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A *TRES C* APPROACH: THREE STEPS TO OIL AND GAS LEASE TERMINATION

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I. Introduction

In *Tres C, LLC v. Raker Resources, LLC* (hereinafter, *Tres C*) the Supreme Court of Oklahoma established the time necessary to determine whether an oil lease has expired due to a cessation of production.[1] Specifically, the Court focused on determining a reasonable time period to establish that there had been a measurable change in production such that would warrant a termination of the oil lease.[2] This timeline is dependent on a "time appropriate under all the facts and circumstance of the case" as opposed to a bright line rule that establishes a specific time to compare a measurable change in production.[3] By outlining the following steps to analyze whether an oil lease has terminated, lessors and lessees are afforded an opportunity to assess the production levels of their leases. This process enables them to collaborate with legal counsel to decide whether legal recourse is necessary based on the established criteria.

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1. Tres C, LLC v. Raker Resources, LLC, 2023 OK 13, ¶ 19 at 11, 532 P.3d 1.
2. *Id.*
3. *Id.* ¶ 30.532 P.3d at 17.

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The Court in *Tres C* asserts courts should continue to use a reasonable period standard when determining whether a lease is producing in paying quantities.[4] This stance remains consistent with previous treatises and cases, which, consider the "reasonableness" surrounding oil leases and their establishment.[5] However, courts differ on whether a cessation-of-production clause modifies these rules and would set a definite time period to determine if cessation has occurred.[6] *Tres C* takes the opposite stance by stating a definite time period is not established and instead asserts that the position of the Kuntz's Treatise on the Law of Oil and Gas should be taken, wherein, a reasonable period standard should be implemented when considering the purpose and effect of a cessation-of-production clause.[7] This article examines the reasonable period standard as set forth by the Court in *Tres C*.[8] This includes two parts: (1) what is considered "reasonable" when analyzing dips in production when a cessation of production has occurred and (2) providing a framework for determining if a lease has terminated or if it was saved by the "savings clause."[9]

While *Tres C* solidified this reasonableness standard, it also outlined a compelling framework that can serve as a systematic approach for both parties and their analyses of lease termination.[10] This article proposes the following steps to determine whether an oil lease terminated:

1. Production Cessation Check: Evaluate whether production *has entirely ceased* at the oil well.[11]

2. Quantitative Assessment: If production has not ceased entirely, proceed to inquire whether production has ceased *in paying* quantities within a reasonable accounting period.[12]

3. Grace Period Compliance: If the answer to *either* step one or two is *affirmative*, proceed to investigate whether the lessee has complied with the cessation of production's grace period.[13]

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4. *Id*.
5. *Id*.
6. *Id*.
7. *Tres C,* 2023 OK 13, ¶ 30, 532 P.3d at 17.
8. *Id.* ¶ 37, 532 P.3d at 20.
9. *Id*. ¶ 28, 532 P.3d at 16.
10. *Id*. ¶ 28 –30, 532 P.3d at 15–17.
11. *Id.* ¶ 28, 532 P.3d at 15–16.
12. *Id.* ¶ 29, 532 P.3d at 16.
13. *Id.* ¶ 28, 532 P.3d at 16.

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After determining if a lease has terminated, the court may proceed to consider the reasonableness of the time period surrounding the cessation.[14] This article will delve into *Tres C,* covering the issue, facts, and the impact of the Court's ruling. Subsequently, it will serve as a guide through a three-step process for determining whether an oil lease has terminated while taking into account the reasonable period standard as established in *Tres C*.

II. Statement of the Case

A. Issue

In *Tres C,* the Supreme Court of Oklahoma analyzes whether a three-month window was long enough to determine if an oil lease experienced a significant enough drop in production to warrant the triggering of the cessation of production clause.[15] If the clause is triggered this would allow the lessor to abandon the oil lease and quiet title it to a third party.[16]

The Court states that this "quiet title action is a matter of equitable cognizance" because plaintiff, *Tres C*, is asking the Court to declare the state of title to the oil and gas rights in the tract of land between themselves and the defendants.[17] Plaintiff asserts they hold the land under a "top" lease.[18] Defendants assert their right under a "bottom" lease which the plaintiff claims should be equitably cancelled due to a failure to produce in paying quantities.[19]

B. Facts

Plaintiff/Respondent (*Tres C*) is an Oklahoma LLC, whose members are the successor-in-interest to certain mineral interests in a portion located in the "northern half of Section 35, Township 15 North, Range 13 West" of Blaine County, OK.[20] Two of the members of *Tres C* executed an oil and gas lease naming JJ. Wright as lessee and concerned mineral interests in the above-mentioned plot in Blaine County ("Cowan Lease").[21] The habendum clause stated the Cowan Lease would remain valid for a primary term of ten

14. *Id*. ¶ 28, 532 P.3d at 15 – 16.
15. *Tres C*, 2023 OK 13, ¶ 19, 532 P.3d at 13.
16. *Id.*
17. *Id*. ¶ 22, 532 P.3d at 14.
18. *Id.* ¶ 19, 532 P.3d at 13.
19. *Id*.
20. *Id*. ¶ 1, 532 P.3d at 2.
21. *Id*. ¶ 2, 532 P.3d at 2.

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years so long as a producing well was drilled.[22] The secondary term of the lease would last "as long thereafter as oil, gas, casinghead gas, casinghead gasoline, or any of the products covered by this lease is or can be produced" with a cessation of production clause included.[23] The primary term was satisfied and the Cowan Well moved into the secondary term.[24]

Defendants/Petitioners are the successors-in-interest of the Cowan Lease, having purchased both the Cowan Well and an assignment of all leaseholds in that plot of land in 2009 as DSM Oil for $35,000.[25] Less than a year after purchasing, DSM Oil assigned all purchased leaseholds to Defendant/Petitioner Continental Resources in exchange for five hundred thousand dollars and 7.5% royalty interest in any of their future Continental-drilled wells.[26] In 2012, Rakers (previously of DSM Oil) bought out DSM Oil's interest through his new company Rakers Resources, LLC (Defendant/Petitioner)–making them the operator of this well for purposes of the *Tres C* appeal at issue in this opinion.[27] DewBlaine Energy engaged in a joint venture with Continental Resources for oil and gas exploration in the Blaine County plot and their ability to drill was limited by Raker Resources.[28]

Although it was producing, it was at very low rates when DSM Oil first acquired the well in 2009.[29] Gary Raker was convinced that improved pressure would revive the well.[30] He was able to increase production of the well "twenty-fold within the first year" of ownership.[31] This progress continued until early 2016 when the royalty checks to Raker Resources from *Tres C* "began to arrive sporadically."[32] At this point, *Tres C* hired attorneys, and *Tres C*'s lawyers sent Raker Resources a letter stating "relevant production records . . . evidence that the GD Cowan No. 1 well has long since ceased producing in paying quantities . . . . [and that] the captioned Lease has expired by its terms" and "demand[ed] that the well be plugged and abandoned, the surface restored to its original condition and

22. *Tres C*, 2023 OK 13, ¶ 1, 532 P.3d at 2.
23. *Id*.
24. *Id*.
25. *Id*. ¶ 3, 532 P.3d at 3.
26. *Id*.
27. *Id*.
28. *Id*.
29. *Id*. ¶ 4, 532 P.3d at 4.
30. *Id*.
31. *Id*.
32. *Tres C*, 2023 OK 13, ¶ 5, 532 P.3d at 4.

the captioned Lease be released of record within 30 days of your receipt of this letter."[33]

In response, Raker reduced the monthly pumper fee so as to reduce the expenses attributed to the Cowan Well and hopefully maintain its production in "paying quantities."[34] *Tres C* requested evidence of costs and revenue from January 2012 to June 2016–Raker's production showed that the gas production patterns had stayed relatively the same but that there had been a dip in production from December 2015 to June 2016 that had been unprofitable.[35] However, after that dip the well did become profitable again, albeit not significantly so.[36] Raker Resources was incredibly proactive in trying to address the problems of production throughout the months, however production did not improve.[37]

Throughout this process of first and second demand letters, Raker Resources contacted Continental Resources to inform them of both demand letters that had been received from *Tres C* and further disclosed that the Cowan Well made "more revenue than costs, but not a whole lot more."[38] Raker inquired after the first letter whether Continental would "protect its leasehold" by drilling another well to increase its own revenue or if it would purchase the Cowan Well and take over the operations.[39] While Raker Resources did not see a continuous increase in production from their wells, there was a noted effort on their part to increase production.[40] They injected soap into the well to try to aerate the fluids to expel them easier; they attempted a practice known as "rocking the well" where coil tubing is used to force fluid up; and they invested $9,000 in the transportation and installation of a compressor which required the Cowan Well to be turned off for two-and-a-half weeks for installation.[41] Although the compressor increased the production of the well to above its previous benchmark, the Cowan Well still struggled with meeting profitability marks for October, November, and December of 2016.[42] *Tres C* hired new attorneys and became more active in pursuing the termination of the Cowan Lease while

33. *Id*. (alterations in original).
34. *Id*.
35. *Id*.
36. *Id*. ¶ 6, 532 P.3d at 5.
37. *Id*.
38. *Id*. ¶ 5, 532 P.3d at 5
39. *Tres C*, 2023 OK 13, ¶ 5, 532 P.3d at 5.
40. *Id*. ¶ 7, 532 P.3d at 5.
41. *Id*. ¶ 7, 523 P.3d at 5–6.
42. *Id*. ¶ 8, 532 P.3d at 5–6.

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Continental Resources found themselves on a different route for their leasehold interests, thus looking at land in a different area, not subject to the terms of the Cowan Lease or under Raker Resources.[43]

C. Arguments of the Parties

Defendants/Petitioners, Raker Resources, posit that the Court should assess whether or not a well is capable of production, "thus perpetuat[ing] the lease under the habendum clause" by using a "reasonable look-back period of time sufficient to consider whether a prudent operator would continue or abandon operations."[44] Raker Resources specifically argues the 60-day savings period in the cessation-of-production clause does not apply unless a true cessation of "profitable production" has occurred over a longer period of time.[45] Further, this period should be determined in light of all equitable circumstances.[46] Raker argues that solely utilizing a 60-day cessation period would mean that a cessation-of-production clause is always engaged, which would put a larger burden on the lessee to constantly evaluate the need to establish new wells in order to save their lease, or risk an interruption in their period of profitable months of production.[47] Raker asserts that this puts an undue burden on lessees to monitor the production of their wells on a "daily basis and [remain] prepared to take action" at any point in time if production appears to dip in profitability.[48]

According to Raker Resources, this is "contrary to Oklahoma law, and wholly unworkable for the oil and gas industry" because it will result in new and "economically unworkable" hurdles for the oil and gas industry within the state.[49] Raker Resources argue that the Court of Civil Appeals not only failed to address this issue of law on appeal but they also disregarded the Court's precedents as set forth in *Stewart v. Amerada Hess Corp.*, *Pack v. Santa Fe Minerals*, and *Hall v. Glamor*, *Blair v. Natural Gas Anadarko, Co*.[50] Additionally, Raker Resources asserts that the court

43. *Id.* ¶ 19, 532 P.3d at 13.
44. *Id.* ¶ 24, 532 P.3d at 14.
45. *Id.*
46. *Id.*
47. *Tres C*, 2023 OK 13, ¶ 24, 532 P.3d at 14.
48. *Id.* ¶ 24, 532 P.3d at 15.
49. *Id.*
50. *Id.*

published an opinion conflicting with the "preeminent treatise on oil and gas" that this Court regularly relied on.[51]

Tres C contends that this Court "cannot endorse [Raker Resource's] 'reasonable look-back period' approach because the terms of the Cowan Lease's 'bargained-for cessation-of-production clause'" would be controlling over the common law temporary cessation doctrine.[52] This would give Raker Resources only 60 days to restore production in paying quantities or risk loss of the lease.[53] Further, it is argued that Raker Resources "seeks to overturn decades of the Court's precedent" as is outlined in cases such as *Hoyt v. Continental Oil Co., French v. Tenneco Oil Co.,* and *Hall v. Galmor*.[54]

Tres C distinguishes the *Pack* and *Blair* cases mentioned by Raker Resources by asserting that those cases had stipulated that the "wells at issue were capable of production in paying quantities", whereas the Cowan Well's capability of producing in paying quantities is being disputed.[55] *Tres C* would have the Court hold that the Court of Civil Appeals correctly rejected the [Defendant/Petitioner's] arguments in finding that the "lease had expired pursuant to its terms due to a cessation of commercial production far in excess of 60 days", thus relying on the teachings of *Hoyt*, *French*, and *Hall*.[56]

III. Decision of the Case

The Court ultimately held that the trial court erred in determining that a cessation of production occurred based on *Tres C's* evidence that the Cowan Well was unprofitable for the three months of September through October, 2016.[57] In making their determination, the Court in *Tres* C began by stating that the cessation-of-production clause "only comes into play after a cessation has occurred."[58] The Court emphasized that the clause has "no bearing" on anything that occurs prior to a complete cessation-of-

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51. Tres C, LLC v. Raker Resources, LLC, 2023 OK 13, ¶ 24, 532 P.3d 1, 15; *see also* 2 Eugene Kuntz, A Treatise on the Law of Oil and Gas §§ 26.6, 26.7(u), 26.13(b) (1990 & Supp. 2021); 4 Eugene Kuntz, A Treatise on the Law of Oil and Gas § 47.3(a)(1) (Supp. 2021)).

52. *Tres C*, 2023 OK 13, ¶ 25, 532 P.3d at 14.

53. *Id.*

54. *Tres C*, 2023 OK 13, ¶ 25, 532 P.3d at 14–15.

55. *Id*.

56. *Id*.

57. *Id*. ¶ 36, 532 P.3d at 20.

58. *Id*. ¶ 28, 532 P.3d at 16.

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production, "including the assessment of whether a cessation has occurred."[59] In considering the cessation-of-production clause's grace periods, the Court took the stance posited by Kuntz stating that "it is not the purpose of the cessation of production clause to establish an accounting period for purposes of determining if production is in paying quantities."[60] If this were the case, that would place a burden on lessees to continuously market their product which this Court has continuously held is not a factor for determining the life of a lease.[61] Further, the lessors argued that the term "production" included the "removal and marketing" of the product which would require lessees to continuously market the gas from the well.[62] The removal and marketing requirement "ignores the express terms of the habendum clause which provide for the lease to continue after the primary term as long as the well is capable of production in commercial quantities regardless of marketing."[63] The Court states that we "must steer clear of using the cessation-of-production clause to define a specific accounting period for determining whether production has been in paying quantities" or else we will face unwanted results.[64] In considering this, the Court looks to prior case law which has established that it is more accurate to look at a longer time period when determining production so that the operation levels of the oil lease can be compared to the "leveling influence over time."[65] Additionally, even if all evidence was taken into account for that period, it was determined that three months is too short for determining whether a cessation-of-production in paying quantities has occurred.[66]

The ruling of the trial court is reversed and judgment should have been entered in favor of Raker Resources.[67] The Supreme Court of Oklahoma held if the trial court had considered the Cowan Well's profitability based on a "time [period] appropriate under all of the facts and circumstances," then judgment would have originally been entered in favor of Raker Resources.[68] This is because "the appropriate time period is not measured in days, weeks or months, but rather by a time appropriate under all of the

59. *Id*.

60. Tres C, LLC v. Raker Resources, LLC, 2023 OK 13, ¶ 29, 532 P.3d 1, 16; 4 Kuntz, *supra* note 51. (alterations excluded).

61. *Tres C*, 2023 OK 13, ¶ 29, 532 P.3d at 16.

62. *Id*.

63. *Id.* ¶ 29, 532 P.3d at 17.

64. *Id*.

65. *Id*. ¶ 30, 532 P.3d at 17.

66. *Id*. ¶ 37, 532 P.3d at 20.

67. *Id*.

68. *Id*. ¶ 37, 532 P.3d at 20.

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facts and circumstances of each case."[69] While this did not set forth a bright-line rule for how long production can lapse before cessation occurs, it did establish a base line (longer than three months) for lessors, lessees, and courts to follow when considering how to evaluate their periods of productivity when assessing their leaseholds.[70] The *Tres C* holding establishes that parties should assess and analyze the "facts and circumstances" surrounding the productivity of their oil wells to determine an accounting of their lease's productivity with the guidance of the Court here that three months is not long enough to make an accurate assessment.[71]

IV. Termination of an Oil Lease

Tres C is significant because it addresses the cessation-of-production clause's relationship to the accounting period as it relates to a cessation-of-production in paying quantities.[72] This has been an unclear area in Oklahoma jurisprudence for years, in part due to cases such as *Hoyt v. Continental Oil Co.* and *French v. Tenneco Oil, Co.* that appeared to take opposite positions on the issue but never adopted a bright-line rule.[73] Following *Tres C*'s decision, this proposed step-by-step analysis will serve as guidance to lessors, lessees, and the practicing bench and bar in Oklahoma in their determination of whether or not an oil lease has terminated for a cessation-of-production or a lack of production in paying quantities when the lease contains a cessation-of-production clause. This section will set forth that analysis in three steps.

A. Step One: Has production ceased entirely?

The Cowan Lease contained a cessation-of-production clause which provided, "if within the primary term of this lease, production on the leased premises shall cease from any cause this lease shall not terminate" with parameters for the saving of the lease both within the primary term and after, "so long as production continues."[74] The Court in *Tres C* explains that it has been repeatedly held that the "cessation-of-production clause is only implicated where production *has already* ceased" signifying that the clause

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69. Tres C, LLC v. Raker Resources, LLC, 2023 OK 13, ¶ 30, 532 P.3d 1, 17(citing Barby v. Singer, 1982 OK 49, ¶ 6, 648 P.2d 14, 16–17).
70. *Tres C*, 2023 OK 13, ¶ 37, 532 P.3d at 20.
71. *Id*.
72. *Id*.
73. *Hoyt,* 1980 OK 1, ¶ 4, 606 P.2d 560; French,1986 OK 22, 725 P.2d 275.
74. *Tres C*, 2023 OK 13, ¶ 2, 532 P.3d at 2.

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can only be enacted if production at the oil well has ceased entirely.[75] The Court's contract interpretation of the cessation-of-production clause states that previous cases, such as *French v. Tenneco Oil Co.*, have described the clause as one that allows for lessees to have a reasonable time period to "resume operations."[76] The *Tres C* Court reasons that such language suggests the clause can *only* be applied *after* a cessation has occurred.[77]

Pack v. Santa Fe Minerals evaluated whether a gas well, that is capable of production but was put into a "shut-in period in excess of sixty (60) days but less than one year due to a marketing decision" expires on its own terms per the cessation-of-production clause.[78] Here, the lessor argued that "production" as used within the cessation-of-production clause would include both "removal and marketing" of the product.[79] This would require the lessee to continuously market gas from the well or risk termination of the lease if they ceased marketing.[80] The Court in *Pack* refused to adopt that interpretation of "production" as they noted it "constrained construction of the clause" by "discount[ing] the intended meaning of production," which, has been determined throughout numerous prior cases.[81] Further, the Court in *Pack* held that the clause does not require lessees to market gas from the oil well because the cessation-of-production clause only requires that the well is capable of producing in paying quantities, and it does not terminate unless it fails to do that or violates another express provision.[82]

French v. Tenneco Oil, Co. supplies a basis for determining whether parties have made a sufficient effort to resume operations within the bounds of their contract.[83] The parties in *French* admitted that there was no production from the oil lease from May – October 1 or from December 1979 – January 1980.[84] However, the defendants stated that their efforts to rework the ground were sufficient under the cessation-of-production clause's provision that the "lessee resume operations for drilling a well within sixty days from such cessation" and given *Hoyt's* reasoning that parties have "bargained for and agreed on a time period for a temporary

75. *Id*. ¶ 28, 532 P.3d at 15–16.
76. *Id*. ¶ 33, 532 P.3d at 18.
77. *Id*.
78. Pack v. Santa Fe Mins., a Div. of Santa Fe Intern. Corp., 1994 OK 23, ¶ 2, 869 P.2d 323, 325.
79. *Id*. ¶ 12, 869 P.2d at 327.
80. *Id*.
81. *Id*.
82. *Pack*, 1994 OK 23, ¶ 14, 869 P.2d at 328.
83. French v. Tenneco Oil, Co., 1986 OK 22, ¶ 3, 725 P.2d 275, 276.
84. *Id*. ¶ 2, 725 P.2d at 275.

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cessation clause."[85] The Court in *French* states that this provision is construed as meaning to "resume production or commence additional drilling" and that under the contract the lessee had 60 days to restore production in paying quantities "by means the lessee deemed advantageous to the circumstances."[86] If production had not resumed, then drilling must have commenced within sixty days. Due to the verbiage of the contract, the Court here states that "[i]f the clause specifically provides for the resumption or commencement of drilling, no other operation will satisfy the clause."[87] Further, while the lessee had reworked and conditioned the well, there was not production, and per the provisions of the contract, drilling should have commenced, therefore there was a complete cessation of production.[88] *French* shows parties that when determining their obligations underneath the oil and gas contract, the courts will look to "[t]he literal provisions of the clause in question" to determine what "type of operation must be commence or resumed."[89]

If parties have undergone the above analysis and determined that cessation-of-production has ceased entirely, then they should proceed to step three to determine if the "savings clause" of the habendum clause has been triggered.[90] In doing so, parties can look to the literal provisions of the oil and gas lease as well as the case law and treatises outlined below for guidance.[91] However, if in analyzing the lease's productivity parties have determined that production has not ceased entirely, thus failing step one, then parties should move to step two to determine if production has ceased in paying quantities.[92]

B. Step Two: If no to step one, has production ceased in paying quantities?

If production has not ceased entirely, thus failing step one, then the parties or the court can continue to step two. This step addresses whether an oil lease's production levels are occurring in paying quantities or not.[93] Per *Hall v. Galmor*, the concept of production has often been "understood to

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85. *Id.* 1986 OK 22, ¶ 7, 725 P.2d at 277 (*citing* Hoyt v. v Continental Oil Co., 1980 OK 1, ¶ 4, 606 P.2d 560, 563).
86. *French,* 1986 OK 22, ¶ 8, 725 P.2d at 277.
87. *French*, 1986 OK 22, ¶ 9, 725 P.2d at 277.
88. *Id.* ¶¶ 7–10, 725 P.2d at 276–78.
89. *Id.*1986 OK 22, ¶ 9, 725 P.2d at 277.
90. *Tres C*, 2023 OK 13, ¶ 28, 532 P.3d at 16.
91. Kuntz, *supra* note 51 at § 47.5.
92. *Tres C*, 2023 OK 13, ¶ 28, 532 P.3d at 16.
93. *Id.*

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mean 'produced in any quantity'" however, in this instance, the Court further states that the term "paying quantities" has consistently been defined as "sufficient to yield a profit to the lessee over operating expenses."[94] An important distinction from *Hall*, is the repeated refusal to place a "requirement of marketing" into the definition of what produce or production means because the Court has held that it is the lease's ability to continuously produce in this manner that is the "important factor rather than actual production applied."[95]

While *Hall* adopts the refusal to require marketing from *Pack*, the Court in *Pack* continued to assert the importance of past precedent by relying on the previous interpretation of the Court to determine what production means.[96] Particularly, *Pack* reiterates the commitment that was noted in *Hoyt* in 1980 where the Court stated that "production means production *in paying quantities* in Oklahoma when the term appears in the habendum clause of an oil and gas lease."[97] *Pack* posits that, based on the holding from *Hoyt*, the cessation-of-production clause "serves the purpose of modifying the habendum clause" so that the lease may continue "for the stated time period."[98] This allows the lessee an opportunity to begin drilling a new well, thus establishing the idea of the "savings clause" as the cessation-of-production clause is nicknamed.[99]

Multiple prior cases do not support the argument for termination of a lease under the cessation-of-production clause, including *Hoyt*, *Blair* and *Pack*.[100] These cases instead affirmed the termination of the oil lease based "upon the terms of the cessation of production clause" because, at the time of the lease's primary term expiring, it had been determined that the wells in question were not capable of producing in *paying quantities*.[101] This meant that they were "non-producing" wells under either the habendum clause or the cessation-of-production clause which requires that the wells be evaluated under the specific terms of each clause.[102] Further, *Pack* held that the "cessation of production clause *only* requires the well be capable of

94. Hall v. Galmor, 2018 OK 59, ¶ 22, 427 P.3d 1052, 1063,

95. *Id.* ¶ 22, 427 P.3d at 1064.

96. *Hall*, 2018 OK 59, ¶ 22, 333; Pack, 1994 OK 23, ¶ 14, 869 P.2d at 328.

97. *Pack*, 1994 OK 23, ¶ 12, 328 *(citing* Hoyt v. Continental Oil Co., 1980 OK 1, ¶ 7, 606 P.2d 560, 563).

98. *Pack.*, 1994 OK 23, ¶ 14–16, 869 P.2d at 328.

99. *Id.*

100. *Id.* ¶ 18, 869 P.2d at 329.

101. *Id.* ¶ 18, 869 P.2d at 329.

102. *Id.*

producing gas in paying quantities" and that failure to market gas from subject wells will not constitute a termination of a gas lease.[103]

Oklahoma courts require that the discovery be "in paying quantities" which, as noted in Hemingway, is consistent with this court's long-held view that "production sufficient to hold the lease during the secondary terms requires production in paying quantities."[104] "Paying quantities" is defined in Hemingway Oil and Gas as production that provides a "profit, even small, over operating expenses."[105] Therefore, in determining production in paying quantities for step two – if a well is producing a profit large enough to surpass operating expenses (i.e., lifting or production costs) then the lease is considered to be producing "in paying quantities" even if the operation may prove unprofitable overall.[106] States such as Oklahoma that do not require marketing to establish production instead require a "well that is completed and capable of producing oil and gas in paying quantities" to satisfy the habendum clause and production requirement.[107] In considering production in paying quantities, Oklahoma cases have been "consistent . . . . in holding that depreciation of producing equipment must be deducted as an expense in calculating paying quantities."[108] This is also consistent with the concept that "in paying quantity" is to be enough to offset production costs even if it is not profitable overall.[109] *Barby v. Singer* explicitly states that "the failure of the lease to produce a profit does not in and of itself terminate the lease," further supporting the definitions provided above in Hemingway Oil and Gas.[110] *Henry v. Clay* also held that production "in paying quantities" is taken in consideration of the lessee's profits and if those profits are enough to exceed the operating expenses, then that constitutes production in paying quantities even if the "operation as a whole may prove unprofitable."[111]

Hoyt v. Continental Oil Co. provides another base line for determining "non-productive time" of the oil lease.[112] In *Hoyt*, the plaintiff alleged 14

103. *Pack*, 1994 OK 23, ¶ 20, 869 P.2d at 329.

104. 1 Owen L. Anderson, John S. Dzienkowski, John S. Lowe, Robert J. Peroni, David E. Pierce, & Ernest E. Smith, *Hemingway Oil and Gas Law and Taxation* (4d. updated 2004), 247.

105. *Id*. 253.

106. *Id*.

107. *Id*. 247.

108. *Id*. 259.

109. *Id*.

110. Barby v. Singer, 1982 OK 49, ¶ 7, 648 P.2d 14 at 17.

111. Henry v. Clay, 1954 OK 170, ¶ 6, 274 P.2d 545, 547.

112. *Hoyt*, 1980 OK 1, ¶ 4, 606 P.2d at 562.

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months of the oil lease which failed to produce in paying quantities.[113] This 14-month time period of non-production was alleged within the petition filed by Plaintiffs, however the last of those two months were determined to represent time that took place after the filing of the petition.[114] The *Hoyt* Court determined that when alleging non-production of an oil lease the time used in the petition must be from before the filing of the petition.[115] This decision stemmed from the Court's assessment of the defendant's title to the oil lease in determining its' validity for production purposes.[116]

In *Blair v. Natural Gas Anadarko Co.*, the plaintiffs alleged that after the primary term of the lease the "cumulative value of 90 days' worth" of production did not exceed what would be 90 days' worth of the cumulative total lifting costs.[117] However, the court here states that this is not sufficient to establish a cessation-of-production.[118] Because the plaintiffs are alleging a complete cessation-of- production and not a cessation "in paying quantities" as the cause of termination, then the court must determine if there was a cessation in paying quantities as well.[119] Plaintiffs in *Blair* alleged that because *Pack* established that "production" and "production in paying quantities" are the same thing, that a "lack of profit equates to a lack of production."[120]

Under this logic, in order for the clause itself to be triggered, a party must first establish that a cessation-of-production occurred in some way before claiming that a cessation occurred in paying quantities for an uninterrupted period of time, thus instituting these three steps for analysis of a lease termination.[121] The well here showed that it was "capable of production in commercial quantities" and it just produced in a quantity "less than the commercial quantities marketed from it."[122] Consequently, the well did not cease to produce, nor did it cease to produce "in paying quantities" as the well in *Hoyt* did.[123] However, it introduced the notion that

113. *Id.*
114. *Id.*
115. *Id.*
116. *Id.*
117. Blair v. Nat. Gas Anadarko Co., 2017 OK CIV APP 57, ¶ 18, 406 P.3d 580, 584.
118. *Id.* ¶ 16, 406 P.3d at 583.
119. *Id.* ¶ 18, 406 P.3d at 584.
120. *Id.*
121. *Blair*, 2017 OK CIV APP 57, ¶ 18, 406 P.3d at 584.
122. *Id.* ¶ 22, 406 P.3d at 585.
123. *Id.*

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production must cease entirely in order to trigger the cessation of production clause and these steps.[124]

When considering production in paying quantities, future lessors/lessees can also look at *Hoyt* in determining when cessation-of-production in paying quantities occurs.[125] The parties in *Hoyt* differed on what the terms of the habendum clause were.[126] Specifically, that the term "cessation-of-production" as used within the habendum clause does not apply to production in paying quantities because the term "production" appears in the habendum clause.[127] However, the Court here establishes that it is a long-standing principle within Oklahoma courts that the term "production" is to also be construed as "production in paying quantities" when referenced in a habendum clause.[128] Therefore, the parties are still required to establish that production either ceased entirely – per step one – or that production has ceased in paying quantities for a reasonable period of time in light of all the facts and circumstances.[129]

Hall v. Galmor adds another qualifier to the concept of "in paying quantities" when it analyzed *Pack*'s addition of "capable of producing in paying quantities" due to the necessity of a lease to have the "ability to produce" as opposed to the actual production that is being applied.[130] While *Hall* does not publish its own definition of "capability" it refuses to adopt the definition that was established by the Texas Court of Appeals in *Hydrocarbon Management, Inc. v. Tracker Exploration, Inc*.[131] It defined capability as "a well that will produce in paying quantities if the well is turned 'on,' and it begins flowing, without additional equipment or repair," thus excluding any wells that were turned on but did not flow.[132] The Court in *Hall* states that this definition is contrary to Oklahoma jurisprudence because it requires operators to "continually maintain" wells that have been shut-in, stating further that capability (i.e., capable of producing in paying quantities) should be evaluated on a case-by-case basis.[133] If using these

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124. *Id*.
125. *Hoyt*, 1980 OK 1, ¶10, 606 P.2d at 563.
126. *Id*.
127. *Id*.
128. *Id*.
129. *Id*.
130. *Hoyt,* 1980 OK 1, ¶ 10, 606 P.2d at 563.
131. *Hall*, 2018 OK 59, ¶ 22–24, 427 P.3d 1052, 1063–1064; Hydrocarbon Mgmt., Inc. v. Tracker Expl., Inc., 861 S.W.2d 427, 434 (Tex. App. 1993)
132. *Hall* ¶ 26, 427 P.3d 1065.
133. *Id*., 2018 OK 59, ¶ 22–24, 427 P.3d at 106364.

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steps to evaluate a "shut-in well" as was seen in *Hall*, then the parties must use the well's capabilities prior to being shut-in when determining if the well is producing in paying quantities.[134]

Tres C takes a firm stance on the accounting period question stating that they "must steer clear of using the cessation-of-production clause to define a *specific accounting* period for determining whether production has been in paying quantities."[135] This is premised on the idea of "avoid[ing] unwanted results," such as continuous marketing of oil or gas extracted from the well to avoid a lease termination due to any temporary cessations of marketing or production.[136] Which, as Hemingway Oil and Gas states, marketing is not considered when determining production for oil and gas leases.[137]

If either the answer to step one or two is yes then parties can proceed to step three to determine if the "grace period" has been utilized.[138] In particular, parties should look at the literal provisions of their oil and gas lease's habendum clause to determine what is required of them to trigger the establishment of this article's proposed grace period.[139]

C. Step Three: Has the lease complied with the cessation of production "grace period?"

Kuntz on Oil & Gas establishes how to interpret a provision within the oil lease as it pertains to whether or not a "grace period" has been established when it stated:

> [t]he literal provisions of the clause in question will govern what type of operation must be commenced or resumed. It may be limited in application to a resumption or commencement of drilling, or it may be less restrictive and apply to reworking and other operations. If the clause specifically provides for the resumption or commencement of drilling, no other operation will satisfy the clause.[140]

Multiple cases in Oklahoma cite *Greer v. Salmon*, a decision from the Supreme Court of New Mexico, on the issue of oil lease termination that

134. *Id.* ¶ 26, 427 P.3d at 1065.
135. *Tres C*, 2023 OK 13, ¶ 29, 532 P.3d at 17.
136. *Id*.
137. Anderson, *supra,* note 104 at 253.
138. *Tres C*, 2023 OK 13, ¶ 28, 532 P.3d at 17.
139. Kuntz, *supra* note 51 at § 47.5.
140. *Id.*`

posited the following regarding to the "grace period" and temporary cessation of production:

> The courts have been unanimous in construing this clause as meaning that cessation of production for longer than the stipulated period cannot be considered 'temporary'. In effect, the provision is construed as giving the lessee a fixed period of time within which to resume production or commence additional drilling or reworking operations in order to avoid termination of the lease; the period of grace having been fixed by agreement of the parties, it cannot be extended by the courts, no matter what the circumstances or cause of the cessation.[141]

Hall posits that the "main function of a cessation-of-production clause" is to serve as a "saving's clause of sorts" to prevent an "automatic termination of the lease under the habendum clause."[142] Further, if the lease were to terminate it would be because the grace period that is outlined within the cessation-of-production clause has expired.[143] In *Hall*, the wells at issue had grace periods far different from what is seen in *Tres C*.[144] Some wells in *Hall* were given a 60-day grace period to re-establish production while the overall range for the outlined grace period ranged from 60 days to 6 months for re-establishment.[145] This demonstrates that the "grace period" is determined based on the terms that the lessor and lessee establish when constructing their cessation-of-production clause within the habendum clause, and the "grace period" can be different depending on the situation.[146]

Hoyt relies on a decision from the Supreme Court of New Mexico in *Greer* which states that the cessation-of-production clause should be construed as a period of grace which was established by a fixed agreement between the parties.[147] This allows the lessee a "fixed period of time . . . to *resume production or commence additional drilling or reworking*

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141. Greer v. Salmon, 82 N.M. 245, 248, 479 P.2d 294 (NM 1970) (quoting Hazlett, 'Effect of Temporary Cessation of Production on Leases and Term Royalties,' Southwestern Legal Foundation, Tenth Annual Institute on Oil and Gas Law and Taxation 201, 249 (1959)).

142. *Hall*, 2018 OK 59, ¶ 35, 427 P.3d 1067.

143. *Id*.

144. *Id*. ¶ 1, 427 P.3d at 1056.

145. *Id*.

146. *Id*. ¶ 36, 427 P.3d at 1068.

147. *Hoyt*, 1980 OK 1, ¶ 10, 606 P.2d at 563–64; *see* Greer, 82 N.M. 245, 479 P.2d 294 (1970).

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operations" and if that does not occur then the lease is considered to be terminated.[148] During a step three analysis, courts can look to either industry standards or the plain language of the party's cessation-of-production clause to determine if the "type of operation [that] must be commenced or resumed" was specified in the contract.[149]

The Court in *French* states that while the concept of reworking can be specifically restricted to the concept of resuming/commencing drilling on the wells, it can also be "less restrictive" and thus apply to "reworking and other operations."[150] Moreover, the clause may "*specifically provide for*" and if so then "no other operation will satisfy the clause," which suggests that parties may determine their own criteria for what actions will satisfy the grace period.[151]

In completing the step three analysis, if parties determine that the "grace period" was satisfied then the lease was not terminated.[152] This is important for later stages of the case because if there was a cessation-of-production, either completely or in paying quantities, then the cocomplete analysis of all three steps will provide the courts with a better gauge of "all of the facts and circumstances" for determining the reasonableness of the accounting period if a cessation-of-production did occur.[153]

VI. Conclusion

Tres C notes that prior case law has provided that the "appropriate time period is not measured in days, weeks or months, but by a time appropriate under all of the facts and circumstances of each case."[154] Therefore, we see that while a three-month accounting period–as utilized by the trial court in *Tres C*–is not sufficient, the courts have provided the parameters of the reasonable accounting period, with multiple cases to provide parameters of what can be considered reasonable.[155] Given that the reasonable period standard requires that courts look at "all the facts and circumstances," it would be helpful to courts to employ steps one through three as outlined above so as to know *what* the circumstances surrounding the potential

148. *Id*.
149. *French*, 1986 OK 22, ¶ 9, 725 P.2d at 277.
150. *Id*.
151. *Id*.
152. *Tres C*, 2023 OK 13, ¶ 28, 532 P.3d at 16.
153. *Id*. ¶ 30, 532 P.3d at 17.
154. *Id*.
155. *Id*.

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cessation of production look like.[156] If parties integrate this three-step process into their analyses of oil leaseholds, then it will provide them with the bases that they need to then determine whether all of the facts and circumstances surrounding a contested lease termination are reasonable per *Tres C*, i.e., whether enough time passed, and whether there a reasonable accounting period given what the oil lease usually produces, etc.[157] Implementing the aforementioned three-step process would provide lessors and lessees with a method for determining the nature of their oil lease and whether or not the lease has truly been terminated due to non-production or if the parties have exhausted all available options to avoid termination.

156. *Tres C*, 2023 OK 13, ¶ 30, 17.
157. *Id.*

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