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PRODUCTION IN PAYING QUANTITIES IN TEXAS

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Texas courts have long confronted disputes between lessors and lessees over the perpetuation of oil and gas leases in the face of limited or no production beyond a lease’s primary term. Habendum clauses, which specifically address this issue, are common in Texas oil and gas leases and typically provide for the continuation of the lease through the primary term and thereafter “as long as oil or gas is produced in paying quantities.”

But questions often arise concerning the meaning and effect of these clauses. What constitutes paying quantities? What costs and revenues are considered for purposes of making the determination? Over what period of time are paying quantities measured? Over the years, these and similar questions have been the source of significant litigation in Texas courts. In most cases, the ultimate decision on this question is for the jury, often resulting in a “battle of the experts” between the lessor’s or other plaintiff’s technical expert and the technical expert for the lessee seeking to maintain the lease. Additionally, the fact-specific, case-by-case nature of the production in paying quantities issue makes carefully crafted jury charges critically important.

In this article, we begin with an analysis of the early history of production in paying quantities under Texas law. We next examine the development of the modern doctrine that exists in Texas today. Finally, we address recent case law that examines jury charges over production in paying quantities.

A. EARLY HISTORY IN TEXAS

Early oil and gas leases were entered into for a fixed term. However, these leases left many lessees without the opportunity to recover a full return on their investment. By the late nineteenth century, leases had begun to tie term length to the continued development of minerals from the leased land. Patrick H. Martin & Bruce M. Kramer, Williams & Meyers, Oil and Gas Law, § 601 (5th ed. 2013).

Virtually all contemporary oil and gas leases contain habendum clauses that provide for a set “primary term”—usually one to ten years—followed by a secondary term in which the lease is preserved by the production of oil or gas in paying quantities. Id. The phrase “produced in paying quantities,” while ubiquitous in oil and gas leases, does not have a uniform definition.2 Some jurisdictions interpret the language of habendum clauses narrowly and require the actual, physical production and marketing of oil or gas for the secondary term to continue. Jessica E. McDonald & Zachary M. Wallen, Defining “Production in Paying Quantities”: A Survey of Habendum Clause Cases Throughout the United States, 90 N.D. L. Rev. 383, 387 (2014). Other jurisdictions focus on the capability of production and do not require the lessee to actually sell or market the production to maintain the lease. Id. In Texas, courts have adopted the actual production interpretation, which has developed piecemeal over the past century with the growth of the oil and gas industry.

In Texas, habendum clauses containing the term “paying quantities” were widely in use in mineral leases by the late nineteenth and early twentieth centuries. See, e.g., Keating v. McCutchen, 36 S.W. 597 (Tex. Civ. App. 1896); Fox v. Robbins, 62 S.W. 815 (Tex. Civ. App. 1901). Some of these leases defined “paying quantities” as a specific amount of production, yet most provided no specific definition. See, e.g. McLean v. Kishi, 173 S.W. 502 (Tex. Civ. App. 1915) (paying quantities defined as one well producing 20 barrels of oil per day). In these early Texas cases, the definition of “production in paying quantities” was generally not disputed by the parties. However, by 1920, parties began to disagree about the meaning of the term “production in paying quantities,” thereby forcing courts to develop a more precise standard.

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2 Historically, different phrases have been used in leases depending on the age of the lease and the sophistication of the parties involved. These phrases include “so long thereafter as oil or gas is ‘produced,’ or ‘produced in paying quantities,’ or ‘found,’ or ‘found in paying quantities,’ or ‘discovered,’ or ‘discovered in paying quantities,’ or ‘can be produced,’ or ‘can be produced in paying quantities,’” Eugene Kunz, A Treatise of Law of Oil and Gas, § 26.5 (Rev. Ed. 2011). These phrases have become terms of art and are not always given their plain meaning in many jurisdictions. Jessica E. McDonald & Zachary M. Wallen, Defining “Production in Paying Quantities”: A Survey of Habendum Clause Cases Throughout the United States, 90 N.D. L. Rev. 383, 385-86 (2014).
The court in Aycock v. Paraffine Oil Co., 210 S.W. 851 (Tex. Civ. App. 1919) provided one of the first definitions of “paying quantities” in Texas. In that case, the court stated that “[t]he term ‘paying quantities,’ as used in an oil lease for a given term and as much longer as oil can be produced in paying quantities, means paying quantity to the lessee. If the well pays a profit, even small, over operating expenses, it produces in paying quantity, though it may never repay its cost, and the operation as a whole may result in a loss.” Id. at 853 (adopting the general definition from Words and Phrases, vol. 6, p. 5247). In reaching its decision, the court in Aycock followed the Indiana Supreme Court’s lead in declaring that “whether oil was found in paying quantities is to be exclusively determined by the operator, acting in good faith” Id. (citing Manhattan Oil Co. v. Carrell, 73 N.E. 1084 (1905)).

The Aycock ruling was upheld two years later in Texas Pacific Coal & Oil Co. v. Bruce, 233 S.W. 535, 539 (Tex. Civ. App. 1921). In that case, the court held that “[i]t is for the operator, acting in good faith, to determine when the lease is no longer profitable; and the lessor cannot terminate it because it is not profitable to him to have it continue.” This early definition of paying quantities was obviously favorable to the lessee, placing discretion squarely in the hands of the operator. Additionally, by focusing only on operating expenses when calculating profit, the definition failed to take into account the up-front capital expenses required to drill and develop an oil or gas well. Under the Aycock rule, an operator could maintain a lease through the operation of a single well even if its minimal profits were dwarfed by the initial capital costs, leaving no chance of net profit.

In 1921, the Court of Civil Appeals further clarified the concept of production in paying quantities in Tex. Pac. Coal & Oil Co. v. Bratton, 239 S.W. 688 (Tex. Civ. App. 1921). In Bratton, the court held that in order for a lease to continue after its primary period, oil must not only be discovered but must also be produced in paying quantities. In reaching this decision, the court took a step towards the current, actual production standard followed by Texas courts. Furthermore, in these early years Texas courts held that the lessor bore the burden of proof to show that there was a lack of production and that there was a lack of good faith in the drilling operations. See Miller v. St. Joseph’s 55 Oil Ass’n, 278 S.W. 457, 459 (Tex. Civ. App. 1925); Morrison v. Swaim, 220 S.W.2d 493 (Tex. Civ. App.—Eastland 1949). This continues to be the rule in Texas today. See Bargsley v. Pryor Petroleum Corp., 196 S.W.3d 823, 829 (Tex. App.—Eastland 2006).

In 1930, the Texas Supreme Court adopted and expanded the concept of actual production in Hanks v. Magnolia Petroleum Co., 24 S.W.2d 5 (Tex. 1930). The lease in Hanks had a secondary term lasting “so long as there was production of gas in paying quantities.” In that case, the lessee drilled a well during the primary term, but the well was shut-in as pipelines and other facilities necessary to market the gas did not exist. The operator waited fourteen years until facilities were built and then began to market the gas at a profit. Id. at 5. The court held that, when considering production in paying quantities,

\[\text{[t]he question is not how much may be derived from the sale of the gas, but rather whether it may be sold in the market for consumption as fuel with the reasonable expectation of profitable returns in excess of costs and expenses. Whether there is a reasonable basis for the expectations of profitable returns from the well is the test. If the quantity be sufficient to warrant the use of the gas in the market, and the income therefrom is in excess of the actual marketing costs, the production satisfies the term ‘in paying quantities’… The true test was as to whether the gas was in paying quantities under the conditions existing [at the time of completion].}\]

Id. at 6 (quoting Barbour, Stedman & Co. v. Tompkins, 93 S.E. 1038 (W. Va. 1917)). Through Hanks, it became clear that in order to meet the requirements of production in paying quantities, an operator is obligated to not only produce gas in sufficient quantities but must also market the production.

The Hanks ruling on marketability was upheld in Stanolind Oil & Gas Co. v. Barnhill, 107 S.W.2d 746 (Tex. Civ. App. 1937). In that case, the lessees discovered and successfully began to recover oil deposits during the primary period. However, the oil recovered was sour and could not be marketed at the time. The court determined that the lease did not continue after the end of the primary period, as this was not production in paying quantities. Barnhill, 107 S.W.2d at 747-48. The court noted that the lease only lasted so long as there was a market for the product and even though the termination of the lease may seem unfair for the lessee, it was “not the duty of the courts to make contracts for parties but only to construe such contracts as they make for themselves.” Id. at 749.

B. FORMATION OF THE MODERN DAY DOCTRINE

In Garcia v. King, 164 S.W.2d 509 (1942), the Texas Supreme Court expanded the production in paying quantities doctrine to its modern day scope. The primary issue in Garcia was whether “produced” meant “produced in paying quantities.” Id. at 510. The lease in question stated that the term would run “for a
term of 10 years ... and as long thereafter as oil, gas, and other minerals is produced from said land hereunder.” *Id.* At the time of the suit, the lessor was receiving $0.08 per day from six wells for a lease that covered 7,500 acres. The *Garcia* court conceded that it was “clear that production was not in paying quantities when the primary term expired.” *Id.* In reaching its decision, the court focused primarily on the terms of the lease and a then-existing split among courts over the meaning of the term “produced.”

At the time of *Garcia*, there were two interpretations of the term “produced” as used in oil and gas leases. One group of states, which included Illinois, Kentucky, and others, followed a strict interpretation of lease terms, finding that there was no implied requirement to produce paying quantities of oil: “A mere showing of oil manifestly is not sufficient, even though produced. The production must be tangible and substantial, but it need not be great.” *Id.* at 511 (quoting *Enfield v. Woods*, 248 S.W. 842 (Ky. 1923)) (emphasis added).

The other group, which included Ohio, Oklahoma, and Montana, read an implied requirement of production in paying quantities into the lease. Courts in these states adopted the view that “the very purpose of the landowner in executing the lease is to have the oil and gas... produced and marketed so that he may receive his royalty therefrom, and the purpose of the lessee is to discover and produce oil and gas in such quantities as will yield him a profit.” *Id.* at 511 (citing *Gypsy Oil Co. v. Marsh*, 248 P. 329, 334 (Okla. 1926)). As a result, these states required production in paying quantities to maintain the lease and to achieve the objectives of the parties’ bargain; mere production – with no profit – was not enough. The court in *Garcia* adopted the latter position, declaring that the lease in question in *Garcia* had terminated. *Id.*

Following *Garcia*, Texas courts continued to grapple with the concept of “actual production.” In Texas, it became clear that the “words ‘discovery’ and ‘production’ do not mean the same thing.” *Morrison v. Swaim*, 220 S.W.2d 493 (Tex. Civ. App.—Eastland 1949). Following this reasoning, the court in *Holchak v. Clark*, 284 S.W.2d 399 (Tex. Civ. App.—San Antonio 1955) refused to follow the West Virginia precedent holding that the mere discovery of oil would extend a lease containing a habendum clause requiring production in paying quantities. The court in *Holchak* held that “[p]roducing production undoubtedly means the production of oil, gas or other minerals from the premises in paying quantities.” *Id.* at 400 (emphasis added).

In 1959, the Texas Supreme Court adopted a two-step approach in *Clifton v. Koontz*, 325 S.W.2d 684 (1959), to determine whether the lessee has maintained production in paying quantities sufficient to maintain a lease. The *Koontz* two-step approach is still recognized today as the applicable standard for resolving disputes over production in paying quantities.

The first step in the *Koontz* approach requires a determination of whether the well turned a profit over a reasonable period of time. If the well pays a profit over that time period, then the well is producing in paying quantities, even if it could never repay the initial capital costs or make the entire enterprise profitable. *Id.* at 390-91 (citing *Garcia*, 164 S.W.2d at 511). In formulating this first step, the *Koontz* court followed the holdings in *Aycock* and *Hanks* and held that profit or loss is to be determined by deducting operating and marketing costs from the sale price while excluding initial capital costs. The court explained that “[t]he underlying reason for this definition appears to be that when a lessee is making a profit over the actual cash he must expend to produce the lease, he is entitled to continue operating in order to recover the expense of drilling and equipping, although he may never make a profit on the over-all operation.” *Id.* at 692. Based on this reasoning, the *Koontz* court rejected the plaintiff’s attempts to include depreciation of the initial investment in the calculation of profit and loss.

Furthermore, the court in *Koontz* made clear that there is no set time period that applies when applying the production in paying quantities doctrine. In *Koontz*, the lessor argued that the lease had terminated when the well failed to operate at a profit for two months. The court rejected this argument, stating that “there can be no arbitrary period for determining the question of whether or not a lease has terminated.” *Id.* at 690.

3 The exclusion of initial capital costs from profit/loss calculations was later held to also exclude well rework costs, which are one time, single expense items that are usually treated as capital investments. See *Psigoda v. Texaco, Inc.*, 703 S.W.2d 416, 418 (Tex. App.—Amarillo 1986, writ ref’d n.r.e.).

4 The time periods used by Texas courts in determining profitability are extremely fact specific. See, e.g., *Sullivan v. James*, 308 S.W.2d 891 (Tex. Civ.App. 1957) (six months); *Psigoda v. Texaco, Inc.*, 703 S.W.2d 416 (two years). In a recent decision, the Amarillo Court of Appeals held that a fifteen month period did not constitute a reasonable period of time for purposes of analyzing the issue of a well’s profitability and whether the well produced in paying quantities. See *BP Am. Prod. Co. v. Laddex, Ltd.*, 458 S.W.3d 683 (Tex. App.—Amarillo 2015). According to one commentator, given the volatile nature of both production and pricing in the oil and gas industry, courts rarely consider periods under one year. See Caleb Fielder, *Marginal Wells and the Doctrine of Production in Paying Quantities*, 57 Landman Mag. 2, 3 (2011).
reasonable period of time, requires the fact finder to
determine if a reasonable and prudent operator would
continue to operate the well under the specific
circumstances at issue. Id. at 391. In formulating this
second step, the court in Koontz followed the tradition
of Aycock, giving discretion to the lessee in
determining whether or not the well is profitable.
However, by imposing a “reasonable and prudent
operator” standard, the Koontz ruling shifted away
from the absolute discretion given to lessees in earlier
Texas cases.

The Koontz court provided a number of factors to
be considered when addressing step two of its
approach. These factors include:

The depletion of the reservoir and the price
for which the lessee is able to sell his product, the relative profitableness of other
wells in the area, the operating and marketing
costs of the lease, his net profit, the lease
provisions, a reasonable period of time under
the circumstances, and whether or not the
lessee is holding the lease merely for
speculative purposes.

Id. at 691. As noted above, the Koontz two-part test
remains the applicable standard for determining
production in paying quantities to this day. See Caleb
Fielder, Marginal Wells and the Doctrine of Production

Post-Koontz decisions continued to develop and
refine the concept of production in paying quantities.
In Gulf Oil Corp. v. Reid, 337 S.W.2d 267 (1960), the
Texas Supreme Court readdressed the question of
marketing, this time in the context of “shut-in royalty”
payments. In Reid, the lessee began drilling a well
days before the lease’s five year primary term was set
to expire. Although the well was ultimately capable
of producing gas in paying quantities, it was not
completed until after the primary term had expired.
Moreover, the lessee shut-in the well due to a lack of
marketing facilities. Id. at 268. One month after
shutting in the well, the lessee tendered a shut-in
royalty payment, which the lessor rejected. Id.

The question addressed by the court in Reid was
“whether the so-called ‘shut-in’ royalty payment,
tenanted after a well capable of producing gas only in
paying quantities had been capped, was so timely made
as to extend the term of an oil and gas lease after
the expiration of the primary term.” Id. at 268. In
considering this question, the court noted that “there
was no production from the well during the term of the
lease as extended by drilling operations; the ‘shut-in’
royalty was not paid so as to bring about constructive
or contractual production, and no provisions of the
lease can be construed to furnish a further extension of
the primary term or to make the tender of royalty in
this case timely.” Id. at 272. Based on these facts, the
court held that while a shut-in royalty may be used to
extend the term of a lease, it must be paid within the
time frame allowed by the lease to be effective. The
court also held that the discovery of amounts capable
of being profitable if a market existed will not
perpetuate a lease that requires production in paying
quantities; an actual market and actual sales in that
market are required.5

5 This ruling was further echoed in 1964, when the Texas Court of
Appeals stated that “the completion of a gas well capable of producing in paying quantities but shut-in due to
lack of pipe line facilities or for other reasons is not considered production.” Midwest Oil Corp. v. Lude, 376
S.W.2d 18 (Tex. Civ. App.—Corpus Christi 1964, writ ref’d
n.r.e).

More recently, in 2002, the Texas Supreme Court
in Anadarko Petroleum Corp. v. Thompson, 94 S.W.3d
550 (Tex. 2002) addressed the issue of a temporary
cessation of production in the context of a lease that
provided for a second term lasting as long as gas
was “capable of being produced.” Relying on this
language, the court held that Garcia did not control
and that actual production was not required to
perpetuate the lease. Id. at 556. The court also found
that it would be nonsensical to apply the lease’s
cessation-of-production clause (which provided for
termination if production ended for 60 days) to every
temporary stoppage in production. Instead, a lease
containing “capable of being produced”-type language
may be sustained by either actual production or by the
capability of production. Id. at 555-57. The court
went on to define “capable of production”:

We believe that the phrase ‘capable of
production in paying quantities’ means a well
that will produce in paying quantities if the
well is turned ‘on,’ and it begins flowing,
without additional equipment or repair.
Conversely, a well would not be capable of
producing in paying quantities if the well
switch were turned ‘on,’ and the well did not
flow, because of mechanical problems or
because the well needs rods, tubing, or
pumping equipment.

Id. (quoting Hydrocarbon Mgmt. v. Tracker
Exploration, 861 S.W.2d 427 (Tex. App.—Amarillo
1993)).

As shown above, Texas courts have refined the
doctrine of production in paying quantities over time.
Initially, courts gave the lessee nearly unfettered
discretion (subject to a showing of good faith) to
determine whether the production in paying quantities

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n.r.e).
requirement had been met. Over time, Texas courts – most notably in the Texas Supreme Court’s decision in Clifton v. Koontz and later in its progeny – developed the two-step approach, which first analyzes the production in paying quantities question over a reasonable time based on a comparison of sales revenues and operating and marketing costs (but excluding capital costs). Assuming that production did not occur in paying quantities, the fact finder must then turn to the question of whether a reasonable and prudent operator would continue to operate the well for profit and not merely for speculation. Courts continue to follow this two-step approach in resolving disputes over lease perpetuation in the face of limited or declining production.

C. CHARGING A JURY ON PRODUCTION IN PAYING QUANTITIES IN 2015

Charging a jury on the issue of production in paying quantities requires careful consideration of the legal issues associated with the Koontz two-step approach and associated questions. Two recent decisions specifically addressed challenges to jury charges on the issue of production in paying quantities. These decisions are noteworthy, as they shed additional light on the issues surrounding jury questions in this area.


   In *BP Am. Prod. Co. v. Red Deer Res., LLC*, No. 07-14-00032-CV, 2015 WL 2400252 (Tex. App.—Amarillo May 18, 2015, pet. filed), the court addressed the proper method of charging a jury on the issue of production in paying quantities. *Red Deer* concerned a lease (the “Vera Murray Lease”) that had a five-year primary term and a secondary term that would continue “as long thereafter as oil, gas or other mineral is produced from said land. *Id.* at *1.* After 1989, only three wells on the lease, the # 9, # 10, and # 11 wells, were producing.

   By 2009, the # 9 well, the highest producing well, suffered a casing malfunction and was plugged. In 2011, the # 10 well suffered a drop in production, from 100 Mcf per day to approximately 20 Mcf per day, and was eventually plugged in 2012. The # 11 well produced 200 Mcf per day in 1994, but that number declined to 100 Mcf by 2000, and then further declined to less than 10 Mcf per day in 2009. From 2009 on, the # 11 well, equipped with a plunger lift system, had a regular flow every other day. *Id.*

   By 2011, the low production of the # 11 well had come to the attention of Red Deer, which had recently obtained a top lease from BP’s lessors. Red Deer notified BP that the wells were “non-commercial.” In 2012, the #11 well began to break its regular flow pattern. BP shut the well in on June 12, 2012. BP sent notice of the shut-in to the lessors on June 13, 2012 and began tendering shut-in royalty payments. *Id.* at *2.*

   Red Deer filed suit, contending that (1) the # 11 well had not been producing in paying quantities before being shut in and, alternatively, (2) the well was not capable of producing in paying quantities after being shut-in and therefore the lease term had terminated. *Id.*

   The trial court’s charge submitted four questions to the jury:

   - **Question 1:** From April 27, 2009 to June 12, 2012, did the Vera Murray lease fail to produce oil or gas in paying quantities?
   
   - **Question 2:** Do you find that, under all the relevant circumstances, a reasonably prudent operator would not continue, for the purpose of making a profit and not merely for speculation, to operate the Vera Murray [l]ease in the manner in which the lease was operated between April 27, 2009 to June 12, 2012?
   
   - **Question 3:** Was the Vera Murray # 11 well incapable of producing in paying quantities when it was shut-in on June 13, 2012?
   
   - **Question 4:** Do you find that, under all the relevant circumstances, if the Vera Murray # 11 [w]ell were turned on, without additional equipment or repairs, a reasonably prudent operator would not, for the purpose of making a profit and not merely for speculation, operate the Vera Murray # 11 well in the manner in which the well had been operated up to June 13, 2012?

   *Id.* at *2-3.

   The jury answered “No” to question 1 and, therefore, did not answer question 2, as it was conditioned on an affirmative answer to question 1. The jury answered “Yes” to both question 3 and question 4. Based on these answers, the trial court declared that the Vera Murray Lease had lapsed and terminated. *Id.* at *3.*

   On appeal, BP argued that both questions 3 and 4 were immaterial and were submitted in error. *Id.* Specifically, BP argued question 3 should never have been submitted to the jury, as it was rendered immaterial by the jury’s negative answer to question 1. The court of appeals, however, found that questions 1 and 3 addressed different subjects, as “question 1 asked about the lease's production during a time both the # 10 and the # 11 wells were in production, while question 3 was limited to the # 11 well.” *Id.* at *5.* A negative
answer to question 1 only determined that the wells were producing gas in paying quantities before the # 11 well was shut-in on June 12, 2012. According to the court, question 3 addressed the invocation of the shut-in royalty clause. In order for the shut-in royalty clause to preserve the lease after the wells had been shut-in for 60 days, the # 11 well would have to be capable of production in paying quantities after it was turned on, without additional equipment or repairs. *Id.* at *5* (citing *Anadarko*, 94 S.W.3d at 558). Therefore, the court found that question 3 was properly submitted to the jury and was not impacted or rendered immaterial by the jury’s answer to question 1.

The court quickly disposed of BP’s argument that question 4 was immaterial, finding that “BP's contention question 4 is immaterial also is based on the argument the jury found the # 11 well was producing in paying quantities through June 12, 2012. Because we conclude the jury made no such finding, we do not agree question 4 is immaterial.” *Id.*

Additionally, BP argued that there were several errors in the instructions provided with question 3, which stated:

> You are further instructed that “operating and marketing costs” include expenses such as taxes, overhead charges, labor, repairs, and ordinary periodic expenditures which were allocated to this well and which were used on this well in order to produce or keep it producing. You shall not consider any costs or one-time investment expenses incurred in connection with the original drilling or any reworking of the wells on the lease. *Id.* at *9*. BP argued that language should have been included in the instruction limiting “expenses offsetting the well's production to actual lifting and marketing expenses and taxes attributable to [the # 11] well and not the lease as a whole.” *Id.* Additionally, BP argued that the last sentence of the paragraph improperly applied the phrase “any costs or one-time investment expenses.” *Id.* The court rejected these arguments, finding the instructions to be consistent with previous opinions. The court noted that “[r]ead as a whole, the quoted paragraph properly limited operating and marketing costs to those allocated to the # 11 well, and BP’s argument does not persuade us the court’s instruction improperly permitted the inclusion of any capital expense attributed to the well.” *Id.*

BP also asserted three additional points of error with respect to question 4 of the jury charge. First, BP asserted error in the instructions that accompanied question 4, which listed factors for the jury to consider in reaching its “reasonably prudent operator” determination. Specifically, BP contended that the trial court erred by failing to include an instruction that “BP was entitled to shut-in the # 11 well and to keep the well shut-in because of Red Deer's title challenge.” *Id.* at *11*. The court rejected BP’s argument, finding that BP had no such authority. *Id.*

Second, BP claimed that the trial court erred by failing to define the word “speculation” included in the jury instruction. The court rejected this argument, noting that “BP does not offer the source of its proposed definition or explain why a word of ordinary or common meaning should be regarded, for purposes of question 4, as a term of art necessitating a verbose definition.” *Id.* at *12*.

Finally, BP argued that the trial court should have focused question 4 on a “lease basis,” rather than referencing the # 11 well specifically, and also erred by refusing to add to the list of factors that influence a reasonably prudent operator the “actual plans to develop other productive formations in the near future.” *Id.* The court of appeals disagreed and found that question 4 was submitted as a conditional question to accompany question 3 and was intended to mirror the second step of the Koontz test. *Id.* According to the court, given that question 3 was limited to the # 11 well, there was no abuse of discretion in similarly limiting question 4. *Id.* The court further found that proof that BP was planning to drill new wells in the formation did not provide proof that the existing well would resume producing in paying quantities once returned to service. *Id.*

D. BP AM. PROD. CO. V. LADDEX, LTD.

Like Red Deer, the court in BP Am. Prod. Co. v. Laddex, Ltd., 458 S.W.3d 683 (Tex. App.—Amarillo 2015, pet. filed), addressed challenges to a jury charge in a dispute over production in paying quantities. The lease in Laddex had a five-year primary term and a secondary term continuing thereafter so long as oil and gas was being produced. *Id.* at 684. The lessee drilled a single well on the lease. In 2005, production from that well began to decline. In 2006, after fifteen months of decline, production from the well was restored to its pre-slowdown levels. In 2007, Laddex entered into a top lease with the lessors and filed suit, claiming that the well ceased to produce in paying quantities during the production decline and that the original lease had, therefore, terminated. The jury found in favor of Laddex, and the court held that the lease had terminated. BP appealed. *Id.* at 685.

The Laddex ruling dealt with a much narrower issue of law than Red Deer. Specifically, the court considered whether the trial court erred by limiting the jury’s inquiry to a specific fifteen month period from August 1, 2005 to October 31, 2006. *Id.* at 688. BP objected to this question, claiming that the fifteen month period did not allow the jury to consider profitability over a “reasonable time.” The court of appeals agreed with BP:
Because the undisputed evidence established that the Arrington lease had resumed profitable production, the jury question, which isolated a fifteen-month period that was not reflective of the true profitability of the lease, limited the jury's consideration to a period of time that was not reasonable to assess whether the lease had ceased to produce in paying quantities. Certainly, evidence that a lease had returned to profitable production is material to the determination of whether a jury question inquires about a period that is reasonable under the circumstances.

Id. at 688-89 (citing Koontz, 325 S.W.2d at 691). The court of appeals found that the trial court had abused its discretion, reversed the findings of the trial court, and remanded for a new trial. Id.

E. CONCLUSION

Today, the production in paying quantities doctrine in Texas continues to follow the Texas Supreme Court’s decisions in Garcia and Koontz. First, the factfinder must determine – based on a comparison of profits against operating and marketing expenses – whether the well produced in paying quantities over a reasonable period of time. Absent clear language to the contrary in the underlying lease, Texas law requires actual sales of production, not simply the capability of producing. If the fact finder determines the well did not produce in paying quantities over the period considered, the second step of the Koontz approach requires a determination of whether a reasonable and prudent operator, under the same circumstances, would continue to operate the well for profit and not merely for speculation. These issues are highly case specific and fact-intensive and often lead to a “battle of the experts.”

Due to the highly fact specific nature of this inquiry, crafting a jury charge in a dispute over production in paying quantities requires careful thought and consideration. Counsel for the parties must ensure that the charge adheres to the two-step approach established in Koontz. This includes consideration of the specific lease language at issue, the costs, expenses, and revenues to be considered, and the period to be used in determining whether the well produced in paying quantities. Counsel must also structure jury instructions to accurately identify the factors to be considered by the jury in making its determination. Careful thought and attention to these issues is critically important when trying a case involving the issue of production in paying quantities.