the temporary cessation of production doctrine, but rather upon the fact that Ridge Oil Co. released its 1937 lease and took new leases).

140. SMITH & WEAVER, *supra* note 4, § 4.4[B][1].

141. *Id.*

142. *See, e.g.*, Cobb v. Nat. Gas Pipeline Co. of Am., 897 F.2d 1307, 1309 (5th Cir. 1990).

143. *Id.* at 1311–12.

144. Midwest Oil Corp. v. Winsauer, 323 S.W.2d 944, 946-48 (Tex. 1959).

145. *See, e.g.*, Bradley v. Avery, 746 S.W.2d 341, 343–441 (Tex. App.—Austin 1988, no writ); *see also* Red River Res., Inc. v. Wickford, Inc., 443 B.R. 74, 82–83 (E.D. Tex. 2010).

146. *See* Kramer, *supra* note 11, at 537.

147. SMITH & WEAVER, *supra* note 4, § 4.4[B][1].

148. Amoco Prod. Co. v. Braslau, 561 S.W.2d 805, 805 (Tex. 1978)

149. *Id.* at 807.

was immediately begun to move up the wellbore and recomplete in the two remaining productive zones.[150] The lessee encountered mechanical difficulties and the well's casing collapsed.[151] Thereafter, the lessee secured Texas Railroad Commission (RRC) approval to drill a new well into the two productive strata.[152] Altogether, production ceased for a three-month period.[153] The Court nevertheless held that the temporary cessation of production doctrine applied and perpetuated the lease because, under the facts presented, the lessee acted with "due diligence" in restoring production after the stoppage.[154]

In short, the common law temporary cessation of production doctrine remains a viable avenue for perpetuating an oil and gas lease that has ceased producing altogether. Though the doctrine once applied in narrow, limited circumstances where the cessation was unforeseeable and/or the result of a mechanical breakdown, the Supreme Court of Texas arguably dispensed with the cause requirement in *Ridge Oil Co.*, potentially expanding Texas's version of the temporary cessation of production doctrine. Though immediate efforts that do, in fact, restore production within a reasonable period of time will usually permit the lessee to utilize the doctrine, the test is inherently fact-intensive and dependent on the circumstances presented in each particular case.

C. Savings Clauses

Although the habendum clause generally controls the lease's duration, other clauses may extend the term of the lease. The category of clauses that might extend the duration of an oil and gas lease beyond the primary term in the absence of production or production in paying quantities, which are generally known as "savings clauses," include, among other clauses, the dry hole clause, the shut-in clause, the cessation of production clause, and the force majeure clause, each of which are discussed in turn below. All of these clauses work successively and repeatedly to aid the lessee in maintaining the lease for its entire economic life.

1. Dry Hole Clause

The dry hole clause allows the lessee to keep a lease alive after the drilling of a dry hole provided that the lessee commences drilling operations for an additional well within a certain period of time.[155] Dry hole clauses account for the speculative nature of oil and gas

150. *Id.*
151. *Id.*
152. *Id.*
153. *Id.*
154. *Id.* at 809–10.
155. 3 WILLIAMS & MEYERS, *supra* note 101, § 612.

exploration and give the lessee additional time to attempt to obtain production.[156] An example of a common dry hole clause follows:

> If at any time prior to the discovery of oil or gas on this land and during the term of this lease, the lessee shall drill a dry hole, or holes on this land, this lease shall not terminate, provided operations for the drilling of a well shall be commenced by the next ensuing rental payment date, or provided the lessee begins or resume the payment of rental in the manner and amount hereinabove provided, and in this event the preceding paragraph hereof governing the payment of rentals and the manner and effect thereof shall continue in force.[157]

To utilize the dry hole clause, the lessee must have completed a well that qualifies as a dry hole—i.e., the well does not produce oil or gas.[158] A well that is capable of producing oil or gas but is not capable of producing oil or gas in paying quantities does not qualify as a dry hole.[159] Moreover, when a unit is pooled for the production of gas only, but the lessee drills a well that produces oil instead of gas, the lessee cannot use the dry hole clause to hold the lease in effect beyond the primary term.[160]

2. Shut-in Clause

In Texas, a well that is shut in waiting for a pipeline connection to make actual production possible will not maintain a lease absent express language to the contrary.[161] Most modern oil and gas leases therefore contain a shut-in clause, providing that that the lease will be maintained if a well capable of producing is shut in. If the shut-in clause only requires a well "capable of production," Texas courts will imply a requirement that such well be capable of producing in paying quantities at the time the well is shut in.[162] This rule applies even where the shut-in clause makes no reference to paying production.[163]

In *BP America v. Red Deer Resources,* the Supreme Court of Texas addressed, for the first time, the "capable of production" issue in the shut-in well context.[164] In *Red Deer*, the top lessee brought a lease

156. *Id.*
157. *Id.* § 613.
158. *See* Rogers v. Osborn, 261 S.W.2d 311, 312–14 (Tex. 1953).
159. *See id.*
160. Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798, 802 (Tex. 1967).
161. SMITH & WEAVER, *supra* note 4, § 4.5[C][1].
162. *See, e.g.*, Hydrocarbon Mgmt. v. Tracker Expl., 861 S.W.2d 427, 432–33 (Tex. App.—Amarillo 1993, no writ).
163. *Id.* at 433.
164. *See, e.g.*, BP Am. Prod. Co. v. Red Deer Res., LLC, 526 S.W.3d 389, 395–400 (Tex. 2017).

termination action against the base lessee.[165] When the base lessee acquired the lease in 2000, the Vera Murray #11 Well was still producing.[166] In May 2012, the well experienced a seven-day period with no production.[167] On June 12, 2012, the base lessee turned off the well valve.[168] The following day, the base lessee sent notice to the lessors that it was invoking the shut-in royalty clause, enclosing checks for the shut-in royalty owed.[169] On the shut-in checks, the base lessee designated June 13, 2012 as the beginning of the shut-in period.[170] The lease's shut-in royalty clause read, in pertinent part, as follows:

> Where gas from any well or wells capable of producing gas . . . is not sold or used during or after the primary term and this lease is not otherwise maintained in effect, lessee may pay or tender as shut-in royalty . . . , payable annually on or before the end of each twelve month period during which such gas is not sold or used and this lease is not otherwise maintained in force, and if such shut-in royalty is so paid or tendered and while lessee's right to pay or tender same is accruing, it shall be considered that gas is being produced in paying quantities, and this lease shall remain in force during each twelve-month period for which shut-in royalty is so paid or tendered . . .[171]

At trial, the top lessee argued that the shut-in clause did not perpetuate the lease because the well was incapable of producing in paying quantities on June 13, 2012.[172] The jury answered "yes" to the question of whether the well was incapable of producing in paying quantities as of that date.[173] The trial court ultimately signed a judgment declaring that the base lessee's lease had "lapsed and terminated for the lease being incapable of producing in paying quantities when the Vera Murray Well #11 was shut-in on June 13, 2012 and that a reasonably prudent operator would not continue to operate the well."[174]

On appeal, the Supreme Court of Texas reversed and rendered a take-nothing judgment in favor of the base lessee.[175] The Court first

165. *Id.* at 392–93.
166. *Id.* at 392.
167. *Id.*
168. *Id.*
169. *Id.*
170. *Id.*
171. *Id.*
172. *Id.* at 393.
173. *Id.*
174. *Id.*
175. *Id.* at 403.

noted that, unlike terminating a lease under the habendum clause for lack of production in paying quantities, following a "total cessation of production" for a period longer than the temporary cessation savings clause, to terminate the lease a party must prove that no other savings clause, such as a shut-in royalty clause, did not sustain the lease.[176] The Court reasoned that the "heart of the parties' dispute is the date on which the capability of production in paying quantities determination is to be made under the . . . lease."[177] On the one hand, the base lessee argued that either June 4 (the last day that gas was sold or used) or June 12 (the day the valve was closed) was the proper measuring date.[178] The top lessee, on the other hand, argued that June 13 was the proper measuring date because it was the day that the lessee "invoked its shut-in rights."[179] Siding with the base lessee, the Court held that the appropriate measuring date was June 4, being the last date gas was sold or used under the lease.[180] It was therefore up to the top lessee to demonstrate that the well was incapable of production over a reasonable period of time as of June 4, 2012.[181] Because the top lessee failed to carry this burden, the base lessee successfully perpetuated the lease under the shut-in clause.[182]

3. Cessation of Production Clause

Because of the lack of predictability of the application of the common law temporary cessation doctrine, modern oil and gas leases often contain an express cessation of production clause.[183] Representative examples of cessation of production clauses sometimes incorporated into oil and gas leases include the following:

> If, after the expiration of the primary term of this lease, production on the leased premises should cease, this lease shall not terminate if lessee is then prosecuting drilling operations, or within 60 days after each such cessation of production commences drilling operations, and this lease shall remain in force so long as such operations are continuously prosecuted, and if production

176. *Id.* at 396.
177. *Id.* at 397.
178. *Id.*
179. *Id.*
180. *Id.* at 397–98.
181. *Id.* at 398, 400.
182. *See id.* at 400.
183. Katy Wehmeyer, *Customizing the Oil and Gas Lease from the Lessee's Perspective*, 2019 No. 6 ROCKY MTN. MIN. L. FOUND. SPECIAL INST., §§ 2-1, 2-9.

> results therefrom, then as long thereafter as oil or gas is produced from the leased premises.[184]
>
> If after the discovery of oil, gas or other hydrocarbons, the production thereof should cease from any cause, this Lease shall not terminate if Lessee commences additional drilling or reworking operations within sixty (60) days thereafter . . .[185]

Like most cessation of production clauses, the clauses quoted above establish a fixed period of time in lieu of the "reasonable" period envisioned by the temporary cessation of production doctrine. These clauses also override the historical, pre-*Ridge Oil Co.* requirement under the temporary cessation of production doctrine that the cessation must result from a mechanical failure or some similar event.

Again, when used in this context, phrases such as "commence drilling operations" and "operations for drilling" do not require the lessee to have a drilling rig in operation on the premises. A lease containing a cessation of production clause might also define "operations" as "drilling, testing completing, reworking, recompleting, deepening, plugging back or repairing of a well in an effort to obtain production." Generally, the phrase "production" only requires taking oil or gas from the well in a "captive" state, meaning oil and/or gas need not be marketed or sold to perpetuate the lease under a cessation of production clause.[186]

Critically, when a lease contains a cessation of production clause, the terms of the oil and gas lease will control, thereby precluding application of the temporary cessation of production doctrine.[187] In *Samano v. Sun Oil Co.*, for example, production from a well ceased due to mechanical difficulties after the expiration of the primary term.[188] The lease contained a cessation of production clause providing that it would remain in effect for a period of ten years "or so long thereafter as Lessee shall conduct drilling or re-working operations thereon with no cessation of more than sixty consecutive days until production results . . ."[189] There was a total cessation of production on the lease for a period of seventy-three days.[190] The Court held that the cessation of production clause limited the "reasonable time" that the lessee would

184. 3 WILLIAMS & MEYERS, *supra* note 101, § 615.1.

185. SMITH & WEAVER, *supra* note 4, § 4.4[B][2].

186. *See* Riley v. Meriwether, 780 S.W.2d 919, 923 (Tex. App.—El Paso 1989, writ denied).

187. Kramer, *supra* note 11, at 545.

188. Sun Oil Co. v. Samano, 607 S.W.2d 46, 48 (Tex. App.—Tyler 1989, writ granted), *rev'd*, 621 S.W.2d 580 (Tex. 1981).

189. Samano v. Sun Oil Co., 621 S.W.2d 580, 581 (Tex. 1981).

190. *Id.* at 580.

ordinarily have to restore production under the temporary cessation of production doctrine.[191] The lessee therefore had sixty days within which to begin drilling or re-working operations. Because it did not so do, the lease automatically terminated.[192]

The dry-hole clause, the operations clause, and the cessation of production clause are cumulative. Thus, the periods provided may be "tacked" to extend the lease. In *Skelly Oil Co. v. Harris*, commenting upon the interaction of the operations clause and the shut-in clause, the Supreme Court of Texas stated:

> [T]he habendum clause is required by its own terms to yield to any and all other provisions which affect the duration of the lease.
>
> . . . .
>
> When the language of the 60-day clause is given its ordinary and commonly accepted meaning, it contemplates and permits either a temporary interruption or a final discontinuance of the operations in progress at the end of the primary term. If such operations result in production at a time when there has been no cessation of more than [60] consecutive days, the lease remains in force so long thereafter as production continues. The 60-day clause thus allows the lessee that period after completion of a well capable of producing within which to begin either actual or constructive production.[193]

For example, a shut-in payment tendered within the 60-day period provided in an operations clause would maintain the lease even though it was not tendered until after the end of the primary term and the shut-in clause did not allow for a "grace" period.

4. Force Majeure Clause

Historically, Texas courts have been hesitant to excuse a lessee from fulfilling lease obligations or to grant relief from lease termination when factors outside the lessee's control have interfered with its operations. Consequently, most lessees include a force majeure provision in their oil and gas leases. Literally, "force majeure" means superior or irresistible force.[194] The term is generally applied to contract clauses designed to protect the parties against the possibility that the contract

191. *Id.* at 582.
192. *Id.* at 584.
193. Skelly Oil Co. v. Harris, 352 S.W.2d 950, 953 (Tex. 1962).
194. *Force Majeure*, BLACK LAW'S DICTIONARY (11th ed. 2019).

cannot be performed due to causes outside the control of the parties and that could not be avoided by due care.[195] The following is an example of a common oil and gas lease force majeure provision:

> If, after production has been obtained, operations under this lease are delayed, interrupted or prevented by acts of God, fire, riots, wars, strikes, inability to obtain equipment due to governmental order or action, or by failure of carriers to transport equipment, or by regulation of State or Federal action, this lease shall not terminate or be forfeited, and no right of damages shall exist against lessee by reason thereof, provided operations are commenced or resumed within [90 days after the cessation] of such cause or causes [and as long thereafter as there are operations on or production from the lease or lands pooled with it]. If at any time within three months prior to the expiration of the primary term of this lease, production has not been obtained and the commencement and continuance of operations for the drilling of a well on said lands is delayed or prevented by any of the causes mentioned in this paragraph, the said primary term and all other terms of this lease may be extended for successive periods of time while such cause or causes exists, by continuing the payment or tender of delay rentals in the manner and amount and for the period of time as provided in Paragraphs _____ of this lease for deferment of the commencement of drilling operations during the said primary term.[196]

If the force majeure clause sets a specific time limit after the expiration of the force majeure event, as is done in the clause quoted above, the lease will terminate at the end of that time period unless the lessee has resumed production within the specified period, or some other lease savings clause or doctrine applies.

IV. OIL AND GAS TOP LEASES

A "top lease" is an oil and gas lease that covers a mineral estate that is already subject to a valid and existing lease, or "base lease."[197] Generally speaking, there are two different types of top leases.[198] On the

195. *Id.*

196. 3 WILLIAMS & MEYERS, *supra* note 101, § 683.1.

197. Michael L. Brown, *Effect of Top Leases: Obstruction of Title and Related Considerations*, 30 BAYLOR L. REV. 213, 213 (1978).

198. J. Hovey Kemp, *Top Leasing for Oil and Gas: The Legal Perspective*, 59 DENV. L. J. 641, 642 (1982).

one hand, a "two-party" or "same-party" top lease exists where the lessee of the original lease secures a second lease from the same lessor covering all or part of the interest covered under the first lease.[199] On the other hand, a "third-party" top lease exists when the lessor under the original lease executes a second lease in favor of a lessee who is a stranger in title to the original lease.[200]

As competition for highly desirable oil and gas leases in the Permian Basin continues, the practice of third-party top leasing has become increasingly prevalent. In many cases, the lessee of a third-party top lease will acquire the lessor's potential causes of action against the base lessee for the purpose of suing the base lessee to have the underlying lease declared terminated and no longer valid. Resolution of these disputes generally turns on whether the base lease has expired, either due to a total cessation of production, a failure to produce in paying quantities, or the absence of any necessary savings clause activities. There are several recurring legal issues implicated by the practice of third-party top leasing, including: (1) whether a top lessee can be held liable for trespass, (2) whether the execution of a top lease amounts to repudiation and/or obstruction of the base lease, (3) whether top leases violate the Rule against Perpetuities, (4) whether top leasing constitutes tortious interference with the base lease, (5) top leasing's potential effect on overriding royalty interests, and (6) whether, and to what extent, base lessees can protect against top leasing by negotiating for a right of first refusal in their leases.

A. Trespass

Trespass to real property is an unauthorized entry upon the land of another, which occurs when one enters, or causes something to enter, another's property.[201] Several courts have found top lessees liable for trespass where they have entered onto the leased premises and commenced drilling activities beyond the primary term of the base lease.[202] Typically, these cases involve scenarios where the top lessee mistakenly believes that the base lease has terminated, while in reality the base lease has entered into its secondary term by pooling, commencement of drilling operations, or production prior to the end of the

199. *Id.*

200. *Id.*

201. *See, e.g.*, Mathis v. Barnes, 377 S.W.3d 926, 931 (Tex. App.—Tyler 2012, pet. granted), *rev'd on other grounds*, 353 S.W.3d 760 (Tex. 2011).

202. *See, e.g.*, Lebow v. Cameron, 394 S.W.2d 773, 776–77 (Ky. 1965); Swiss Oil Corp. v. Hupp, 69 S.W.2d 1037, 1041–42 (Ky. Ct. App. 1934), *abrogated on other grounds by* Harrod Concrete & Stone Co. v. Crutcher, 458 S.W.3d 290 (Ky. 2015). *See also* Superior Oil Co. v. Devon Corp., 604 F.2d 1063, 1072–73 (8th Cir. 1979).

primary term.[203] Conversely, other courts have held that a base lessee can potentially be held liable in trespass where he fails to surrender the leasehold after the expiration of the base lease.[204] In the trespass context, the measure of damages is dependent on whether the trespass occurred in good faith.[205] "If a producer trespasses in good faith, the measure of damages is the value of the minerals [produced] minus [the trespasser's] drilling and operating costs."[206] A "bad faith trespasser" is one who enters land without "an honest and reasonable belief in the superiority of [their] title."[207] If a producer trespasses in bad faith, the measure of damages is "the value of the things mined at the time of severance without making deduction for the cost of labor and other expenses incurred in committing the wrongful act . . . or for any value he may have added to the minerals by his labor."[208]

B. Obstruction/Repudiation

Under the equitable doctrine of obstruction, also sometimes referred to as repudiation, the lessor of an oil and gas lease is not permitted to assert that the lease has terminated or otherwise come to an end for the lessee's failure to produce oil or gas or to otherwise comply with the terms of the lease if the lessor has obstructed the lessee's operations.[209] When a lessor, through his words or conduct, obstructs and/or repudiates the lease, the lessee is not required to continue lease-related activities while a legal dispute over the lease's validity is pending.[210]

Texas courts have recognized that the mere act of executing a top lease can be considered obstruction/repudiation, indicating the lessor's denial or rejection of the base lease's validity or continuation. In *Teon Management, LLC v. Turquoise Bay Corp.*, for example, Teon Management acquired top leases from the lessors to seven existing base leases.[211] At the time, Turquoise Bay was the operator of four wells drilled on the lands covered by the seven leases.[212] Teon Management eventually sued Turquoise Bay, claiming that the base leases expired

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203. *See Lebow*, 394 S.W.2d at 776–77; *Swiss Oil Corp.*, 69 S.W.2d at 1041–42. *See also Superior Oil Co.*, 604 F.2d at 1072–73.

204. *See, e.g.*, Lone Star Prod. Co. v. Walker, 257 So. 2d 496 (Miss. 1971) (holding that a top lessee could recover trespass damages—i.e., the value of production less reasonable and necessary costs—from a base lessee who was adjudged to have an invalid lease after production ceased for an unreasonable time during the base lease's secondary term).

205. *See, e.g.*, Moore v. Jet Stream Inv., Ltd., 261 S.W.3d 412, 428 (Tex. App.—Texarkana 2008, pet. denied).

206. *Id.*

207. *See id.*

208. *Id.* at 428–29.

209. KUNTZ, OIL & GAS LAW, *supra* note 13, § 26.14[a].

210. Teon Mgmt., LLC v. Turquoise Bay Corp., 357 S.W.3d 719, 730 (Tex. App.—Eastland 2011, pet. denied).

211. *Id.* at 722.

212. *Id.*

because Turquoise Bay did not timely commence reworking operations during the period specified in the base leases.[213] The court held that Turquoise Bay's failure to commence operations was excused under the repudiation doctrine.[214] According to the court, "[t]he signing of new leases with Teon Management . . . constituted unqualified notice to Turquoise Bay of the lessors' repudiation."[215] The Texarkana Court of Appeals reached a similar result in *Shell Oil Co. v. Goodroe*, holding that the lessors' act of executing a top lease and demanding that the base lessee execute a release of the underlying lease constituted a repudiation of the base lease as a matter of law.[216]

C. Rule against Perpetuities

The Texas Rule against Perpetuities states that no interest in real property is valid unless it must vest, if at all, within twenty-one years after the death of some live or lives in being at the time of the conveyance.[217] The purpose of the Rule is to facilitate the unrestricted transfer of land to future generations, ensuring that the property is not burdened by contingencies that would grant someone control over land ownership long after death.[218]

Top leases can potentially violate the Rule against Perpetuities if they are not carefully drafted. In *Peveto v. Starkey*, the Supreme Court of Texas held that the Rule invalidated a royalty interest designed to become effective upon the expiration of a prior term interest.[219] In that case, Jones, the landowner, had previously conveyed a royalty interest that was valid for fifteen years and "as long thereafter as oil, gas, or other minerals . . . is produced . . . in paying commercial quantities."[220] When Jones executed a secondary-term royalty to another grantee in the thirteenth year of the initial lease, the second royalty deed stated that it would only become effective upon the expiration of the existing lease.[221] The Court determined that the interest conveyed by the first-term royalty deed was a determinable fee, meaning it had the potential to continue indefinitely if oil, gas, or other mineral production occurred during the remaining period of its term.[222] Since the royalty created by the second deed would only take effect upon the termination of the

213. *Id.* at 722, 729.
214. *Id.* at 730.
215. *Id.*
216. Shell Oil Co. v. Goodroe, 197 S.W.2d 395, 400 (Tex. App.—Texarkana 1946, writ ref'd n.r.e.).
217. Peveto v. Starkey, 645 S.W.2d 770, 772 (Tex. 1982).
218. *See* Kettler v. Atkinson, 383 S.W.2d 557, 560–61 (Tex. 1964).
219. *Peveto*, 645 S.W.2d at 772.
220. *Id.* at 771.
221. *Id.*
222. *Id.* at 771–72.

prior interest, the Court determined that it might not vest within the timeframe allowed by the Rule, rendering it void.[223]

The Amarillo Court of Appeals relied on *Peveto* in *Hamman v. Bright & Co.* to invalidate top leases that "expressed an intent to preclude a present conveyance of any interest whatsoever to the lessee."[224] The top leases in question contained a provision stating that the rights, interests, estate, privileges, and royalties of the lessors would remain vested in them during the existence and continuance of the bottom lease.[225] This provision implied that the lessees' interests would only vest upon the expiration of the bottom lease, potentially outside the permissible timeframe of the Rule against Perpetuities.[226] Ultimately, the court ruled that these top leases violated the Rule and were therefore void.[227]

After *Hamman*, parties preparing top leases have adopted two principal drafting techniques to ensure compliance with the Rule against Perpetuities.[228] The first method involves specifying that the top lease will vest, if at all, within a specified period.[229] By setting a clear timeframe for vesting, this approach ensures that the top lease does not violate the Rule.[230] The second method involves carving out the top lease from the lessor's possibility of reverter.[231] Under this approach, the top lease is granted on the lessor's reversionary interest in the premises but remains subject to the existing lease.[232] The possessory rights of the top lessee are postponed until the termination of the existing lease.[233] This method allows for the immediate vesting of an interest in the top lease while still respecting the limitations of the Rule.[234]

D. Tortious Interference

In Texas, tortious interference with an existing contract is a common law tort that occurs when a party intentionally sabotages or otherwise damages the plaintiff's contractual business relations with a third party.[235] The elements of tortious interference are: (1) the existence of a valid contract, (2) the defendant "willfully and intentionally

223. *Id.* at 772.

224. Hamman v. Bright & Co., 924 S.W.2d 168, 172 (Tex. App.—Amarillo 1996, writ granted w.r.m.), *vacated*, 938 S.W.2d 718 (Tex. 1997).

225. *Id.*

226. *Id.* at 172–73.

227. *Id.*

228. *See* SMITH & WEAVER, *supra* note 4, § 4.2[C].

229. *Id.*

230. *Id.*

231. *Id.*

232. *Id.*

233. *Id.*

234. *Id.*

235. *See* Comm. Health Sys. Prof. Servs. Corp. v. Hansen, 525 S.W.3d 671, 689 (Tex. 2017).

interfered with that contract," (3) the interference proximately caused the plaintiff's injury, and (4) the plaintiff incurred actual damage or loss.[236] As to the willful and intentional interference element, Texas law is clear that "a plaintiff is not limited to showing that the contract was actually breached."[237] Instead, "[a]ny interference that makes performance more burdensome or difficult or of less or no value to the person entitled to performance is actionable."[238]

While no Texas court has directly addressed the issue, the mere solicitation and execution of third-party top leases could potentially lead to claims for tortious interference with existing contract against top lessees. As discussed, several Texas courts have held that the execution of a top lease can constitute obstruction/repudiation of the underlying base lease.[239] Because "[r]epudiation of a contract is a breach of contract," a top lessee who convinces a base lessor to execute a top lease arguably knowingly and intentionally interferes with the base lease by inducing the lessor to breach the same.[240]

The filing and recording of top leases in the real property records could also create a cloud on the base lessee's leasehold title, casting doubt on his exclusive right to produce and sell the hydrocarbons beneath the base lease and otherwise hindering the base lessee from fully and efficiently developing the leasehold.[241]

Courts should be particularly attentive to cases involving modern top lease forms. By their own text and stated purpose, many modern top lease forms used by top lessees are contracts designed to effectuate the destruction of the underlying base lease. Among other repudiation-inducing language sometimes found in modern top leases, these forms may: (1) state that the top lease is superior to the base lease, (2) require the top lessee to use diligence to ensure that the base lease has expired, or (3) purport to vest the top lessee with the lessor's potential causes of action against the base lessee for the purpose of having the base

236. *Id.*

237. Lamont v. Vaquillas Energy Lopeno, Ltd., 421 S.W.3d 198, 216 (Tex. App.—San Antonio 2013, pet. denied).

238. Khan v. GBAK Prop., Inc., 371 S.W.3d 347, 360 (Tex. App.—Houston [1st Dist.] 2012, no pet.); *see also* Tippett v. Hart, 497 S.W.2d 606, 610 (Tex. App.—Amarillo 1973, writ ref'd n.r.e.) ("[I]nterference with contract relations includes not merely the procurement of a breach of contract, but all invasion of contract relations, including any act injuring or destroying persons or property which retards, makes more difficult or prevents performance.").

239. Teon Mgmt., LLC v. Turquoise Bay Corp., 357 S.W.3d 719, 730 (Tex. App.—Eastland 2011, pet. denied); Shell Oil Co. v. Goodroe, 197 S.W.2d 395, 400 (Tex. App.—Texarkana 1946, writ ref'd n.r.e.).

240. *See* Mar-Len of La., Inc. v. Gorman-Rupp Co., 795 S.W.2d 880, 887 (Tex. App.—Beaumont 1990, writ denied) (emphasis added); *see also* Abrams v. Brent, 362 S.W.2d 155, 159 (Tex. Civ. App.—Austin 1962, writ ref'd n.r.e.) ("Appellees at great length by a current pleading alleged the non-existence of any binding contract on the church or its pastor or appellee trustees. This was a repudiation of the contract. Repudiation of a contract is a breach of contract.").

241. Kemp, *supra* note 198, at 659.

lease declared terminated and no longer valid. The inclusion of such language in a top lease interferes with the base lease by, without limitation, precluding the base lessee from developing the property as he sees fit, damaging the base lessee's relationship with his mineral lessors, and disturbing the base lessee's quiet title and enjoyment and warranties of title under the base lease.

Operators who have been top leased should consider asserting tortious interference claims against top lessees to protect their interests and hold top lessees accountable for undermining their contractual rights.

E. Effect on Overriding Royalty Interests

One of the questions that may arise in top leasing is whether overriding royalty obligations created during the term of the base lease survive the activation of a top lease.[242] Because the overriding royalty interest is created out of the leasehold estate, it typically does not survive termination of the base lease unless the parties agree otherwise.[243] To prevent a lessee from eliminating such interest by simply taking a new lease, the instrument creating the overriding royalty interest will frequently include "anti-washout" provisions.[244] Anti-washout provisions generally provide that, in the event the subject lease terminates, the overriding royalty interest shall apply to extensions and renewals of the lease and/or new leases.[245]

In *Yowell v. Granite Operating Co.*, the plaintiff filed suit to establish that its overriding royalty interest attached to top leases acquired by the lessee.[246] The instrument creating the overriding royalty interest contained an anti-washout provision, providing that the overriding royalty interest attached to extensions, renewals, and new leases.[247] The Supreme Court of Texas focused on the "new leases" provision in the anti-washout clause, holding that the clause violated the Rule against Perpetuities because the underlying lease was of an indefinite duration.[248] Nonetheless, the Court held that the anti-washout provision should be "reformed" under Section 5.043 of the Texas Property Code to reflect the creator's intent.[249] This statute provides that "[w]ithin the limits of the rule against perpetuities, a court shall reform or construe an interest in real property that violates the rule to effect the

242. *See* Yowell v. Granite Operating Co., 620 S.W.3d 335, 343–45 (Tex. 2020).
243. *See* Apache Deepwater, LLC v. McDaniel Partners, Ltd., 485 S.W.3d 900, 905 (Tex. 2016).
244. *See Yowell*, 620 S.W.3d at 341.
245. *See, e.g.*, TRO-X, L.P. v. Anadarko Petroleum Corp., 548 S.W.3d 458, 460 (Tex. 2018).
246. *Yowell*, 620 S.W.3d at 342.
247. *Id.* at 341.
248. *Id.* at 342–49.
249. *Id.* at 349–50.

ascertainable general intent of the creator of the interest."[250] The Court concluded that the reformation statute applied to corporate conveyances of property interests, including anti-washout provisions, and remanded the case for further proceedings related to reformation of the specific clause at issue.[251]

F. Rights of First Refusal

In simple terms, a right of first refusal in the real property context most typically refers to a contractual provision requiring that the owner of the burdened property give the right-holder notice and an opportunity to purchase the burdened property prior to entering into a sale of the property with a third party.[252] Accordingly, rights of first refusal inherently involve three parties: (1) the owner of the burdened property, (2) the third-party potential purchaser, and (3) the holder of the right. Broken down further, it is clear from the case law that the operation of a right of first refusal encompasses at least four distinct elements: (1) an offer to purchase, (2) an election to sell, (3) notice to the right-holder, and (4) acceptance by the right-holder of the same terms offered by the third party.[253]

It is increasingly common for oil and gas leases to contain right of first refusal provisions that give the lessee the right to renew a lease before any third party has a chance to top lease. The following is a representative example of language sometimes incorporated into oil and gas leases to accomplish this purpose:

> **Right of First Refusal**. If, at any time within the primary term of this lease or any continuation thereof, or within six (6) months thereafter, Lessor receives any bona fide offer, acceptable to Lessor, to grant an additional lease (top lease) covering all or part of the afore described lands, Lessee shall have the continuing option, by meeting any such offer, to acquire such a lease. Any offer must be in writing and must set forth the proposed Lessee's name, bonus consideration and royalty consideration to be paid for such lease, and include a copy of the lease form to be utilized reflecting all pertinent and relevant terms and conditions of the top lease. Lessee shall have fifteen (15) days after receipt from Lessor of a complete copy of any such offer to advise Lessor in writing or its election to enter into an oil and

250. TEX. PROP. CODE ANN § 5.043(a) (West 2021).
251. *Yowell*, 620 S.W.3d at 352.
252. Palmer v. Liles, 677 S.W.2d 661, 665 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.).
253. *See id.*

> gas lease with Lessor on equivalent terms and conditions. If Lessee fails to notify lessor within the aforesaid fifteen (15) day period of its election to meet any such bona fide offer, Lessor shall have the right to accept said offer. Any top lease granted by Lessor in violation of this provision shall be null and void.

By including such a provision in an oil and gas lease at the lease's inception, base lessees can ensure some degree of protection over the future of their valuable leasehold rights in the face of actual or threatened challenges to the ongoing validity of their underlying base leases.

V. POTENTIAL DEFENSES TO LEASE TERMINATION CLAIMS

Even if a lease has terminated for failure to produce in paying quantities or a total cessation of production, and no savings clause activities would otherwise save the lease, there are a number of defenses available to operators who have been sued for lease termination by their lessors and/or top lessees, including ratification and/or revivor, estoppel, and adverse possession. An operator can also assert the affirmative defense of obstruction/repudiation to suspend leasehold requirements during the pendency of an existing lease where the lessor denies that the lease remains in full force and effect.

A. Ratification and/or Revivor

Ratification occurs where a party recognizes the validity of a contract by acting under it, performing it, or affirmatively acknowledging it.[254] Revivor, on the other hand, applies when a subsequent instrument executed by a mineral owner makes reference to a terminated lease and clearly acknowledges the validity of the lease.[255] As numerous Texas courts of appeals have recognized, "there is confusion in Texas law concerning the distinction between the doctrines of ratification and revivor, with the terms sometimes being used interchangeably."[256] But any confusion between ratification and revivor only exists because the distinction between the two is merely academic. They are accomplished in essentially the same way, and they are one and the same for most practical purposes; it is only the context of their use that determines whether a ratification or a revivor has occurred:

> Revivor applies where an effective conveyance of a property interest has terminated on its own terms. When

254. *See* Zieban v. Platt, 786 S.W.2d 797, 802 (Tex. App.—Houston [14th Dist.] 1990, no writ).

255. Loeffler v. King, 236 S.W.2d 772, 774 (Tex. 1951); Humble Oil & Ref. Co. v. Clark, 87 S.W.2d 471, 474 (Tex. 1935).

256. Bradley v. Avery, 746 S.W.2d 341, 343 (Tex. App.—Austin 1988, no writ).

> applied, the doctrine of revivor causes the creation of a new estate in land. Revivor requires the execution of a formal document that "expressly recognize[s] in clear language the validity of the lifeless deed or lease."
>
> The doctrine of ratification is similar in that it, too, requires "the subsequent execution of a formal document" that "expressly recognizes in clear language the validity" of a prior instrument or conveyance. But where revivor applies to a lease that was valid at execution but subsequently terminated, ratification applies to a conveyance that was inoperative or invalid in its original execution.[257]

Accordingly, as long as (1) a formal instrument is executed, which (2) clearly recognizes the validity of a prior instrument and (3) specifically references the prior instrument to be given life, then it will operate as a ratification even if the prior instrument was never valid to begin with, or it will operate as a revivor if the prior instrument was initially valid but subsequently terminated.[258]

Notably, Texas courts have held that ratification and/or revivor of an oil and gas lease can occur merely by making a subsequent deed "subject to the terms of said lease" after the lease expires,[259] by executing division orders if detrimental reliance is found on the part of the lessee,[260] and by "accept[ing] under an oil and gas lease (such as a lease royalty payment of a lease that has lapsed) in addition to [having] an instrument in writing (such as a ratification of a unit or pooling agreement)."[261] The distinction between ratification and revivor is the effect that each has, not the means by which they are accomplished.

The Supreme Court of Texas's holding in *Loeffler v. King* demonstrates how ratification and revivor can operate to extend an oil and gas lease that has otherwise terminated.[262] In that case, the Court addressed whether the plaintiff-grantee ratified/revived an oil and gas lease that had allegedly terminated for failure to produce in paying quantities when he accepted a royalty deed containing the following language: "It is distinctly understood and herein stipulated that said land is under an Oil and Gas lease providing for a royalty of 1/8 of the oil and certain

257. Allegiance Expl., LLC v. Davis, No. 02-13-00349-CV, 2016 WL 1164331, at *23 (Tex. App.—Fort Worth Mar. 24, 2016, pet. denied) (citing *Bradley*, 746 S.W.2d at 344).

258. *See id.*

259. *See Humble Oil & Ref. Co.*, 87 S.W.2d at 473–74.

260. *Bradley*, 746 S.W.2d at 344.

261. Wright v. E.P. Operating Ltd. P'ship, 978 S.W.2d 684, 689 (Tex. App.—Eastland 1998, pet. denied).

262. Loeffler v. King, 236 S.W.2d 772, 774 (Tex. 1951).

royalties or rentals for gas and other minerals."[263] Because the deed identified the lease, the Court held that the parties ratified and revived the lease and that the plaintiff-grantee therefore brought his entire interest within the lease's terms: "By authority of an unbroken line of decisions by this court it must be held that, by the execution and acceptance of the royalty deed the parties ratified and gave new life to the Horwitz lease, even if it had in fact theretofore terminated."[264] Because "even if the lease terminated, it was later revived" by the parties, the Court did not need to address whether the lease terminated for failure to produce in paying quantities.[265]

B. Quasi-Estoppel

The doctrine of quasi-estoppel precludes a party from accepting the benefits of a transaction and then taking a subsequent inconsistent position to avoid corresponding obligations.[266] It applies when it would be unconscionable to allow a person to maintain a position inconsistent with one in which he or she previously acquiesced.[267] In the lease termination context, it may, under certain circumstances, operate to preclude a lessor or his successors from asserting a claim for lease termination.[268]

For instance, in *Cambridge Production, Inc. v. Geodyne Nominee Corp.*, the defendant's predecessor-in-title filed a pooling declaration that contained an erroneous description of the productive stratum.[269] The lease on Tract A was pooled with a lease on Tract B, which contained the lone unit well.[270] As a result of the erroneous unit declaration, the Tract A lessors accepted royalties from the unit they were not entitled to under the literal terms of the unit designation.[271] That is, they accepted royalties from unpooled depths that, in fact, belonged to those owning interests in Tract B.[272] The Tract A lessors eventually executed top leases with the plaintiff, who asserted that the lease terminated for lack of production on Tract A.[273] The court reasoned that quasi-estoppel barred the Tract A lessors, and therefore the plaintiff,

263. *Id.*
264. *Id.*
265. *Id.* at 773.
266. Cambridge Prod., Inc. v. Geodyne Nominee Corp., 292 S.W.3d 725, 732 (Tex. App.—Amarillo 2009, pet. denied).
267. Lopez v. Munoz, Hockema & Reed, LLP, 22 S.W.3d 857, 864 (Tex. 2000).
268. *See Cambridge Prod., Inc.*, 292 S.W.3d at 732–33.
269. *Id.* at 728–29.
270. *Id.*
271. *Id.* at 732.
272. *See id.*
273. *Id.* at 727, 729–30.

from challenging the unit's validity.[274] As a result, the plaintiff was also barred from claiming that the lease terminated.[275]

Ordinarily, to prevail on an equitable estoppel defense asserted in response to a lease termination claim, the lessor must engage in some type of affirmative conduct after the lease has allegedly terminated, such as inviting or assisting in development or accepting certain lease benefits, like delay rentals or shut-in royalties.[276] Though courts have generally recognized that a lessor can be estopped from claiming the expiration of a lease by the acceptance of delay rentals and shut-in royalties, the same is not necessarily true as to the lessor's acceptance of royalties on production.[277] That is, the lessor's acceptance of royalties after a lease is alleged to have expire, without more, will not necessarily estop the lessor's lease termination claim because the royalty represents only a fraction of the production to which the lessor would otherwise be entitled if the lease had terminated.[278] If a lessor receives nothing more than what he would be entitled to without the existence of the lease, the lessor may arguably realize no unconscionable "benefit," precluding the operator from asserting quasi-estoppel as a potential defense.[279] As discussed below, however, the lessor's acceptance of royalties could potentially lend support to an operator's adverse possession defense.[280]

C. Adverse Possession

Adverse possession (more formally, title by possession or title by limitations) is a legal doctrine captured by statute in Texas providing that title to real property is given to the occupier of another's land upon the occupier's possession of the land for a statutory period of time.[281] The current statutory definition of adverse possession in Texas is "an actual and visible appropriation of real property, commenced and continued under a claim of right that is inconsistent with and is hostile to the claim of another person."[282] In Texas, limitations title suits are governed by statutes requiring three, five, ten, or twenty-five years of

274. *Id.* at 732.

275. *Id.*

276. *See* Brannon v. Gulf States Energy Corp., 562 S.W.2d 219, 222 (Tex. 1977); Shell Oil Co. v. Goodroe, 197 S.W.2d 395, 399 (Tex. App.—Texarkana 1946, writ ref'd n.r.e.).

277. *See, e.g.*, Clark v. Perez, 679 S.W.2d 710, 714 (Tex. App.—San Antonio 1984, no writ).

278. *See id.*

279. *See id.*

280. *See* Nat. Gas Pipeline Co. of Am. v. Pool, 124 S.W.3d 188, 196–97 (Tex. 2003).

281. *Adverse Possession*, BLACK LAW'S DICTIONARY (11th ed. 2019). *See generally* Thomas K. McElroy, *Adverse Possession of Mineral Estates*, 11 BAYLOR L. REV. 253 (1959).

282. TEX. CIV. PRAC. & REM. CODE ANN. § 16.021 (West 1985).

adverse use.[283] For each statute, there are different requirements and levels of proof required.[284]

Generally, in order to mature title to a mineral estate through adverse possession after severance of the mineral and surface estates, actual possession must occur.[285] "In the case of oil and gas, [actual possession] means drilling and production of oil or gas."[286] The few Texas courts that have addressed the issue tend to agree that to support an adverse possession claim to the mineral estate underneath a tract of land, there must be drilling and production from wells located on that particular tract.[287]

Natural Gas Pipeline Co. of Am. v. Pool, a 2003 Supreme Court of Texas decision, demonstrates how adverse possession can be used to overcome lease termination claims.[288] In *Pool*, the trial court addressed two separate suits brought by the same lessors, both of which involved the same causes of action against the same lessees.[289] Though the trial court and the appellate court confronted both cases separately, the Supreme Court of Texas consolidated the two cases.[290] *Pool 1* concerned two leases, executed in 1926 and 1936 respectively.[291] *Pool 2* involved one lease, executed in 1937.[292] At trial, the lessors argued that the leases terminated due to a cessation of production.[293] In response, the lessees maintained that the leases did not terminate because there had been production in paying quantities at all times.[294] Alternatively, the lessees argued that they obtained a fee simple determinable in the mineral estates by way of adverse possession.[295] The court of appeals agreed with the lessors, holding that the leases terminated and that the lessees could not establish adverse possession because they did not give notice of repudiation of the lessors' title or of the lease.[296] The Supreme Court of Texas reversed, and instead held that the lessees established adverse possession as a matter of law.[297]

The Court reasoned that, once the lease expired, the lessees retained no interest in the minerals, which instead reverted back to the

283. *Id.* §§ 16.021–16.038.
284. *See generally* TEX. CIV. PRAC. & REM. CODE ANN. CH. 16.
285. *Nat. Gas Pipeline Co. of Am.*, 124 S.W.3d at 193.
286. *Id.*
287. *See, e.g.*, Hunt Oil Co. v. Moore, 656 S.W.2d 634, 641 (Tex. App.—Tyler 1983, writ ref'd n.r.e.).
288. *Nat. Gas Pipeline Co. of Am.*, 124 S.W.3d at 198.
289. *Id.* at 190.
290. *Id.*
291. *Id.*
292. *Id.*
293. *Id.* at 191.
294. *Id.*
295. *Id.*
296. *Id.* at 192.
297. *Id.* at 199.

lessors.[298] Though the Court agreed that possession cannot be considered adverse until the tenancy has been repudiated, and notice of such repudiation has been given, it noted that actual notice of repudiation is not required; rather, it can be inferred or constructive.[299] The Court held that the lessees gave notice of adverse possession through their "continued production and sale of all the oil and gas and payment of royalty on only a relatively small percentage of the proceeds . . . to the lessors, who received payments each month of only 1/8 royalty for more than ten years after they sa[id] the leases terminated."[300] The court further stated that this was "an act hostile to the lessors' exclusive right to explore for and remove the valuable minerals as well as the lessors' exclusive right to make the decision whether to drill."[301] Consequently, even though the lease terminated, the lessees secured title to the lease under the same terms and conditions as the original leases by way of adverse possession.[302] Consistent with *Pool*, an operator may assert adverse possession as a defense to lease termination claims where he demonstrates an intent to claim an interest adverse to that of the lessor after the lease has expired, whether by paying the lessor lease royalties or engaging in similar conduct that is inconsistent with the existence of a cotenant relationship between the operator and the lessor.

D. Obstruction/Repudiation

As discussed, a lessor's obstruction/repudiation of a lease "relieves the lessee of any obligation to conduct any operation on the land in order to maintain the lease in force pending a judicial resolution between the lessee and the lessor over the validity of the lease."[303] An operator, when faced with a claim for lease termination, can utilize the doctrine to perpetuate or otherwise extend an existing lease without securing production or conducting savings clause activities when the lessor has repudiated the lease. "A lessor repudiates an oil and gas lease when he denies that it is valid or that it is still in force."[304] The elements of repudiation are (1) a subsisting lease (i.e., a lease that has not expired) and (2) the lessor's notice that the lease has been forfeited or terminated.[305] Texas courts have found repudiation where the lessor

298. *Id.* at 197.
299. *Id.* at 194.
300. *Id.* at 197.
301. *Id.*
302. *Id.* at 199.
303. Teon Mgmt., LLC v. Turqoise Bay Corp., 357 S.W.3d 719, 730 (Tex. App.—Eastland 2011, pet. denied) (citations omitted).
304. SMITH & WEAVER, *supra* note 4, § 4.5.F.
305. *See, e.g.*, Rippy Ints., LLC v. Nash, 475 S.W.3d 353, 362–63 (Tex. App.—Waco 2014, pet. denied).

executed a top lease with a third party,[306] where a lessor notified the lessee in writing that its lease expired,[307] where a lessor told the lessee's secretary "that the lease had expired because of non-production, and that he wanted a release of the lease,"[308] and where the lessor filed suit to have the lessee's lease declared terminated.[309] Following repudiation, the operator will be afforded additional time to recommence operations under the lease, with the extension period often being based on the time the operator either did not or could not conduct lease operations due to the lessor's repudiation.[310] Though an operator whose lease has been repudiated has the option to suspend operations, it is not required to do so, and the operator can still conduct lease operations without waiving the right to assert the repudiation defense.[311]

VI. CONCLUSION

The oil and gas lease is, and will continue to be, one of the primary documents by which operators develop their valuable real property interests, both in the Permian Basin and beyond. As the competition for oil and gas leases and lease-busting attempts in the Permian Basin continue, operators would be well-served to develop familiarity with the terms of their leases, including definitions of any industry terms, the type of activities and/or production required to perpetuate the lease, and the availability and application of any savings clause language. By understanding the mechanics of their leases, pertinent case law, and judicial trends in construction—as well as remaining vigilant in undertaking any activities necessary to perpetuate their leases—operators can mitigate, if not avoid, the operational and financial stress occasioned by challenges to their valuable leasehold interests.

306. *Teon Mgmt., LLC*, 357 S.W.3d at 730; Shell Oil Co. v. Goodroe, 197 S.W.2d 395, 400 (Tex. App.—Texarkana 1946, writ ref'd n.r.e.).

307. Kothmann v. Boley, 308 S.W.2d 1, 3–4 (Tex. 1957).

308. Morgan v. Fox, 536 S.W.2d 644, 649–50 (Tex. App.—Corpus Christi-Edinburg 1976, writ ref'd n.r.e.).

309. NRG Expl., Inc. v. Rauch, 671 S.W.2d 649, 652 (Tex. App.—Austin 1984, writ ref'd n.r.e.).

310. *Kothmann*, 308 S.W.2d at 4; Cheyenne Res., Inc. v. Criswell, 714 S.W.2d 103, 105 (Tex. App.—Eastland 1986, no writ); Flato v. Weill, 4 S.W.2d 992, 995 (Tex. App.—San Antonio 1928, no writ).

311. *See, e.g.*, Rippy Ints., LLC v. Nash, 475 S.W.3d 353, 365–66 (Tex. App.—Waco 2014, pet. denied) ("[T]he mere fact of a lessee's continuing operations after an alleged repudiation of the lease . . . does not negate as a matter of law the lessee's reliance on the alleged repudiation."); Chesapeake Expl., LLC v. Valence Operating Co., No. H-07-2565, 2008 WL 4240486, at *4 (S.D. Tex. Sept. 10, 2008) ("[T]he court has not located any Texas law stating that a party claiming repudiation of a lease with an operations clause waives the repudiation defense by continuing operations. To the contrary, the statements of law regarding repudiation of an oil and gas lease speak in terms of the relief of an obligation to perform, not a bar to further performance . . . Furthermore, it seems rather a paradox to find that a lessee can lose his right to perform more operations under the lease by performing operations under the lease.").