The Effect of the Cessation of Production Clause during the Secondary Term of an Oil and Gas Lease

Mohan Kelkar
NOTES AND COMMENTS

THE EFFECT OF THE CESSATION OF PRODUCTION CLAUSE DURING THE SECONDARY TERM OF AN OIL AND GAS LEASE

I. INTRODUCTION*

As the price crisis looms over the oil industry, a legal crisis is brewing in Oklahoma and Texas. This legal crisis has resulted from recent decisions in these states. Courts have strictly construed an oil and gas lease by holding that a lease may terminate if the lessee does not commence an appropriate action, as required by the cessation of production clause, after a temporary cessation of production from the lease.

The Oklahoma Supreme Court first dealt with this issue in *Hoyt v. Continental Oil Co.* In *Hoyt*, the supreme court held that the reference to “production” in the cessation of production clause meant “production in paying quantities.” As a result, the court held that the lease had terminated, because Continental Oil Company failed to resume drilling operations within sixty days after the production stopped. The court also stated that the clause is applicable even where there is a temporary cessation of the production. In *Hoyt*, however, the court was silent regarding the question of whether the cessation of production clause will be inapplicable until production in less than paying quantities is established over a reasonable period of time. In *French v. Tenneco Oil Co.*, the court

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* The author is an Assistant Professor of Petroleum Engineering at The University of Tulsa. He obtained his M.S. in Petroleum Engineering and Ph.D. in Chemical Engineering at the University of Pittsburgh.

2. See infra note 44 and accompanying text.
4. See supra note 2.
5. See *Hoyt*, 606 P.2d at 563; see also infra note 17 and accompanying text.
7. See Lowe, *Developments in Nonregulatory Oil and Gas Law*, 32 INST. ON OIL & GAS L. &
addressed this issue in holding that the cessation of production clause will apply as soon as production in less than paying quantities is obtained.\textsuperscript{9}

In Texas, a similar conclusion was reached in \textit{Samano v. Sun Oil Co.}\textsuperscript{10} in dealing with the cessation of production clause. In \textit{Samano}, the Texas Supreme Court held that the terms of the lease control in determining the effect of the cessation of production clause. The Texas court concluded that the lease terminated, because Sun Oil Company did not commence reworking or drilling operations within sixty days after the production stopped, as required by the lease.\textsuperscript{11} The court also stated that the cessation of production is applicable even if the production ceases temporarily.\textsuperscript{12}

These recent decisions indicate that the courts in Oklahoma and Texas will strictly interpret the cessation of production clause against the lessees. As a result, the terms of the clause may lead to a premature termination of the lease instead of being applied as a shield for the lessee,\textsuperscript{13} which is the clause's intended purpose.

\section{II. Relevant Clauses in an Oil and Gas Lease}

\subsection{A. Habendum Clause}

In order to understand the significance of the cessation of production clause, the habendum clause of an oil and gas lease should be reviewed. This clause defines the time period for which the lease will remain in force. A typical habendum clause reads as follows: "This lease shall remain in force for a period of . . . from this date, called 'primary term', and as long thereafter as oil and gas and other minerals are produced from the said land."\textsuperscript{14} This clause provides for a fixed period, called a "primary term," and also provides that the lease will continue to be in effect so long as oil and gas is produced from the lease. The period after the primary term for which the lease remains in effect is called a "secondary term."

\begin{itemize}
\item \textsuperscript{9} 725 P.2d 275 (Okla. 1986).
\item \textsuperscript{10} \textit{Id.} at 277.
\item \textsuperscript{11} 621 S.W.2d 580 (Tex. 1981).
\item \textsuperscript{12} \textit{Id.} at 584.
\item \textsuperscript{13} \textit{Id}.
\item \textsuperscript{14} See Lowe, supra note 7, at 175.
\end{itemize}

\textsuperscript{14} American Association of Petroleum Landmen (AAPL) Form 675—approved for use in Texas by the AAPL.
A strict interpretation of the habendum clause indicates that the lease will terminate immediately after the well stops producing oil and gas from the lease during the secondary term. However, this interpretation of the clause may be unfair to both the lessor and the lessee. For instance, if the lessee produces only nominal amounts of oil and gas in order to save the lease for speculative purposes, the overall production will not result in any benefit to the lessor. The lessor will not receive any substantial royalties, hence defeating his purpose of leasing the land for his benefit. On the other hand, if during the secondary term of the habendum clause the well stops producing temporarily, as is a common occurrence, a strict interpretation of the habendum clause will lead to the termination of the lease.

This premature termination will also defeat the primary purpose of the lease, which is to recover as many hydrocarbons as possible in a prudent manner. Leasing oil and gas interests is a business transaction, entered into between two parties for their mutual benefit. Therefore, any clause in the lease should be interpreted to honor the true intention of the parties—to optimize the benefits for both parties.

In order to give effect to the true intention of the parties, the courts have developed certain rules over the past century. First, the term “production” during the secondary term is defined as “production in paying quantities.” Production in paying quantities may be defined as the amount of production which will generate more operating revenues than operating expenses.

Similar to most business ventures, the operation should produce a profit over a reasonable period of time. By defining the production as production in paying quantities, the lessee is prevented from holding the lease for speculative purposes. This approach will also encourage the

15. See Lowe, supra note 7, at 180.
17. See Walden, 194 Okla. at 455, 152 P.2d at 924. The Supreme Court of Oklahoma stated:

[I]f oil or gas is produced in “paying quantities” means that if oil is actually produced in such quantities as will pay a profit to the lessee over operating expenses it is produced in paying quantities, though it may never repay the cost of drilling and equipping the well or wells.

See also Garcia, 164 S.W.2d at 511. In Garcia, the court stated “[i]f a well pays a profit, even small, over operating expenses, it produces in paying quantities, though it may never repay its costs, and the enterprise as a whole may prove unprofitable.”
18. See Note, supra note 7, at 83.
development and exploration of the property resulting in more production from domestic sources, hence less dependence on foreign oil.

The determination that a "production in paying quantities" has been obtained is a question of fact. The operator may lose money over a certain period of time; however, by improving the operations and methods of production, he may be able to produce the hydrocarbons in a profitable manner over the long run. There is no set period over which the production in paying quantities can be determined. Rather, a prudent operator standard is used in determining whether the lease is producing in paying quantities. If a prudent operator will continue to operate a given lease with the intention of making a profit, the lease will remain in force. Therefore, the lease has permanently stopped producing in paying quantities only if a reasonable prudent operator will stop production. Another factor to be considered in interpreting the habendum clause is whether a temporary cessation will terminate the lease. During the secondary term, the well may not produce in a continuous manner. The well may require workover operation or a government agency may dictate that the well be shut in temporarily. These factors may result in a temporary cessation of the production. However, the lease should not be terminated, because the lease is still capable of producing, and a prudent operator should be given every opportunity to produce as much as he can. To allow the lease to continue, the courts have established a "temporary cessation" doctrine. According to this doctrine, the lessee's interest will not be lost as a result of a temporary cessation of production. This doctrine takes into account the practical aspects of oil and gas production and assumes that temporary cessation must have been contemplated by the parties when they entered into an agreement.

Several factors are evaluated when determining whether the produc-

21. Id. at 82, 325 S.W.2d at 691. The Supreme Court of Texas stated:
[T]he standard by which paying quantities is determined is whether or not under all the relevant circumstances a reasonably prudent operator would, for the purpose of making a profit and not merely for speculation, continue to operate a well in the manner in which the well in question was operated.
24. See 2 E. Kuntz, supra note 22, § 26.8(d).
tion is temporary or permanent. These factors include the time period over which the cessation has extended, the cause of termination, and the operator’s diligence in restoring the production. These factors are construed according to the reasonable prudent operator’s standard. If the operator does not use due diligence in restoring the production, cessation may be considered permanent even if the cause of termination is temporary. Although temporary cessation is hard to define, the causes of temporary cessation may typically include mechanical breakdown of the equipment, regulations of government agencies, accidents, financial difficulties, and improvements in operations.


In Texaco, 228 Kan. at 589, the court stated:

[...the better rule precludes the use of a rigid fixed term for determination of profitability and uses a reasonable time depending upon the circumstances of each case, taking into consideration sufficient time to reflect the current production status of the lease and thus to “provide the information which a prudent operator would take into account in whether to continue to abandon the operation.” (citations omitted).]

In Wheeler, 398 S.W.2d at 477, the court stated: “[t]he issue of what is an unreasonable time must be determined by the facts and circumstances surrounding each case.”

In Belden, 106 Ill. App. 3d at 192, 435 N.E.2d at 936, the court stated: “temporary cessation... is not a cessation of production... if, in the light of all surrounding circumstances, reasonable diligence is being exercised by the lessor to continue production of oil and gas under the lease.” (quoting Gillespie v. Wagoner, 28 Ill.2d 217, 220, 190 N.E.2d 765, 767 (1963)).

26. See, e.g., Hunter v. Clarkson, 428 P.2d 210 (Okla. 1967); Wagner v. Smith, 8 Ohio App. 3d 90, 456 N.E.2d 523 (1982). In Hunter, 428 P.2d at 212, in deciding that the lease had terminated due to operator’s imprudence, the Supreme Court of Oklahoma stated:

The circumstances in this case reveal that the defendant originally produced two tanks of oil and ceased production, moved his equipment back to the well when plaintiff purchased the land, over plaintiffs’ protest, and produced one more tank of oil, moved off and later returned to produce one more tank of oil when this action was commenced. The cessation was voluntary and there appears to be no circumstances justifying the trial court’s continuance of the lease.

In Wagner, 8 Ohio App. 3d at 90, 456 N.E.2d at 525, the court stated: “[a] critical factor in determining the reasonableness of the operator’s conduct is the length of the time as is out of production... Additionally... all attendant circumstances must be taken into account.”


Although a lease may not terminate when the cessation of production is temporary, it will terminate by the terms of the lease once the cessation becomes permanent. If the production ceases because all of the producible oil and gas has been recovered, the cessation may be considered permanent. In a few states, a lessee may be allowed to explore for other formations within a reasonable time, once a particular formation is exhausted. In these states, the lessee may be allowed to drill at other locations on the lease without fearing the loss of the lease during this reasonable period of time.

The majority of the states, however, do not maintain such a liberal view. In Oklahoma and Texas, for example, the lessee is not allowed to explore further after the producing formation ceases production because of exhaustion. In *State v. Amoco Production Co.*, the Oklahoma Supreme Court stated that: "[a]fter production was established, lessee became vested with an estate that would endure as long as it conducted diligent operations to produce from the known formation." This statement implies that the lessee will be allowed to produce from known formations as long as he operates as a reasonably prudent operator. However, once production ceases permanently as a result of exhaustion of hydrocarbons from the known formations, the lessee may not be allowed to explore for other formations.

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32. See 2 E. Kuntz, *supra* note 22, § 26.8(i).

In *Western*, 143 Okla. at 212, 288 P. at 969, while describing the interest of the lessee, the court stated:

[T]he lessee after having discovered oil or gas during the initial term of the lease may continue to produce oil or gas therefrom until the exhaustion of the oil or gas discovered during the initial term . . . . but such a lessee may not continue exploration after the expiration of the initial term and the exhaustion of the oil and gas discovered during the initial term.

34. See *Sunray DX Oil Co. v. Texaco, Inc.*, 417 S.W.2d 424, 428 (Tex. Civ. App. 1967). In *Sunray*, the court stated:

[T]he courts have recognized . . . to keep the lease in effect after the expiration of the primary term cannot be continuous, since breakdowns in equipment, reworking operations, and other things are bound to occur and cause a temporary cessation of production, suffice it to say that this [case] cannot be characterized as such a temporary cessation situation. The record reflects that there was a gradual decline of production, a depletion to the extent that primary recovery methods were of no avail, and that all production ceased as of December 12, 1962.

35. 645 P.2d 468 (Okla. 1982).
36. *Id.* at 470.
37. See 2 E. Kuntz, *A TREATISE ON THE LAW OF OIL AND GAS* § 26.8(f) (12th rev. ed. Supp. 1986). In analyzing this statement, Professor Kuntz stated that:

[When production ceases from the only well because of exhaustion of the producing formation, the cessation of production is temporary if the lessee diligently restores production
In *Sunray DX Oil Co. v. Texaco, Inc.*, the Texas Supreme Court concluded that cessation of production was permanent after the decline of production from the primary recovery methods. After cessation, the court did not allow the lessee to use secondary recovery methods in the absence of a clause in the lease specifying such right.\(^{39}\)

In sum, the habendum clause in Oklahoma and Texas may be implicitly read as: "This lease shall remain in force for a period of . . . from this date, called 'primary term', and as long thereafter as the production of hydrocarbons is obtained in paying quantities and without permanent cessation." Implicit in the clause is the understanding that the temporary cessation will not terminate the lease. At the same time, the lessee will not be allowed to explore further if the producing formation is exhausted. In Oklahoma, the well need not produce in paying quantities, so long as it is *capable* of producing in paying quantities. In other words, marketing is not required to sustain the lease.\(^{40}\) In a majority of the states, the habendum clause will implicitly be read in this fashion with slight variations.\(^{41}\)

From this analysis, one thing is certain: the courts in a majority of states will not strictly interpret the habendum clause. Rather, in analyzing the habendum clause, the courts have considered the business realities of the oil and gas lease. As a result, the lease will not terminate as long as hydrocarbons are produced in paying quantities without perma-

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39. *Id.* at 428.
40. See *McVicker v. Horn, Robinson & Nathan*, 322 P.2d 410 (Okla. 1958). In this case, the court held that oil or gas can be produced to satisfy the habendum clause and extend the lease term, even though no product is being marketed from the lease.

In *Stewart*, the court stated:

Under a literal or strict interpretation of the "thereafter" provision in a habendum clause, uninterrupted production—following expiration of primary term—would be indispensable to maintain a lease in force. This would mean . . . that any cessation of production [in the paying-quantities sense of the term], however slight or short, would put an end to the lease. Oklahoma has rejected that literal view. Our law is firmly settled that the result in each case must depend upon the circumstances that surround cessation. Our view is no doubt influenced in part by the strong policy of our statutory law against forfeiture of estates. . . . [U]nder no circumstances will cessation of production in paying quantities *ipso facto* deprive the lessee of his extended-term estate.

*Stewart*, 604 P.2d at 858 (citations omitted).
nent cessation. However, once the formation pressure is so depleted that primary recovery becomes impossible, the lease will be terminated. If the lessee desires to explore for the other formations on the leased premises or to commence secondary recovery operations, he should assign himself exploration rights in the lease.

B. Cessation of Production Clause

The cessation of production clause defines the rights of the lessee to commence operations if the production ceases. During the secondary term of the lease, this clause modifies the habendum clause. A typical cessation of production clause reads: "If after the expiration of the primary term, production on this lease shall cease, this lease nevertheless shall continue as long as said operations continue or additional operations are had... where not more than sixty (60) days elapse between abandonment of operations..." Because this clause modifies the habendum clause, courts will interpret the cessation of production clause instead of using the standard habendum clause in determining whether the lease has terminated during the secondary term.

Two key words in this clause are important in interpreting the clause: "cessation" and "production." Using a similar interpretation as in the habendum clause, the word "production" should be interpreted to mean "production in paying quantities." Several courts and commentators have agreed with this analysis. Although it has been argued, on a different rationale, that production means the total production, this interpretation is inconsistent with the assumption that the cessation of production clause modifies the habendum clause during the secondary term. If the word "production" in the habendum clause means "production in paying quantities," a similar meaning should be attached to the word "production" in the cessation of production clause.

The word "cessation" is likewise confusing. Does the word mean a temporary cessation or a permanent cessation? It has been suggested that the word "cessation" means a temporary cessation; once the cessa-

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42. See 4 E. Kuntz, A TREATISE ON THE LAW OF OIL & GAS § 47.3(a) (12th rev. ed. 1964).
43. See, e.g., Hoyt, 606 P.2d at 563.
44. See 4 E. Kuntz, supra note 42, § 47.3(a).
45. See, e.g., Hoyt, 606 P.2d at 563; French, 725 P.2d at 277.
46. See 4 E. Kuntz, supra note 42, § 47.3(b); H. Williams & C. Meyers, OIL AND GAS LAW § 616.1 (abr. ed. 1975).
47. See Lowe, supra note 7, at 195.
48. See Hazlett, Effect of Temporary Cessation of Production on Leases and Term Royalties, 10 INST. ON OIL & GAS L. & TAX'N, 201, 249 (1959). Hazlett stated that:
cessation of production exceeds the stipulated period in the clause, the lease is terminated. It also has been suggested that the word "cessation" means "total cessation" of the production;\textsuperscript{49} once the production ceases totally, the lessee should commence a required action within the stipulated period.

A correct interpretation of the word "cessation," however, should be a "permanent cessation." As discussed before, the interpretation of the habendum clause has already provided protection to the lessee from a temporary cessation. The courts are very liberal in providing such protection.\textsuperscript{50} It is unreasonable to assume that the lessee will restrict his protection during a temporary cessation to a stipulated period by providing a clause, when the courts have allowed a temporary cessation period as long as four years without a termination of the lease.\textsuperscript{51} The interpretation "total cessation" may also restrict the lessee's rights. A lease may stop producing "totally" for the stipulated period; however, after certain workover operations, it may start producing in paying quantities. That is, although the production has ceased "totally," it has not ceased "permanently." In other words, a "total" cessation may be a "temporary" cessation of the production. If one wants to assess the true intentions of the parties, the logical conclusion would be that the lessee was extending his rights, and not restricting them, by including such a clause. These rights are rights to explore. The lessee's intention to expand his right to explore new formations during the secondary term is consistent with the oil and gas business realities. After producing hydrocarbons from one formation until exhausted, the lessee would like to explore other parts of the lease for additional hydrocarbons. Often there may be several producing formations underlying each other. After exhausting known formations, the lessee may intend to drill deeper to produce more hydrocarbons. Or, he may decide to drill at other potential locations. Because this will result in additional production, it is beneficial to both the lessee and the lessor, so long as the lessee operates to satisfy the prudent operator's standard.

\textsuperscript{49} See Lowe, supra note 7, at 185.

\textsuperscript{50} See 2 E. Kuntz, supra note 22, § 26.8(d).

\textsuperscript{51} See Saulsberry v. Siegel, 221 Ark. 152, 252 S.W.2d 834 (1952).
Another possibility that should not be overlooked is the use of secondary or tertiary oil recovery methods to produce additional oil from the same formations. With the advent of new technology, many techniques have become economically feasible to produce additional reserves. The interpretation of the habendum clause, however, does not provide these additional rights. By providing an additional sixty days to explore and drill, the lessee has given himself those rights. Professor Kuntz has stated that:

[It] would be more reasonable to construe the cessation of production clause so that the provision “or if after the discovery of oil or gas in paying quantities the production thereof should cease from any cause” refers not to a temporary cessation of production but to a cessation of production that would be permanent unless corrected by reworking or drilling operations.

The view that the cessation of production clause is not applicable during a temporary cessation is honored in a few jurisdictions. For example, in Wilson v. Talbert, a storage tank was ruptured, and the difficulties encountered in repairing it resulted in a temporary cessation of production for more than sixty days. The lease provided a typical ‘sixty days’ cessation of production clause. The lessor demanded that the lease be terminated. The Arkansas Supreme Court refused to terminate the lease, stating that: “[Although] [t]he wording of this provision

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52. Currently, the estimated reserves in the United States are 470 billion barrels of oil. Only 25 percent or approximately 120 billion barrels of oil will be produced using primary recovery techniques. It is estimated that, with the available technology, 25 percent additional reserves may be produced; i.e. addition of another 120 billion barrels with the help of secondary and tertiary oil recovery methods. See Doscher & Wise, SPE Preprint No. 5800, presented at SPE/DOE First Symposium on Enhanced Oil Recovery, Tulsa, Oklahoma (1976).

53. See 4 E. Kuntz, supra note 42, § 47.3(a). See also 2 E. Kuntz, A TREATISE ON THE LAW OF OIL & GAS § 26.13 (12th rev. ed. Supp. 1986). In reemphasizing his position, Professor Kuntz stated:

Once it is recognized that any brief interruption in the operation must be tolerated as a practical matter, it becomes necessary to adopt a doctrine that permits temporary cessations of production. The resumption of operations clause [which is very similar to the cessation of production clause] was never designed to eliminate or to avoid the operation of such doctrine or to require that oil or gas be produced and marketed in a continuous, uninterrupted operation. It was intended to preserve a lease in order to permit a lessee to restore production if production should cease under circumstances that require drilling or reworking on his part in order to restore production. Accordingly . . . the clause “or if after the discovery of oil or gas in paying quantities the production thereof should cease from any cause” refers, not to a temporary cessation of production, but to a cessation of production that would be permanent unless corrected by reworking or drilling operations.

Id. § 26.13.


56. Id. at __, 535 S.W.2d at 808.

57. Id.
is . . . ambiguous[,] . . . it evidently refers to a threatened permanent cessation which can be averted only by extensive measures such as the drilling of a new well or the reworking or deepening or plugging back of an existing well.\(^{58}\)

In *Huhn v. Marshall Exploration, Inc.*,\(^{59}\) a similar clause was held to be inapplicable when a temporary cessation resulted from vandalism of the production equipment.\(^{60}\) The Louisiana Court of Appeals reasoned that as long as reasonably diligent and timely efforts were made to restore the production after temporary cessations, the cessation of production clause was inapplicable.\(^{61}\)

In sum, the cessation of production clause is included to extend, and not to restrict, the lessee’s rights during the secondary term. These rights include exploration and drilling of new formations once the production from the original formation is exhausted. As a result, if the production ceases temporarily, so long as the lessee makes a reasonable and diligent effort to restore the production, the lease should not terminate by virtue of the cessation of production clause.

### III. Analysis of Recent Decisions in Oklahoma and Texas

Both the Oklahoma and Texas Supreme Courts have rendered decisions on the application of the cessation of production clause during the secondary term.\(^{62}\) In *French v. Tenneco Oil Co.*,\(^{63}\) the lessee did not obtain any production from the lease for four months. However, during that time the operator tried to restore the production by various procedures.\(^{64}\) The plaintiff argued that the lease should be terminated by the terms of the cessation of production clause which included sixty days to commence drilling operations. In granting this request, the supreme court stated that: “Where the parties have bargained for and agreed on a time period for a temporary cessation clause, that provision will control over the common law doctrine of temporary cessation allowing a ‘reasonable time’ for resumption of drilling operations.”\(^{65}\) The court construed

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58. 259 Ark. at ___, 535 S.W.2d at 809.
60. Id. at 564.
61. Id. at 565.
62. See, e.g., *French*, 725 P.2d 275; *Hoyt*, 606 P.2d 560; *Samano*, 621 S.W.2d 580.
63. 725 P.2d 275 (Okla. 1986).
64. “These procedures included swabbing the well, blowing the well to the atmosphere, acidizing, injecting Dowell Versene, and pulling tubing, reperforating and sand fracturing.” *French*, 725 P.2d at 276.
65. Id. at 277. (emphasis added) (quoting *Hoyt*, 606 P.2d at 563.)
that the cessation of production clause is applicable during a temporary cessation. Note that the word "temporary" is not included in the cessation of production clause. The supreme court read this word into it. However, the foregoing analysis shows the appropriate meaning of "cessation" should be a permanent cessation rather than a temporary cessation.

In French, the court used the legal precedent of Hoyt v. Continental Oil Co. In Hoyt, the operator did not produce gas in paying quantities for fourteen months of the lease. The lease included a cessation of production clause. In terminating the lease, the supreme court stated that:

If... production does not cease entirely but does cease to be in paying quantities, there may or may not be such a cessation of production for purposes of the cessation of production clause, depending upon whether or not the effect is to modify the habendum or drilling clause. . . . [Thus, if] the primary term has expired and the effect of the [cessation clause] is to modify the habendum clause . . . [.] there is a cessation of production if the habendum clause requires production in paying quantities and such requirement is not met.

The court construed correctly the word "production" in the cessation of production clause to mean production in paying quantities. However, the court also determined that the meaning of cessation should be a temporary cessation rather than a permanent cessation.

In Samano v. Sun Oil Co. the Texas Supreme Court construed the cessation of production clause against the lessee in arriving at the result. The habendum clause in the lease read in part:

[T]his lease shall remain in force . . . as long THEREAFTER as oil, gas or other mineral is produced from said land, . . . or as long THEREAFTER as Lessee shall conduct drilling or re-working operations thereon with no cessation of more than sixty consecutive days until production results, so long as any such mineral is produced.

During the secondary term, production had stopped for a period of seventy-three days before Sun Oil Company took any action. The supreme court reasoned that the word "thereafter," during the secondary term,

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66. 606 P.2d 560 (Okla. 1980). Incidentally, the French and Hoyt decisions are written by the same justice—Justice Hargrave.
67. Id. at 562.
68. Id. at 563.
69. Id.; French, 725 P.2d at 277.
70. See supra note 53 and accompanying text.
71. 621 S.W.2d 580 (Tex. 1981).
72. Id. at 581.
73. Id.
modifies the habendum clause by the cessation of production clause. Therefore, when the production stopped temporarily, the lessee had to commence drilling or reworking operations within sixty days. Because the lessee failed to do so, the lease terminated.

The Texas Supreme Court used a strict construction of the clause to arrive at its result. Although the habendum clause did not explicitly state whether the cessation had to be temporary or permanent, the court used a strict meaning of the word “produced,” and assumed that when the production stopped, the sixty-day period in the cessation clause began. The court also stated that the temporary cessation doctrine was not applicable in this case.

In reaching this decision, the court used the legal precedent established in *Sunray DX Oil Co. v. Texaco, Inc.* The Texas and Oklahoma supreme courts also quote *Wainwright v. Wainwright*, *Sullivan & Garnett v. James*, and *Clifton v. Koontz* in arriving at their decisions in *Samano* and *Hoyt* respectively. However, these cases can be distinguished from *Samano* and *Hoyt*.

In *Sunray*, the production stopped because of the exhaustion of primary reserves. The court correctly ruled that it was a permanent cessation. In *Wainwright*, although the cessation of production was temporary, due to the operator’s imprudence, the court deemed the cessation to be a permanent one. In both *Sullivan* and *Clifton*, the

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74. Id. at 582.
75. Id. at 584.
76. Id.
77. Id.
78. 417 S.W.2d 424 (Tex. Civ. App. 1967), writ ref’d n.r.e.
79. 359 S.W.2d 628 (Tex. Civ. App. 1962), writ ref’d n.r.e.
80. 308 S.W.2d 891 (Tex. Civ. App. 1957), writ ref’d n.r.e.
81. 160 Tex. 82, 325 S.W.2d 684 (1959).
82. *Sunray*, 417 S.W.2d at 428. In distinguishing a temporary cessation from a cessation as a result of a gradual decline, the court recognized that a continuous production from a lease is not possible due to breakdown of equipment, workover operations, and other correctional remedies. However, this type of cessation is different from a cessation of production as a result of gradual decline (which indicates the exhaustion of primary reserves). *Id.*
83. See supra note 37 and accompanying text.
84. Wainwright v. Wainwright, 359 S.W.2d at 629-30 (Tex. Civ. App. 1962), writ ref’d n.r.e. In this case, the lessee had voluntarily shut down the production for more than ninety days. The lease contained a clause that the lessee had a duty to start drilling operations within ninety days, if the production ceases from any cause. The court stated that the operator acted imprudently in shutting down the well. In the analysis, the court stated that if the cessation is held temporary, a good well may be shut down for unlimited time, and an imprudent operator may refuse to produce without danger of losing the lease.
85. Sullivan & Garnett v. James, 308 S.W.2d at 893 (Tex. Civ. App. 1957), writ ref’d n.r.e.
86. Clifton v. Koontz, 160 Tex. at __, 325 S.W.2d at 692.
courts stated that the production in paying quantities has to be ceased over a reasonable period. Because a prudent operator will not be able to produce from these leases, the courts will deem the cessation to be a permanent one. In all these cases, the courts applied the cessation of production clause only after the leases had stopped producing permanently. In contrast, the courts in Hoyt, Samano, and French construed the cessation of production clause to mean that even if the production ceases temporarily, the lease may terminate if the lessee did not take appropriate action within the period stated in the cessation of production clause.

The only cases which support the rationale advanced in Hoyt and Samano are Woodson Oil Co. v. Pruet, Haby v. Stanolind Oil and Gas Co., and Greer v. Salmon. However, Woodson and Greer can be distinguished from Samano and Hoyt. In Woodson, the facts reveal that the court applied the cessation of production clause only after the production had ceased permanently. In Greer, although the cessation of production was temporary, the operator’s imprudence resulted in a permanent cessation of the production. Unfortunately, in both Woodson and Greer, the courts’ reasoning did not explicitly state that the cessation of production was permanent. Instead, the courts seemed to apply the cessation of production clause even after the temporary cessation of production.

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87. In Clifton, the Texas Supreme Court stated that the cessation of production should be established first; the test being what a reasonably prudent operator would do under given circumstances. If the prudent operator stops producing, the cessation is permanent, and the well has stopped producing in paying quantities. By virtue of the cessation clause, the lessee has the stated “grace” period to commence reworking or drilling operations. Id. at __, 325 S.W.2d at 690-91.

91. 281 S.W.2d 159 (Tex. Civ. App. 1955), writ ref’d n.r.e.
92. 228 F.2d 298 (5th Cir. 1955).
94. Woodson, 281 S.W.2d at 162. In quoting an expert witness, the court noted that: “[T]he well ‘was completely dead’ in February, 1953, when the workover crew was there, that the fact that there was a small amount of gas from the well after the swabbing . . . would indicate . . . that the well was completely dead . . . .” Id. at 162-63 (emphasis added).
95. Greer, 82 N.M. at __, 479 P.2d at 295. The facts of the case reveal that “[f]rom October 1956 until June 1960, except for 7 MCF produced in May 1958, no gas was produced into the pipeline of the purchaser, . . . as a result of a leak in the flow line . . . . The leak was discovered in May 1960 . . . .” Id. Although the court does not explicitly state so, a period of four years to discover a gas leak indicates an imprudent operation.
96. See Woodson, 281 S.W.2d at 164; Greer, 82 N.M. at __, 479 P.2d at 297. In Greer, the court quotes Hazlett’s article in support of its decision. Id. at __, 479 P.2d at 297. See also supra note 48 and accompanying text (concerning temporary cessation).
tion.\textsuperscript{97} The temporary cessation had resulted because of government regulations.\textsuperscript{98} \textit{Haby} has been criticized on the grounds that shutting down a well in compliance with government orders was not the kind of cessation contemplated by parties.\textsuperscript{99}

In sum, except for \textit{Haby}, all of the previous decisions can be explained using the analysis of the cessation of production clause as discussed before. Unfortunately, these decisions did not explicitly state that the application of the cessation of production clause was proper only after a permanent cessation. Instead, some courts apparently advocate the principle that the cessation of production clause can be applied even after a temporary cessation.\textsuperscript{100} This principle was used by the supreme courts of Oklahoma and Texas in reaching their recent decisions.\textsuperscript{101}

Fortunately the Texas Court of Civil Appeals reached a decision different from \textit{Samano}. In \textit{Shelton v. Taylor},\textsuperscript{102} the production had ceased temporarily due to mechanical failure of the lifting pump. The court quoted from the lease that contained a clause which stated in part:

If at the expiration of the primary term, oil, gas or other minerals [sic] is not being produced . . . but Lessee is then engaged in drilling or reworking operations thereon, the lease shall remain in force for so long as operations are prosecuted with no cessation of more than thirty (30) consecutive days.\textsuperscript{103}

By upholding the trial court and deciding not to find the lease terminated, the court stated that this clause was not applicable for a temporary cessation of production.\textsuperscript{104} The court carefully distinguished the formal setting in \textit{Samano} from that in \textit{Shelton} by stating that in \textit{Samano} the cessation of production clause "was in the same sentence as the lease term's definition," whereas, the \textit{Shelton} cessation of production clause

\begin{thebibliography}{99}
\bibitem{97} \textit{Haby}, 228 F.2d at 305. The lease contained a provision which stated "if after discovery of oil and gas the production thereof should cease \textit{from any cause}, this lease shall not terminate if Lessee commences additional drilling or re-working operations within 60 days thereafter." \textit{Id.} In strictly construing the clause, the court stated that the words "\textit{from any cause}" included the cessation of production clause as a result of government regulations. Stanolind did not comply with the clause because it failed to start drilling or reworking operations within 60 days. The court further added that "additional drilling was economically impractical is no excuse" to Stanolind's noncompliance. \textit{Id.} at 306.
\bibitem{98} The facts of the case reveal that Stanolind Oil & Gas Co. did not produce any gas from April 1, 1953 to January 1, 1954 as a result of order from Railroad Commission of Texas. However, on January 1, 1954, Stanolind had secured an exception from the Railroad Commission order, and subsequently started production. \textit{Id.} at 301-02.
\bibitem{99} See Hazlett, \textit{supra} note 48, at 251.
\bibitem{100} See \textit{supra} note 96 and accompanying text.
\bibitem{101} See, \textit{e.g.}, \textit{Hoyt}, 606 P.2d at 563; \textit{Samano}, 621 S.W.2d at 581.
\bibitem{103} \textit{Id.} at 915.
\bibitem{104} \textit{Id.} at 916.
\end{thebibliography}
was located after the lease term was defined. This distinction was rather superficial, because it already has been well established that the cessation of production clause modifies the habendum clause during the secondary term of the lease, no matter where the clauses are located in the lease. However, the Texas Civil Court of Appeals, as a lower court, had to distinguish Samano to avoid overruling the Texas Supreme Court's decision.

IV. CONCLUSION

French v. Tenneco Oil Co., Hoyt v. Continental Oil Co., and Samano v. Sun Oil Co. stand out as isolated cases which construe the cessation of production clause as applicable even after a temporary cessation of the production. In all three cases, the courts used strict rules of construction to hold that if the temporary cessation of production lasts longer than the stated period in the cessation of production clause, the lease will terminate unless the lessee commences the required action. All of the cases refer to several previous decisions as precedent. However, a clear reading of the cases relied upon distinguishes them from French, Hoyt, or Samano. All of those previous decisions held that the cessation of production in paying quantities cannot be arbitrarily determined. Rather, before the cessation of production clause is applied, it must be established that production in paying quantities has permanently ceased. The typical rule applied is the prudent operator's rule. Therefore, if the production cessation is only temporary, but the operator acts imprudently, the cessation may be deemed permanent.

The reality of today's business requires that an operator be given a fair opportunity to show that he has acted prudently in producing hydrocarbons from the lease. For example, in the current oil crisis, if the oil price was $15 per barrel during February and March of 1986, and if the

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105. Id. at 915.
106. See, e.g., Miami Oil Producers, Inc. v. Larson, 203 Mont. 225, —, 661 P.2d 1260, 1262 (1983) (the habendum clause was in paragraph 2 of the lease; the cessation of production clause was in paragraph 6); Greer v. Salmon, 82 N.M. at —, 479 P.2d at 295-96 (1970) (the habendum clause was in paragraph 2; the cessation of production clause was in paragraph 8 of the lease); Sunray DX Oil Co. v. Texaco, Inc., 417 S.W.2d at 426-27 (Tex. Civ.App. 1967) (the habendum clause was in paragraph 3; the cessation of production clause was in paragraph 7). In none of the decisions did the courts distinguish from other cases on the basis of the physical location of the cessation of production clause within the lease document.
108. 606 P.2d 560 (Okla. 1980).
110. See, e.g., Hoyt, 606 P.2d at 563; Samano, 621 S.W.2d at 581.
associated production cost was $15.50 from a particular well, the decisions in Hoyt and French require that the lessee start drilling or reworking operations in April to save the lease. However, a prudent operator may wait longer under the current fluctuating market conditions. There are hundreds of marginal wells in Oklahoma and Texas whose profitability depends entirely upon the price of a barrel of oil. When oil prices are so low that the well may not be producing in paying quantities, a

\[\text{Month/Year} \quad \text{Oil Price, $/bbl}\]

<table>
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See OIL AND GAS J., Energy Database (October 23, 1986). The prices quoted here are based on the monthly average basis. During each month, the spot prices varied widely. In the same period, the average oil prices in Oklahoma and the neighboring states varied over a wide range as well. The average crude prices in Oklahoma and its neighboring states are listed below.

<table>
<thead>
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<th>Month/yr</th>
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</table>

See: 84 OIL & GAS J. 40 (June 30, 1986).

This unprecedented drop in the price of oil was unexpected to the entire oil industry. As a result of the price decline, many wells which had been profitable, became unprofitable, and were forced to shut down. Phillips Petroleum Co., for example, shut in about one thousand oil producing wells at which operating costs exceeded revenue from production; most of the wells are in Oklahoma; more than three hundred in the Burbank field in Osage County. Similarly, UNOCAL Corp. shut-in four hundred twenty five unprofitable wells in California and other states. See: 84 OIL & GAS J. NEWSLETTER (May 5, 1986).

The term "stripper well" refers to an oil well producing less than ten barrels of oil per day. As the price of oil decreases, these wells become unprofitable. As a result, some wells have to be shut in to minimize losses. It should be noted, however, that if the price of oil increases, these wells can be produced profitably (or in paying quantities).

Striper wells accounted for approximately 15 percent of the total U.S. production during 1984. However, as the price of oil plunged, so did the production from stripper wells. The following table illustrates the dramatic effect oil price has on production from stripper wells.
prudent operator could be one who stops production. The lapse in production could then be attributed to a temporary attempt to minimize losses. If the oil prices rise again, the operator will start the production in a profitable manner.

By construing the cessation of production clause to require the operator to act prudently, both parties to a lease would be given a fair opportunity to exploit the hydrocarbons. If the production from a given formation ceases, the entire benefit of a lease can be developed by allowing the lessee to explore further without fear of lease termination. At the same time, by using the prudent operator's standard, the lessee would not be allowed to take undue advantage of the lessor. Some states have adopted the prudent operator standard.\textsuperscript{113} Oklahoma\textsuperscript{114} and Texas,\textsuperscript{115} however, have not. Ironically, Oklahoma and Texas were the first states whose courts ruled that the word "production" in the habendum clause means "production in paying quantities."\textsuperscript{116}

The future of leases containing the cessation of production clause does not look promising in Oklahoma or Texas. It has been suggested that the word "production" should be replaced by "total production" in this clause.\textsuperscript{117} However, this construction would not have saved the lease terminated in \textit{French}.\textsuperscript{118} Although a well may be shut-in for a two month period, it does not necessarily follow that the cessation is a permanent one. The well may stop producing "totally"; however, by workover

<table>
<thead>
<tr>
<th>Oil Price, $/bbl</th>
<th>Production Lost, bbl/day</th>
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<tr>
<td>$10.0</td>
<td>640,000</td>
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</table>

As the oil prices dip below $15.00, the production from these wells declines sharply.

Most of these wells are located in Oklahoma, Texas, and Kansas; 56 percent of U.S. stripper well production comes from these three states. Consequently, with the decrease in the price of oil, these three states are affected significantly by the loss of production from the stripper wells. See 38 J. \textit{PETROLEUM TECH.} 740 (July 1986).


118. \textit{French}, 725 P.2d at 276.
operations, it may be brought back to producing in paying quantities. Therefore, the word “total” cannot be equated to “permanent.” With the inclusion of the word “total,” the lease may become more specific and thus may be unintentionally terminated.

One alternative which has been suggested is to replace the word “cessation” in the cessation of production clause with “permanent cessation.” For example, a typical clause may read: “If after the expiration of the primary term . . . production shall cease permanently from any cause . . . [the] lease shall not terminate . . . provided lessee resumes drilling or reworking operations within sixty days.” By inserting the word “permanently,” the lease expressly repudiates the word “temporary.” Therefore, even using a strict construction, the plaintiff seeking lease termination will have to show that the production has permanently ceased. Even using the word “permanent,” the temporary cessation doctrine may still be invoked. Thereby, the courts will not be able to use temporary cessation to terminate the lease.

A second alternative which may avoid a premature termination of the lease is to make an attempt to distinguish between French, Hoyt, Samano, and other cases. Tenuous reasoning may be used to show that the production in paying quantities had ceased in the factual situations of the three cases, and that therefore the cessation of production clause came into effect. After distinguishing these cases, the cases in other states should be argued persuasively to indicate the true meaning of the clause.

A third and better alternative to avoid termination of a lease may be to persuade the courts to allow the intentions of the parties to govern. No oil or gas well produces hydrocarbons continuously and most wells require corrective operations from time to time. During these times, the well may not produce or may produce in smaller quantities. However, a prudent operator will continue to operate the well. Both the lessee and the lessor have engaged in a business transaction to make a profit. Unless the lessee operates the well for speculative purposes, he should be given every opportunity to show that the cessation of production was a temporary one, and that the well, over a reasonable period of time, will produce in paying quantities. The current oil crisis will lead to a premature termination of several oil and gas leases if the cessation of production clause is strictly applied as it was in the cases of French and Samano. Practical considerations such as the amount of capital already invested or the potential for development of previous formations dictate that, once produc-
ing, oil and gas leases in the secondary term should remain in effect as long as the operator acts in a prudent manner.

Mohan Kelkar