IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re:	§	**Chapter 11**
EP ENERGY E&P COMPANY, L.P.	§	**Case No. 19-35647 (MI)**
Reorganized Debtor. [1]	§	**Re: Case No. 19-35654 ECF No. 1480**

EP ENERGY'S BRIEF REGARDING
THE FUTILITY OF MSB'S TEMPORARY CESSATION TRESPASS CLAIM

[Relates to Case No. 19-35654 ECF Nos. 1480, 1489, 1539,[2] 1540]

[1] The Debtor in this case, along with the last four digits of the debtor's federal tax identification number, is EP Energy E&P Company, L.P. (7092). The debtor's primary mailing address is 601 Travis St., Suite 1400, Houston, TX 77002. On December 28, 2020, the Bankruptcy Court entered the *Final Decree Closing Certain of the Chapter 11 Cases* [ECF No. 1587] closing the chapter 11cases for the following Reorganized Debtors: EP Energy Corporation; EPE Acquisition, LLC; EP Energy LLC; Everest Acquisition Finance Inc.; EP Energy Global LLC; EP Energy Management, L.L.C.; and EP Energy Resale Company, L.L.C.

[2] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed in ECF No. 1539.

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I. INTRODUCTION

EP Energy E&P Company, L.P. ("**EP**") files this brief to demonstrate the futility of MSB's pursuit of trespass damages.[3] EP temporarily stopped producing from the entire Eagle Ford field in May of 2020 as a result of an unprecedented collapse in oil prices and resumed production in June of 2020 as the markets recovered. MSB contends that its sixteen leases to EP terminated as a result of that gap in production.[4] MSB's claims are futile because all sixteen leases remain in force as a matter of bedrock Texas oil and gas law and lease interpretation. Accordingly, EP asks this Court to retain its jurisdiction and dismiss the claims.

EP can explain why it should win in two sentences: First, for those leases that remain in their continuous development phase, EP maintains the entire lease by drilling on schedule under the continuous development clause, regardless of whether there is production on the lease. Second, for those leases that have moved beyond their continuous development phase such that production is required, Texas courts uniformly construe cessation-of-production clauses like that in the MSB Leases to permit maintenance of the lease by restoring actual production within the permitted time period, even if the lessee conducts no drilling or reworking operations.

EP could thus dispense with MSB's untenable claims in just a few pages. Nevertheless, because swiftly resolving this case is important, and in respect of the Court's instruction that EP not file a reply to MSB's forthcoming response to this brief, EP provides the following thorough argument with extensive citation to case law and other authorities to confirm beyond any question that MSB's claims are, indeed, futile.

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[3] "**MSB**" means Storey Minerals, Ltd., Storey Surface, Ltd., Maltsberger, LLC, Maltsberger/Storey Ranch, LLC, Maltsberger/Storey Ranch Lands, LLC, the Estate of Sarah Lee Maltsberger, and Rene R. Barrientos, Ltd.

[4] The sixteen leases at issue are identified in MSB's proposed state-court petition as the one Maltsberger Lease; the three A Leases; the three B Leases; the three C Leases; the three D Leases; and the three E Leases (collectively, the "**MSB Leases**" or the "**Leases**"). Case No. 19-35654 ECF. No. 1610-1 at ¶¶ 2-3.

A. Brief Background

In late February and early March 2020, the COVID-19 pandemic and an oil price dispute between Russia and Saudi Arabia made for a perfect storm in which the market for oil (and thus its price) collapsed as rapidly decreasing demand caused a glut in the nation's oil storage. As a result, EP temporarily stopped producing from the entire Eagle Ford field (which includes the wells on the MSB Leases) for roughly the month of May to limit the amount of oil sold at unprecedented low prices, to the extent it could be sold at all.[5] EP was not alone in curtailing Eagle Ford production at that time.[6]

In October 2020, MSB filed its Administrative Expense Motion (Docket No. 1480) and Threshold Motion (Docket No. 1489), requesting leave to file a new lawsuit in state court for lease termination and associated trespass damages and seeking administrative priority for any such damages. EP opposed MSB's request and asked this Court to retain its jurisdiction to adjudicate the claims. At the March 24th hearing on the jurisdictional issue, the Court called for briefing on the futility of MSB's claims, concluding that, "If this is futile, then we're not going to be spending a whole lot of time and money on it." ECF No. 49 at 52:10-12. EP will herein demonstrate that MSB's claims are just that—futile—and respectfully requests that the Court rule that EP maintained all of the Leases and accordingly dismiss all of MSB's claims.

B. Brief Primer on the Lifecycle of a Texas Oil and Gas Lease

MSB's claims implicate several phases in the lifecycle of a large Texas oil and gas lease. The duration of an oil and gas lease is generally set out in the lease's "habendum clause," which

[5] Decl. of Sarah Blome, **Exhibit 1** ("**Blome Declaration**"), at ¶¶ 4-7.

[6] *Shale Shocked: U.S. Producers Shut-In 1.5 Million Bpd Since Early April, but When Will Crude Production Return?*, GENSCAPE BLOG (May 22, 2020), https://www.genscape.com/blog/shale-shocked-us-producers-shut-15-million-bpd-early-april-when-will-crude-production-return.

classically "provides that the lease will remain in force during [the] fixed primary term and as long thereafter as oil, gas or other minerals is produced during the secondary term." *BP Am. Prod. Co. v. Red Deer Res., LLC*, 526 S.W.3d 389, 394 (Tex. 2017). Paragraph III of the MSB Leases contains the habendum clause and provides that the MSB Leases are effective as of September 30, 2009 and for a four-year primary term. During the primary term, no drilling or production is required to keep the MSB Leases in force.

Some modern and large oil and gas leases contain a "continuous-development clause," which "allows the lessee to retain its interest in the entire tract during the secondary term only by complying with the required drilling schedule." *Endeavor Energy Res., L.P. v. Energen Res. Corp.*, 615 S.W.3d 144, 146 (Tex. 2020). A continuous-development clause is one example of a "savings clause" that permits the lease to be maintained "even though there is no production." *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.*, 554 S.W.3d 586, 597 (Tex. 2018).[7] In other words, a lease in its continuous-development phase cannot terminate due to a temporary cessation of production. The MSB Leases contain a continuous-development clause at Paragraph VIII, pursuant to which seven of the sixteen MSB Leases remain in their continuous-development phase (the "**CD Leases**").[8]

Thus, "a habendum clause generally extends the entire lease so long as some production is occurring on the lease, and a continuous-development clause further extends the entire lease so long as the operator remains engaged in the required development efforts." *Endeavor Energy Res., L.P.*, 554 S.W.3d at 598.

[7] The term "savings clause" refers to all manner of provisions that "extend the habendum clause's term . . . to prevent the automatic termination of the lease upon a cessation of production." *Red Deer Res., LLC*, 526 S.W.3d at 394.

[8] Those seven are the Maltsberger Lease, the three A Leases, and the three B Leases. Counsel for EP inadvertently stated at the March 24th hearing that the D Leases also remained in their continuous-development phase. To correct the record: continuous development has ended on the D Leases, as discussed below. Having confirmed that continuous development has ended on the D Leases, EP has released the deep rights to MSB in accordance with Paragraph XI.

Yet another provision—called a "retained-acreage clause"—takes effect "after the continuous drilling or other savings provisions reach their end." *Mayo Found. for Med. Educ. v. Courson Oil & Gas, Inc.*, 505 S.W.3d 68, 70 (Tex. App.—Amarillo 2016, pet. denied). A retained-acreage clause "divides the leased acreage such that production or development will preserve the lease [under the habendum clause] only as to a specified portion of the leased acreage"—typically "only as to acreage that had been assigned to a well" in a so-called "production unit." *See Endeavor Energy Res., L.P.*, 554 S.W.3d at 597–98, 606.[9] The MSB Leases contain a retained-acreage clause at Paragraph XI. The MSB Leases also define the maximum number of acres that can be held by production on a "production unit" at Paragraph IX. As to the remaining nine MSB Leases, the continuous-development phase has ended and therefore the retained-acreage clause has taken effect. EP has designated production units on those nine Leases, the acreage of which is now held by production—or "HBP"—with producing wells on each separate production unit (the "**HBP Leases**" or the "**HBP Units**").[10]

Finally, there is one more type of savings clause relevant here: a "cessation-of-production" clause. "[A] typical cessation-of-production clause provides that a lease will remain in force during the secondary term in the absence of actual production if the lessee conducts drilling or reworking operations within a fixed number of days of the original cessation of production." *Red Deer Res., LLC*, 526 S.W.3d at 394–95. The MSB Leases contain a cessation-of-production clause at Paragraph XI(d), providing that gaps in production from any production unit will be deemed

[9] Retained-acreage clauses followed the development of Pugh clauses to ensure that operations on one well would not maintain an entire large lease. A "Pugh clause," sometimes known as a "Freestone Rider," modifies the habendum clause and "restricts the extent to which drilling a producing well within a [pooled] unit perpetuates a lease included in the unit." *Cmty. Bank of Raymore v. Chesapeake Expl., L.L.C.*, 416 S.W.3d 750, 754 (Tex. App.—El Paso 2013, no pet.) (citing *Sandefer Oil & Gas, Inc. v. Duhon*, 961 F.2d 1207, 1209 (5th Cir. 1992)).

[10] Those nine are the three C Leases, the three D Leases, and the three E Leases.

permanent and therefore result in termination of that production unit if they last more than 120 days and the lessee has not begun drilling or reworking operations.

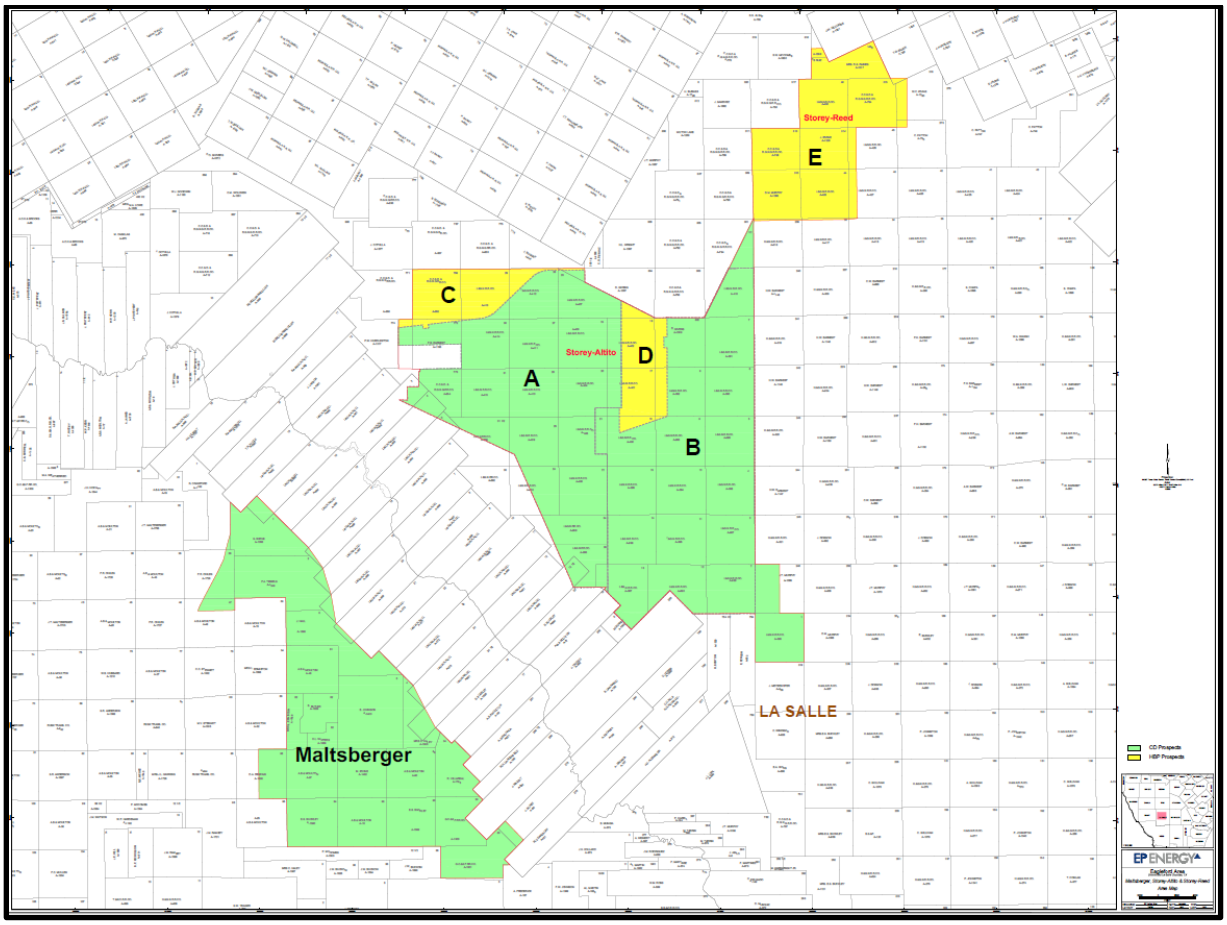
For as long as a lease remains in force, the lessee owns the fee simple interest in the oil and gas. *Red Deer Res., LLC*, 526 S.W.3d at 394. EP thus has a vested property right in all of the minerals in place under the MSB Leases for their respective lifespans. *Id.*

The following table details the Lease provision pursuant to which EP maintained each Lease through the May 2020 temporary cessation of production (as discussed in detail below) and the relative net mineral acres covered by each Lease, with the CD Leases highlighted in green and the HBP Leases highlighted in yellow[11]:

Lease Name	Net Acres	% of Total MSB Acres	Clause Keeping the Lease in Force
Maltsberger Ranch	9,745.555	30%	Continuous-Development Clause, ¶ VIII, *see* Part III.B below
MSB 'A' Leases	8,561.086	27%	Continuous-Development Clause, ¶ VIII, *see* Part III.B below
MSB 'B' Leases	10,264.43	32%	Continuous-Development Clause, ¶ VIII, *see* Part III.B below
MSB 'C' Leases	519.229	2%	Cessation-of-Production Clause, ¶ XI(d), *see* Part III.A below
MSB 'D' Leases	1,352.175	4%	Cessation-of-Production Clause, ¶ XI(d), *see* Part III.A below
MSB 'E' Leases	1,748.574	5%	Cessation-of-Production Clause, ¶ XI(d), *see* Part III.A below
Total MSB Acres	32,191.049		

[11] Decl. of Derek Shannon, **Exhibit 2** ("**Shannon Declaration**"), at ¶ 2.

And below is a map depicting the boundaries of each Lease with the same highlighting[12]:



[12] **Exhibit 3**; *see* Shannon Decl. at ¶ 3.

II. SUMMARY OF ARGUMENT

EP maintained all sixteen Leases as a matter of bedrock Texas oil and gas law and lease interpretation. Given the Court's interest in the temporary cessation issue at the March 24th hearing, EP will focus on the HBP Leases first (and in Part III.A. below) and will address the CD Leases second (and in Part III.B. below).

EP maintained the HBP Leases because the gap in production was temporary—the wells began producing again within the permitted time period set out in the cessation-of-production clause. As "the party claiming total cessation of production," MSB "***must prove that (1) there has been a total cessation of production for a period longer than that permitted in the lease's cessation-of-production savings clause***; and (2) no other savings provision . . . sustains the lease." *Red Deer Res., LLC*, 526 S.W.3d at 396 (emphasis added). It is undisputed that EP restored actual production within 120 days on every HBP Unit,[13] thus maintaining all nine HBP Leases under Paragraph XI(d).

MSB complains that EP did not take the useless step of re-entering each of the wells with reworking operations before restarting production, arguing that EP therefore did not invoke the cessation-of-production clause's operations provision. But Texas law is clear that because "actual production began within the [120] days" permitted under Paragraph XI(d), "the requirements of the [cessation-of-production] clause in these particular leases were fully complied with." *Mayers v. Sanchez-O'Brien Minerals Corp.*, 670 S.W.2d 704, 711 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.). *Mayers* is directly on point and demonstrates that the cessation-of-production clause in the MSB Leases permits temporary gaps in production for shorter than 120 days, ***even without drilling or reworking operations***. *See id.* (construing "drilling or reworking" language parallel to

[13] Shannon Decl. at ¶ 9; *see* **Exhibit 5** (Well-By-Well Cessation Period Summary).

that in the MSB Leases). All other Texas courts to touch on this issue agree that restoring production maintains a lease as an alternative to commencing drilling or reworking operations. Here, EP restored actual production within the permitted time period. MSB therefore has no viable path to establish lease termination with respect to the HBP Leases.

EP maintained the CD Leases because it is undisputed that EP has always drilled wells on schedule under the continuous-development clause.[14] MSB does not allege otherwise in its proposed state-court petition or in any other pleadings. *See* Case No. 19-35654 ECF. No. 1610-1. Instead, MSB lumps the CD Leases in with its termination argument regarding the HBP Leases. MSB contends that all sixteen "Leases terminated upon their terms based on EP Energy's failure to obtain production during May 2020." *Id.* at ¶ 30. That argument fails with respect to the CD Leases, too, because no production is required during the continuous-development phase. *Mayo Found. for Med. Educ. v. Courson Oil & Gas, Inc.*, 505 S.W.3d 68, 73 (Tex. App.—Amarillo 2016, pet. denied). *Mayo* is directly on point, rejecting MSB's argument that production is required on each production unit during continuous development. *Id.* at 72-73 (construing language parallel to that in the MSB Leases). The continuous-development clause gives EP the right to drill either to well density or until EP elects to stop. EP has elected to continue drilling and has always drilled on schedule. Indeed, EP has drilled more than 150 horizontal Eagle Ford wells on the CD Leases.[15] Although those Leases have produced tremendous amounts of oil and gas,[16] production is not required so long as EP continues drilling, because Paragraph VIII permits the CD Leases to be

[14] Shannon Decl. at ¶¶ 6-8.

[15] Shannon Decl. at ¶¶ 6-8.

[16] *Accord* Blome Decl. at ¶ 9 (reflecting that, in 2020 alone, EP paid MSB nearly $14 million in royalties on production from properties operated by EP in which EP currently credits MSB with an interest, which includes the CD Leases).

maintained "even though there is no production." *Endeavor Energy Res., L.P.*, 554 S.W.3d at 597. MSB therefore has no viable path to establish lease termination with respect to the CD Leases.

Finally, only two facts are material to the controlling legal issues presented, and both facts are undisputed: first, that EP restored actual production within 120 days on every HBP Unit; and second, that EP has always drilled on schedule under the continuous-development clause on every CD Lease. While MSB cannot dispute either of those two facts, EP nonetheless provides the Court with record support to confirm their truth.[17] That lack of any genuine issue of material fact enables the Court to rule, as a matter of law, that MSB's lack of any viable theory of lease termination renders futile MSB's pursuit of trespass damages that could have extended beyond plan confirmation and this Court's jurisdiction.

III. ARGUMENT AND AUTHORITIES

EP owns title to the minerals covered by the Leases in fee simple determinable. *Red Deer Res., LLC*, 526 S.W.3d at 394. EP's title "continue[s] indefinitely" until a termination occurs. *Id.* MSB bears the burden "to establish . . . a title superior to [EP's] title" by showing that the Leases have terminated. *Brumley v. McDuff*, 616 S.W.3d 826, 829 (Tex. 2021). MSB has no viable path to establish lease termination as to either the HBP Leases or the CD Leases. MSB's claim for trespass damages that could continue after plan confirmation is therefore futile.

The principles for answering lease-termination questions are well settled. Each part of the Leases must be read together, as well as against the background of Texas law. *Endeavor Energy Res., L.P.*, 615 S.W.3d at 148 (when interpreting a lease, "we examine the entire lease and attempt to harmonize all its parts even if different parts appear contradictory or inconsistent") (internal quotation marks omitted). Additionally, the Leases must be read "from a utilitarian standpoint

[17] Shannon Decl. at ¶¶ 5-9; **Exhibit 5** (Well-By-Well Cessation Period Summary).

bearing in mind the particular business activity sought to be served, and avoiding unreasonable constructions when possible and proper." *Id.* (internal quotation marks omitted).

As the Texas Supreme Court recently explained in *Red Deer*, when a lessor claims that its lease has terminated for lack of production, the lessor must show that "(1) there has been a total cessation of production for a period longer than that permitted in the lease's cessation-of-production savings clause; ***and*** (2) no other savings provision . . . sustains the lease." 526 S.W.3d at 396 (emphasis added). Part A below explains that MSB fails the first test as to the HBP Leases because production ceased for fewer than 120 days. Part B below explains that the CD Leases survive because they are sustained by another savings provision—the continuous-development clause.

A. EP Maintained the Held-By-Production Leases by Restoring Actual Production within Fewer than 120 Days.

Because the continuous-development phase has ended on the nine HBP Leases, maintenance of the HBP Units is now governed by the habendum clause and the retained-acreage clause in Paragraph XI(d).

Paragraph XI(d) first modifies the habendum clause by providing that "production from or operations conducted on each production unit shall maintain this lease in force" as to, and only as to, the portions of the lease included in the associated production unit. The second part of Paragraph XI(d) contains the cessation-of-production clause:

> If production should cease from any production unit, this lease shall terminate as to all lands and depths included within such unit unless lessee commences drilling or reworking operations on such unit within one hundred twenty (120) consecutive days thereafter . . . .

Finally, the third part of Paragraph XI(d) expressly distinguishes a ***temporary*** cessation of production from a ***permanent*** cessation of production:

> Any cessation or absence of drilling or reworking operations or production on or from a production unit which continues for a period of one hundred twenty (120) consecutive days or more shall be deemed for all purposes of this lease to be ***permanent*** and not ***temporary***.

(Emphasis added).

MSB contends that because EP did not conduct drilling or reworking operations within 120 days of the initial cessation of production, the HBP Leases terminated, notwithstanding the undisputed fact that EP restored actual production on every HBP Unit within fewer than 120 days.[18] MSB is wrong. EP maintained the HBP Leases for three mutually reinforcing reasons. First, black-letter Texas law provides that a cessation of production in the secondary term does not terminate a lease unless the cessation is ***permanent***, and the gap in production here was not permanent. Second, Texas courts uniformly construe cessation-of-production clauses like this one to permit maintenance of the lease by restoring production within the stated time period, ***even if no drilling or reworking operations are conducted***. Third, Texas courts do not limit the applicability of cessation-of-production clauses like this one based on the cause of cessation. Accordingly, the HBP Leases remain valid as a matter of law.

1. A Temporary Cessation of Production for a Period of Time Shorter than that Authorized by the Leases does not Result in Termination.

It is undisputed that EP resumed production on all wells holding the HBP Units within 31 days on average and in no event more than 40 days.[19] Under Texas law and the plain language of the Leases, that temporary cessation of production does not result in termination.

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[18] Specifically, MSB contends that "On or about May 1, 2020, EP Energy began shutting in its wells across all of the Leases. Ultimately, all production across the various Leases stopped. At that time, there was no production occurring that would perpetuate the Leases . . . Under Texas law and the plain language of the Leases, absent production, the Leases terminated." Case No. 19-35654 ECF. No. 1610-1. At the March 24th hearing, counsel for MSB elaborated, "[T]here's only two things that they can do to bring themselves under the protection of the subparagraph (d) and that's drilling a well, which they didn't do, or [r]eworking a well . . . They didn't recomplete or repair these wells, certainly not all of them." ECF No. 49 at 36:6-9, 14-15.

[19] Shannon Decl. at ¶¶ 9; **Exhibit 5** (Well-By-Well Cessation Period Summary).

The requirement of production to maintain a lease in its secondary term does not necessitate continuous production without interruption of any kind. As the Texas Supreme Court has repeatedly explained, a "temporary cessation of production . . . does not terminate a lease." *Ridge Oil Co., Inc. v. Guinn Invs., Inc.*, 148 S.W.3d 143, 150 (Tex. 2004). "[O]nly ***permanent*** cessation of production may cause the estate to terminate." *Id.* at 151 (emphasis added); *Anadarko Petroleum Corp. v. Thompson*, 94 S.W.3d 550, 554 (Tex. 2002) ("[A] typical Texas lease . . . automatically terminates if actual production ***permanently*** ceases during the secondary term." (emphasis added)); *see Sutton v. SM Energy Co.*, 421 S.W.3d 153, 158 (Tex. App.—San Antonio 2013, no pet.) ("A lease . . . automatically terminates if actual production during the secondary term ceases ***other than temporarily***." (emphasis added)). "The doctrine of temporary cessation of production is a practical necessity, because oil and gas are ***never*** produced and marketed in a continuous, uninterrupted operation that goes on every hour of the day and night." 2 Eugene O. Kuntz, *A Treatise on the Law of Oil & Gas* (hereinafter, "Kuntz") 417 (emphasis added).

Under the common law articulation of this principle, "a lease will continue for a reasonable period of time, despite the cessation of production, to give the lessee an opportunity to resume production." *Red River Res., Inc. v. Wickford, Inc.*, 443 B.R. 74, 81 (Bankr. E.D. Tex. 2010) (citing *Watson v. Rochmill*, 155 S.W.2d 783, 784 (Tex. 1941)). However, if the lease expressly defines the time period constituting a permanent, rather than temporary, cessation of production, then the time period provided in the lease controls. *Red Deer Res., LLC*, 526 S.W.3d at 395–96. Where the lease contains such express language, a cessation results in termination only where "there has been a cessation of production for a period in excess of that allowed under the lease." 3 Howard R. Williams and Charles J. Meyers, *Oil and Gas Law* (hereinafter, "Williams & Meyers"), § 616; *see, e.g., Wainwright v. Wainwright*, 359 S.W.2d 628, 629 (Tex. Civ. App.—Fort Worth 1962, writ

ref'd n.r.e.) ("[T]he lease terminated if production was voluntarily discontinued by appellee for more than 90 days.").[20]

In the MSB Leases, Paragraph XI(d) defines a "permanent" cessation of production as one lasting 120 days or longer. Thus, to show that the HBP Leases terminated, MSB "must prove that [] there has been a total cessation of production for a period longer than" 120 consecutive days. *See Red Deer Res., LLC*, 526 S.W.3d at 396. MSB cannot carry its burden because, in fact, "no HBP Well experienced a total cessation of production of oil and gas for a period of 120 days or longer." Shannon Declaration at ¶ 9.

2. The Leases Do Not Require Drilling or Reworking Operations Where Such Operations are Unnecessary.

Consistent with Texas law conditioning lease termination on a permanent cessation of production, Texas courts uniformly construe cessation-of-production clauses like that in the MSB Leases to permit maintenance of the lease by resuming production within the permitted time period, even if the lessee conducts no drilling or reworking operations.

i. *Mayers* Precludes MSB's Theory of Termination.

Mayers v. Sanchez-O'Brien Minerals Corp. is directly on point. There, the San Antonio Court of Appeals held that three leases were held by the commencement of actual production within the permitted time period under the cessation-of-production clause, even without drilling or reworking operations at any point. 670 S.W.2d 704 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.). The court reached that holding notwithstanding that the cessation-of-production clause contained "drilling or reworking" language parallel to that in the MSB Leases. *Id.* at 708–09.

[20] The lease in *Wainwright* contained "drilling operations" language parallel to that in the MSB Leases. *See id.* at 629.

In *Mayers*, the lessees had completed a well capable of production shortly after the end of the primary term, but shut-in the well (*i.e.*, stopped it from producing) pursuant to the leases' "shut-in royalty" clause. *Id.* at 706. A "shut-in royalty clause provides for a substitute or contractual method of production," and the lessee's compliance with a shut-in royalty clause is deemed "constructive" (as distinguished from "actual") production that maintains the lease under the habendum clause. *Red Deer Res., LLC*, 526 S.W.3d at 395. In *Mayers*, the lessees invoked the shut-in royalty clause under the leases and paid the "annual" shut-in royalty on August 10, 1978, resulting in deemed constructive production for the ensuing year. 670 S.W.2d at 706–07. At the end of the first year (August 10, 1979), the lessees had not made a second shut-in royalty payment, but they did restore actual production shortly thereafter, on October 2, 1979, when the subject well "was put on line producing oil and gas." *Id.*

The lessees argued, and the court agreed, that any failure to timely make the second shut-in royalty payment triggered the 60-day cessation-of-production clause at the end of the first year of constructive production, which "operated, in effect, to give the lessee an additional sixty days [] beyond August 10, 1979, in which to resume operations or commence production from the oil well." *Id.* at 709. The dispute thus centered on the whether the lessees maintained the leases by restoring actual production on October 2, 1979. *Id.* at 706–07. Although the lessees did not conduct any drilling or reworking operations at any point, the court held that the leases were maintained because—as with every well on the HBP Units here—the well at issue "was put on line producing oil and gas" and thus "***began actual production*** before the end of the 60-day cessation of production clause." *Id.* at 707, 711 (emphasis added).

The Fifth Circuit has endorsed the holding in *Mayers* that the lessees could maintain the leases under the cessation-of-production clause "if within the 60 days after the expiration of

[constructive production from] the shut-in payment period ***actual oil, gas, or other mineral is produced***." *Norman v. Apache Corp.*, 19 F.3d 1017, 1028 (5th Cir. 1994) (quoting *Mayers* at 709) (emphasis added). Professors Ernest Smith and Jacqueline Weaver have also confirmed the holding in *Mayers*, writing that "[i]f actual production ceases . . . the operations clause (which in this context is sometimes referred to as the cessation-of-production clause) will normally allow the lessee [a specified time period] in which to ***begin actual production*** from the well ***or else*** begin reworking or drilling operations." 1 Ernest E. Smith and Jacqueline L. Weaver, *Texas Law of Oil and Gas* (hereinafter, "Smith & Weaver") § 4.5[B] (4-51–4-52) (2nd ed.) (citing *Mayers*) (emphasis added).

In support of its conclusion, the *Mayers* court cited the Texas Supreme Court's reasoning concerning a clause "essentially the same as the one in the present case" in *Skelly Oil Co. v. Harris*, 352 S.W.2d 950 (Tex. 1962). *Mayers* at 709. In *Harris*, the court construed a "continuous operations"[21] savings clause providing that "the lease shall remain in force so long as operations are prosecuted with no cessation of more than sixty (60) consecutive days." *Harris*, 352 S.W.2d at 951 n.1. There, the lessee prosecuted drilling operations until completing a well capable of producing gas on November 24, 1953. The lessee capped the well but did not pay a shut-in royalty. The lessee did not prosecute any further operations within the 60-day window, but "[p]roduction of gas from the well began on January 4, 1954"—41 days after the cessation of drilling operations. *Id.* at 952. The court held that the lease was maintained, because "[t]he 60-day clause [] allows the lessee that period after completion of a well capable of producing within which ***to begin either actual or constructive production***." *Id.* at 953 (emphasis added).

[21] A "continuous operations" clause "sustains the lease so long as drilling operations continue 'and if production results therefrom, then as long as production continues.'" *Anadarko Petroleum Corp.*, 94 S.W.3d at 555.

As the *Mayers* court emphasized, the decisive fact in *Harris* was that—as is the case here—the lessee "commenced actual production" within the permitted time period. *Mayers* at 709 (discussing *Harris*). Again, Professors Smith and Weaver agree, noting that "the operations clause [in *Harris*] allowed the lessee sixty days within which ***to begin actual or constructive production***," and that "[t]he reverse proposition also holds" under a cessation-of-production clause, because the lessee "has [a specified time period] in which ***to begin actual production or*** to rework the well ***or*** to begin new drilling." Smith & Weaver, § 4.5[C][3] (4-60 & n.183) (citing *Harris* and *Mayers*, respectively) (emphasis added).

ii. Numerous Other Courts Agree with *Mayers* that Restoring Production Maintains the Lease.

Mayers, along with the above authority confirming its holding, decisively precludes MSB's theory of termination as to the HBP Leases. But *Mayers* does not stand alone. Other Texas courts to touch on this issue uniformly agree that restoring production—whether actual production or constructive production—would maintain a lease as an alternative to commencing drilling or reworking operations.

For example, in *Hall v. McWilliams*, the Austin Court of Appeals held that the lease terminated under the cessation-of-production clause because "there was ***no production*** from the lease in question ***and*** no drilling or reworking operations on the lease for more than 60 days." 404 S.W.2d 606, 608 (Tex. Civ. App.—Austin 1966, writ ref'd n.r.e.) (emphasis added). Similarly, in *Sun Operating Ltd. Partnership v. Holt*, the Amarillo Court of Appeals reasoned that upon the initial cessation of production, "the lessee still has 60 days to ***either remedy the situation which caused production to stop or*** initiate drilling or reworking operations." 984 S.W.2d 277, 282 (Tex. App.—Amarillo 1998, pet. denied). And in *Morris Exploration, Inc. v. Guerra*, the San Antonio Court of Appeals phrased the dispositive question to be "whether [another savings clause]

perpetuated the lease, ***absent actual production or*** the commencement of drilling or reworking operations within the prescribed time limits." 751 S.W.2d 710, 711–12 (Tex. App.—San Antonio 1988, writ dism'd w.o.j.) (emphasis added). All of the leases at issue in these cases contained "drilling or reworking operations" language parallel to that in the MSB Leases, and each of these courts suggested that actual production would suffice to maintain the lease.

Still other Texas courts agree that restoring production maintains the lease in cases involving constructive production (as distinguished from actual production) by payment of a shut-in royalty. For example, in *Shell Oil Co. v. Goodroe*, the lessee maintained the lease because "[t]he shut-in royalty payment was made within the ninety-day period, after production ceased, in compliance with [the cessation-of-production clause]," even though the cessation-of-production clause contained "drilling or mining operations" language similar to the "drilling or reworking" language at issue here. 197 S.W.2d 395, 398 (Tex. Civ. App.—Texarkana 1946, writ ref'd n.r.e.).

The Texas Supreme Court later recognized that in *Goodroe* "the 'shut-in' royalty payment was tendered within the 90-day period after production had ceased in compliance with the terms of the [cessation-of-production clause in the] lease." *Gulf Oil Corp. v. Reid*, 337 S.W.2d 267, 271 (1960). The *Gulf Oil* court distinguished *Goodroe* on the facts of that case, but *Goodroe* remains good law following *Gulf Oil*. *Marifarms Oil & Gas, Inc. v. Westhoff*, 802 S.W.2d 123, 126 (Tex. App.—Fort Worth 1991, no writ). In *Marifarms*, the court similarly distinguished *Goodroe* on the facts, but agreed that production would suffice, holding that the lease terminated because "[f]or approximately 84 days there was no production and no substitute for production." *Id.* Here, of course, EP restored actual production within the permitted time period.

Finally, to the knowledge of counsel for EP, no Texas court has ever construed a cessation-of-production clause of this type to require drilling or reworking operations to maintain the lease

where actual production resumed within the stated time period. That reality comports with the Texas Supreme Court's general instruction to construe lease language "from a utilitarian standpoint bearing in mind the particular business activity sought to be served, and avoiding unreasonable constructions when possible and proper," *Endeavor Energy Res., L.P.*, 615 S.W.3d at 148, as well as the court's specific instructions regarding cessation-of-production clauses of this type. In *Anadarko Petroleum*, the court approvingly quoted Professor Eugene Kuntz's discussion of precisely this type of clause:

> The fact that the event which is designed to prevent termination is the commencement of drilling or reworking operations gives some indication of the purpose of the clause and the intention of the parties. It indicates that the parties are concerned with a situation where cessation of production is of the type that is remedied by drilling or reworking operations. Thus, the parties must have intended that the clause would become operative if a dry well is drilled or if a producing well ceases to be capable of producing in paying quantities. A literal application of the clause to every temporary cessation of production could lead to absurd and unintended results.

94 S.W.3d at 556 (quoting Kuntz 416-17). "Moreover," the court noted, "this construction avoids imposing an unnecessary limitation on the grant." *Id.*[22]

By contrast, reading this type of cessation-of-production clause as MSB asserts would impose an unnecessary limitation on the grant because it would result in lease termination despite

[22] In *Anadarko Petroleum*, the court noted that the clause at issue, when read in the broader context of the lease, "indicate[d] the parties' intent that the cessation-of-production clause apply only when the circumstances require the lessee 'to resume operations for drilling a well.'" *Id.* at 556. That reading of the particular lease in *Anadarko Petroleum* does not conflict with the reading urged by EP here. The lease in *Anadarko Petroleum* contained an atypical habendum clause, which did not require "actual production" to maintain the lease but rather "last[ed] as long as gas 'is ***or can be*** produced.'" *See id.* (emphasis in original). Thus, as the *Anadarko Petroleum* court made clear, the "general rule involv[ing] leases with typical habendum clauses" like the MSB Leases "[did] not control how to construe [the atypical] habendum clause" in *Anadarko Petroleum*. *Id.* Instead, in order to give meaning to every term in the atypical lease at issue, the *Anadarko Petroleum* court read the cessation-of-production clause to operate "only . . . when production—as defined in the habendum clause—ceases"—meaning that "the circumstances [would] require the lessee 'to resume operations for drilling a well.'" *Id.* at 556-67. The court ultimately held that the lease was sustained under the habendum clause even without any drilling operations, because "a well actually producing or capable of producing gas sustains this particular lease under the habendum clause," and "the cessation-of-production clause only applies if the lease would otherwise terminate under the habendum clause." *Id.* at 553, 556-57 (citation omitted).

the restoration of actual production, unless the lessee conducts unnecessary "drilling or reworking operations." That reading would result in the absurd scenario where a lessee would be required to conduct perfunctory, useless operations that "would be of no benefit to either party," or else lose the lease. *See Garcia v. King*, 164 S.W.2d 509, 511 (Tex. 1942). Professors Smith and Weaver again concur, noting that such a result would "hardly make[] sense":

> . . . If production ceases because of mechanical problems, regulatory action, or termination of a gas purchase contract, requiring renewed drilling or reworking operations hardly makes sense. . . . If some other type of remedial action is appropriate, such as repairing broken machinery, it must not only be begun within the sixty-day period, but must result in renewed production within that time frame . . . the period specified clearly limits the permissible time which may elapse before the lessee must ***either obtain renewed production or*** undertake the types of operations described in the clause.

Smith & Weaver, § 4.4[B][2] (4-45–4-46) (emphasis added).

Under Texas law, such an absurd reading cannot obtain, because "the very purpose of the landowner in executing the lease is to have the oil and gas on the leased premises 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," and "[t]hese are material elements to be considered in the interpretation of the contract." *Garcia*, 164 S.W.2d at 511. Indeed, EP's decision to temporarily stop production on the MSB Leases because of external market forces both complied with the Leases and, as discussed more fully below at part A.3., also yielded an increased royalty to MSB under the circumstances.

The cessation-of-production clause here provides a 120-day window after initial cessation for the lessee to avoid termination. Texas courts construe this language to permit maintenance of the lease by restoring actual production within that window, even if no drilling or reworking operations are undertaken (because, in this case, such operations were unnecessary). Again, it is undisputed that "no HBP Well experienced a total cessation of production of oil and gas for a

period of 120 days or longer." Shannon Declaration at ¶ 9. Accordingly, the HBP Leases were held by production and therefore did not terminate as a matter of law.

3. The Leases do not Limit Applicability of the Cessation-of-Production Clause Based on the Cause of the Cessation.

At the March 24th hearing, MSB suggested that the cessation-of-production clause applies only to "wells that go offline, generally, unintentionally." ECF No. 49 at 34:17-18. But nothing in the text of Paragraph XI(d) or in Texas law supports limiting application of the cessation-of-production clause based on the cause of the cessation.

Paragraph XI(d) provides in relevant part: "***If production should cease*** from any production unit, this lease shall terminate as to all lands and depths included within such unit unless . . . ." (emphasis added). There is no reference to the cause of the cessation, and to construe the text otherwise impermissibly inserts limiting language that is not there. *See Great Am. Ins. Co. v. Primo*, 512 S.W.3d 890, 893 (Tex. 2017) ("We also refuse to insert language or provisions the parties did not use or to otherwise rewrite private agreements."). Indeed, MSB's attempt to read in a cause limitation where none exists in the text has been expressly rejected in Texas:

> "[N]o case has been found which restricts application of a [cessation-of-production] clause to situations where production ceases solely because of mechanical breakdown, depletion, or the like. Nor do we care to be the first to so hold, given the purpose of the clause. As illustrated by the Texas Supreme Court in *Samano*, a [cessation-of-production] clause deals with prolonging the viability of the lease once production stops, not with the reasons why production stopped.

Sun Operating Ltd. P'ship, 984 S.W.2d at 282 (citing *Samano v. Sun Oil Co.*, 621 S.W.2d 580, 583–84 (Tex. 1981)). No court has elected to forge a different path after *Sun Operating*.

MSB's suggestion appears to track an obsolete trend in Texas law whereby courts previously seemed to limit application of the ***common-law*** temporary-cessation-of-production doctrine to stoppages caused by mechanical breakdown "or the like." *See, e.g.*, *Watson*, 155 S.W.2d at 784. Were such cases good law today, they would nonetheless be inapplicable here

because the MSB Leases contain an ***express*** cessation-of-production clause that trumps the common-law doctrine. *See Red Deer Res., LLC*, 526 S.W.3d at 395-96. But these cases are no longer good law, as the Texas Supreme Court made clear in 2004 when it confirmed that "the circumstances in which this and other courts have applied the [common-law temporary cessation] doctrine have not been so limited." *Ridge Oil Co., Inc.*, 148 S.W.3d at 149-50 (discussing *Watson* and other similar cases).

But even so, while the cause of the cessation is irrelevant, here the cause was the unprecedented and sudden crash in oil prices in spring 2020.[23] In this case, EP's prudent decision to temporarily stop production in fact preserved royalty value for MSB. Specifically, instead of pulling barrels of oil out of the ground in May to sell at $5 or $10 or $15 per barrel—to the extent any barrels could be sold at all—EP kept those barrels in the ground while the price remained low and then, once the price recovered, pulled those barrels out of the ground later in the summer at $35 or $40 or $45 per barrel. *Id.*at ¶ 6, 8-9. The below table tells the story[24]:

2020 MSB Oil Royalties			
Month	**MSB Barrels Sold**	**WASP Per Barrel**	**Oil Royalties Accruing to MSB**
Jan.	34,434.00	$58.40	$1,923,604.04
Feb.	32,207.47	$51.60	$1,594,649.22
Mar.	37,399.61	$30.62	$1,095,651.72
Apr.	27,641.58	$14.61	$387,650.60
May	0	-------	-------
Jun.	42,115.83	$34.27	$1,406,367.51
Jul.	38,258.86	$38.84	$1,419,582.67
Aug.	35,955.55	$40.52	$1,391,437.74
Sep.	31,727.33	$37.06	$1,122,130.10
Oct.	29,538.11	$36.89	$1,039,967.10
Nov.	29,095.18	$38.57	$1,070,971.83
Dec.	31,152.96	$44.37	$1,318,918.99
TOTAL	**369,528.51**		**$13,770,970.59**

[23] Blome Decl. at ¶¶ 2-7.

[24] Blome Decl. at ¶ 9.

That reality belies MSB's further alleged concern at the March 24th hearing that under EP's reading of Paragraph XI(d), EP would:

> . . . have the right to turn every well off on all 16 leases at any time, for any reason, no reason, because they want to, because they don't like the prices, so long as once every 120 days, they have one day of production and that they could theoretically cycle these wells two to three times a year, produce less than five barrels and hold the lease.

ECF No. 49 at 36:24-37:5. MSB's sky-is-falling argument does not describe what actually happened here and also ignores that in this case EP preserved royalty value for MSB. In other words, it wasn't simply "more business savvy for [EP] just to shut the wells in," ECF No. 49 at 37:13-15—in fact, the decision inured to MSB's benefit.[25]

MSB's alleged concern would sound under the reasonably prudent operator standard, not questions of lease termination.[26] In *Anadarko Petroleum*, the Texas Supreme Court rejected exactly MSB's alleged concern "that allowing the capability of production to sustain the lease would allow the lessees to sustain the lease indefinitely—without actual production," noting that "the implied duty to manage and administer the lease as a reasonably prudent operator . . . would limit the lessees' ability to sustain the lease" under similar circumstances. 94 S.W.3d at 557.

Thus, in the extreme hypothetical case posed by counsel for MSB, if the lessors believed the lessee was "truly failing to pursue the true potential of [the] property, the owners could sue for breach of that clause or the implied duty." *See Apache Deepwater, LLC v. Double Eagle Dev.*,

[25] Blome Decl. at ¶ 9. EP provides the Blome Declaration and the above table only to aid in the Court's understanding of the context for EP's decision and the resulting preservation of royalty value benefitting MSB. None of the facts underlying the Blome Declaration or this table are material to the controlling legal issues presented herein. As discussed above, only two facts are material to the controlling questions, and both of those facts are undisputed: first, that EP restored actual production within 120 days on every HBP Unit; and second, that EP has always drilled wells on schedule under the continuous-development clause on every CD Lease.

[26] "The reasonably prudent operator concept is infused into every implied covenant in the oilfield," and thus "[e]very claim of improper operation by a lessor against a lessee should be tested against the general duty of the lessee to conduct operations as a reasonably prudent operator in order to carry out the purposes of the oil and gas lease." *Bowden v. Phillips Petroleum Co.*, 247 S.W.3d 690, 700 n.4 (Tex. 2008) (citation omitted).

LLC, 557 S.W.3d 650, 658 (Tex. App.—El Paso 2017, pet. denied). Such a suit would ***still*** not provide a viable path to establish lease termination, however, because the Texas Supreme Court has "consistently held that breach of an implied covenant in an oil and gas lease 'does not automatically terminate the estate, but instead subjects the breaching party to liability for monetary damages, or in extraordinary circumstances, the remedy of a conditional decree of cancellation.'" *Anadarko Petroleum Corp.*, 94 S.W.3d at 560 (quoting *Rogers v. Ricane Enters., Inc.*, 772 S.W.2d 76, 79 (Tex. 1989), other citations omitted).

In this case, MSB would have no claim even for money damages under the reasonably prudent operator standard, because EP's decision to temporarily stop production was demonstrably prudent in that it preserved royalty value for MSB.

B. EP Maintained the Continuous-Development Leases by Drilling Wells on Schedule.

In contrast to the HBP Leases discussed above, the CD Leases remain in their continuous-development phase. Again, MSB does not allege in its proposed state-court petition or in any other pleadings that continuous development has ended on these Leases. *See* Case No. 19-35654 ECF. No. 1610-1. It is undisputed that EP has always drilled wells on schedule. Nevertheless, for the avoidance of doubt, EP will demonstrate that it has complied with the continuous-development clause and "maintain[ed] all of the [] lease property by drilling a well on the property every [120] days" under Paragraph VIII. *Mayo Found. for Med. Educ*, 505 S.W.3d at 73.[27]

Because MSB does not dispute that the CD Leases remain in their continuous-development phase, MSB's theory of termination with respect to the CD Leases is limited to its claim that these "Leases terminated upon their terms based on EP Energy's failure to obtain production during May 2020." *Id.* at ¶ 30. That argument fails with respect to the CD Leases, because no production is

[27] Shannon Decl. at ¶¶ 6-8 (reflecting drilling schedules on every CD Lease).

required during the continuous-development phase. *Mayo Found. for Med. Educ*, 505 S.W.3d at 73.

MSB also contends that, contrary to the Leases' terms, production must be maintained at the same time as continuous development under the retained-acreage clause. In *Mayo Foundation*, the court addressed exactly this question—"whether the [] lease provides for automatic termination of individual production units as they cease to produce, regardless of whether the lessee is continuing to drill wells on undeveloped acreage"—and held that retained-acreage clauses like these "typically do not take effect until after the continuous drilling or other savings provisions reach their end." 505 S.W.3d at 70. The same is true here, as discussed at parts B.2. and B.3. below. As a result, MSB has no viable path to establish lease termination with respect to the CD Leases.

1. The Continuous-Development Clause Gives EP the Right to Drill to Well Density to Maintain the "Lease in Force as to All the Leased Premises," and EP has Always Complied with the Required Drilling Schedule.

As discussed above at part I.B., "[c]ontinuous-development clauses in general permit a lease to be perpetuated at the expiration of the primary term even when there is no oil or gas being produced on the leased premises, if the lessee is then engaged in some form of continuous operations for drilling or reworking of a well." *PPC Acquisition Co. LLC v. Delaware Basin Res., LLC*, 08-19-00143-CV, 2021 WL 651666, at *5 n.7 (Tex. App.—El Paso Feb. 19, 2021, no pet. h.) (citing *Red Deer Resources, LLC*, 526 S.W.3d at 394-95). To that end, the continuous-development clause "extends the ***entire lease*** so long as the operator remains engaged in the required development efforts." *Endeavor Energy Res., L.P.*, 554 S.W.3d at 598 (emphasis added); *see* Williams & Meyers at § 617 ("There is no question but that a drilling operations or continuous drilling operations clause is effective to keep a lease alive after the expiration of the primary term

even though there is no production at that time, if the requisite drilling operations are being pursued.").

The continuous-development clause in the MSB Leases, which is typical among large oil and gas leases, contains three parts, all of which confirm the lessee's right and option to drill to well density "to continue this lease in force as to all the leased premises"[28]:

- First, the continuous-development clause provides an initial means for the lessee to maintain the lease beyond the initial primary term by "drilling [] an additional well on the leased premises." MSB has never disputed (and does not now dispute) that EP commenced the drilling of such "additional well" on each of the CD Leases within the permitted time period.

- Second, the continuous-development clause provides for a subsequent, similar means for the lessee to maintain the lease beyond that first extension by "drilling [] yet another well on the leased premises." Again, MSB has never disputed (and does not now dispute) that EP commenced the drilling of "yet another well" on each of the CD Leases within the permitted time period.

- Third, the continuous-development clause provides for an additional subsequent, similar means for the lessee to maintain the lease beyond that second extension, giving the lessee the option to drill either to density "to continue this lease in force as to all the leased premises" or until the lessee decides to stop. Again, MSB has never disputed (and does not now dispute) that, with respect to the CD Leases, EP has continued "the commencement and drilling of successive wells" within the permitted time period.

In other words, no production is required for EP to maintain its fee simple determinable interest in the entire leased premises for the duration of continuous development, provided that EP complies with the drilling schedule.

The drilling schedule set out in Paragraph VIII requires the lessee to commence drilling "within one hundred twenty (120) days after completion" of each dependent continuous-development well. EP has always complied with that schedule. Again, MSB has never contended (and is not now contending) otherwise. In fact, in 2018, MSB entered into a letter agreement

[28] The Leases define "leased premises" to mean all of the land covered by the lease. *See* Paragraph II ("The land described in said *Exhibit A* shall be hereinafter referred to as the *"leased premises."*).

confirming that EP was "deemed . . . to satisfy the timing requirements contained in Section VIII of the Leases for the calendar year 2018" as to the A Leases and the B Leases, and that those Leases were then still "being developed pursuant to Section VIII of the Leases-Continuous Development." Exhibit 4 ("**2018 CD Letter Agreement**") at 1. Nevertheless, for the avoidance of doubt, EP provides the drilling schedules set out at paragraphs 6, 7, and 8 of the Shannon Declaration to demonstrate that it has complied with the required drilling schedules with respect to the A Leases, the B Leases, and the Maltsberger Lease, respectively. For the sake of brevity, EP has confirmed its compliance with the drilling schedule from the 2018 CD Letter Agreement forward on the A Leases and B Leases, and from January 2018 forward on the Maltsberger Lease—which covers and goes beyond the time period at issue in MSB's claims here.

2. The Retained-Acreage Clause does not Take Effect Until After the Cessation of Continuous Drilling Operations.

As discussed above at part I.B., in addition to the continuous-development clause (Paragraph VIII), the Leases also contain a retained-acreage clause (Paragraph XI). A retained-acreage clause "divides the leased acreage such that production or development will preserve the lease [under the habendum clause] only as to a specified portion of the leased acreage"—here, "only as to acreage that had been assigned to a well" in a so-called "production unit." *See Endeavor Energy Res., L.P.*, 554 S.W.3d at 597–98, 606.

The retained-acreage clause contains four subparagraphs. First, subparagraph (a) provides for a partial termination "upon the expiration of the primary term or upon the cessation of continuous drilling operations . . . ***whichever occurs later***." In this case, because EP has elected to exercise its continuous-development rights, the partial termination did not occur at the end of the primary term and will instead occur "upon the cessation of continuous drilling operations," which has not yet been reached on the CD Leases. At that future time, the lease "shall ***then*** terminate" as

to all lands not included in a production unit[29]—including a depth-severance provision regarding so-called "deep rights" below each such production unit—as follows:

> (a) **Termination**. If this lease has not otherwise terminated as herein elsewhere provided, then upon the expiration of the primary term ***or upon the cessation of continuous drilling operations conducted in accordance with Paragraph VIII hereof***, ***whichever occurs later***, this lease shall ***then*** terminate as to all lands covered hereby except land within a production unit or units ***at that time***. In addition, this lease shall ***then*** terminate with respect to [the deep rights] below . . . each such production unit ***at the time of such termination*** . . . .

(Emphasis added). As with other typical retained acreage clauses, here Paragraph XI "control[s] the termination of the leases ***after*** cessation of continuous development." *Chesapeake Expl., L.L.C. v. Energen Res. Corp.*, 445 S.W.3d 878, 882 (Tex. App.—El Paso 2014, no pet.) (emphasis added).[30]

Second, following any termination under subparagraph (a), subparagraph (b) requires the lessee to thereafter designate production units "for wells then producing" and release any acreage not contained in a production unit:

> (b) **Release of Leased Premises and Assignment of Rights in Geophysical Information**. Within sixty (60) days after any partial termination of this lease as provided in this Paragraph XI, lessee ***shall deliver to lessor a plat showing the production units designated*** by lessee for wells ***then producing*** oil or gas, ***and a release*** properly describing by metes and bounds the acreage released . . . .

(Emphasis added). For example, EP has now designated production units and released the deep rights with respect to the C, D, and E Leases because continuous-development has ended on those Leases.

[29] As discussed above at part I.B., the term "production unit" is defined in Paragraph IX, which designates the maximum number of acres that can be held by production on such production unit..

[30] As in the MSB Leases, the lease in *Chesapeake Exploration* gave the lessee the right to continue drilling pursuant to the drilling schedule "until the above described land is drilled to [] density . . . , or this lease shall terminate . . . ." 445 S.W.3d at 880.

Third, in the event that the lease "terminate[s] in part and [is] partially released" under subparagraphs (a) and (b), subparagraph (c) provides that the "lessee shall have and retain such easements over and across such terminated portions or portions of the [Lease]" notwithstanding any such partial termination. Subparagraph (c) is not in issue here.

Fourth, subparagraph (d) provides that "production from or operations conducted on each production unit shall maintain this lease in force" as to, and only as to, the portions of the lease included in the associated production unit. In other words, it "divides the leased acreage such that production or development will preserve the lease only as to a specified portion of the leased acreage." *See Endeavor Energy Res., L.P.*, 554 S.W.3d at 598 (citing Williams & Meyers at § 603.7). Specifically, it provides:

> (d) **Subsequent Operations.** After the occurrence of any event described in *subparagraph (a)* of this *Paragraph XI*, production from or operations conducted on each production unit shall maintain this lease in force as to, but only as to, that portion of the leased premises included within such production unit . . . .

(Emphasis in original).

The operative temporal phrase "[a]fter the occurrence of any event described in *subparagraph (a)* of this *Paragraph XI*" governs when in sequence the retained-acreage clause takes effect. As discussed above, subparagraph (a) describes two events: (1) a partial termination "upon the expiration of the primary term," or (2) a partial termination "upon the cessation of continuous drilling operations . . . whichever occurs later." Read in context and harmonized with the other provisions of Paragraph XI and the entire lease, the only reasonable way to construe the phrase "after the occurrence of any event described in *subparagraph (a)* of this *Paragraph XI*" is to read it to mean "after the occurrence of any [partial termination] described in *subparagraph (a)* of this *Paragraph XI*."

Only that reading comports with the well-settled concept that the "triggering event [for a retained-acreage clause is] the end of each lease's continuous-development period." *Endeavor Energy Res., L.P.*, 554 S.W.3d at 605. Texas courts have repeatedly explained that "retained acreage clauses . . . typically ***do not take effect until after*** the continuous drilling or other savings provisions reach their end." *Mayo Found. for Med. Educ.*, 505 S.W.3d at 70 (citing *Chesapeake Expl., LLC*, 445 S.W.3d at 886; *Sutton*, 421 S.W.3d at 158–59) (emphasis added); *see PPC Acquisition Co.*, 2021 WL 651666, at *6 (noting that, in *Endeavor*, "the retained-acreage clause was triggered ***at the cessation of continuous development***" (emphasis added)); *Chesapeake Expl., L.L.C.*, 445 S.W.3d at 885 (noting that the retained acreage clause in *Nafco* took effect "when continuous development ceased" (discussing *Nafco Oil & Gas, Inc. v. Tartan Res. Corp.*, 522 S.W.2d 703 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.)); *id.* (noting that the retained acreage clause in *Seale* took effect "upon the lessee's failure to comply with the continuous drilling program" (discussing *Humphrey v. Seale*, 716 S.W.2d 620, 621 (Tex. App.—Corpus Christi 1986, no writ)).

Consistent with settled law, even counsel for MSB agrees that "***[w]hen continuous development ceases***, ***this*** generally triggers a retained acreage provision that provides for an automatic termination of some portion of leased acreage." Austin Brister and Chris Halgren, *Twelve Lessor/Lessee Issues to Consider when Navigating the "New Normal,"* OILANDGASLAWDIGEST.COM (May 18, 2020), https://oilandgaslawdigest.com/uncategorized/twelve-lessor-lessee-issues-to-consider-when-navigating-the-new-normal/ (emphasis added). Indeed, MSB itself has also long agreed with EP's reading. MSB presented the Court with a letter demonstrating that as of April 20, 2020, MSB agreed that "maintain[ing] continuous drilling operations on the Leases" under Paragraph VIII would "perpetuate[] the Leases," with no mention

of any requirement of production to maintain production units at that time. Case No. 19-35647 ECF No. 36-11 at 3. Similarly, MSB entered into the 2018 CD Letter Agreement confirming that EP was "deemed . . . to satisfy the timing requirements contained in Section VIII of the Leases for the calendar year 2018" as to the A Leases and the B Leases, and that those Leases were then still "being developed pursuant to Section VIII of the Leases-Continuous Development"—again, with no mention of any requirement of production to maintain production units at that time. Exhibit 4 at 1.

Under the plain language of the Leases and settled Texas law, the retained-acreage clause in the CD Leases does not take effect until after the cessation of continuous drilling operations under the continuous-development clause, which has not occurred on the CD Leases. Again, it is undisputed that EP has always complied with the drilling schedule such that the CD Leases remain in their continuous-development phase.[31]

3. *Raymore* and *Mayo* Preclude MSB's "Separate Leases During Development" Reading.

At the March 24th hearing, however, counsel for MSB reversed course, suggesting that Paragraph XI(d) "operates to create . . . separate leases" at "the end of the primary term," such that "as production ceases from a production unit, that unit is lost," regardless of continuous development. ECF No. 49 at 35:1-12. MSB's "separate leases during development" reading is wrong under the plain language of the Leases and it has also been expressly rejected by multiple Texas courts interpreting similar provisions.

First, *Community Bank of Raymore v. Chesapeake Exploration, LLC*, demonstrates that the retained-acreage clause in the CD Leases "has not sprung into life." 416 S.W.3d 750, 755 (Tex.

[31] Shannon Decl. at ¶¶ 4-8.

App.—El Paso 2013, no pet.). *Raymore* involved a depth-severance provision like that in Paragraph XI.[32] The depth-severance provision in *Raymore* was to be triggered—just like MSB now reads subparagraph (d) of the retained-acreage clause here—"[a]t the expiration of the Primary Term *or* the conclusion of the continuous development program." *Id.* at 752 (emphasis added).[33] During the primary term, the lessee drilled thirteen wells, and thereafter the lessee maintained the continuous-development program set out in the lease. *Id.* The lessor nonetheless demanded a release of the deep rights at the end of the primary term, arguing that the depth-severance provision was triggered at the end of the primary term, which had already occurred, rather than taking effect at the end of continuous development. *Id.* The court held that the depth-severance provision had not been triggered, because the disjunctive word "or," as used in the lease, meant the later to occur of either the conclusion of the primary term or continuous development—not the first to occur as the lessor contended. *Id.* at 755. The court emphasized that the lessor's construction would make "little commercial sense" because it would frustrate the goal of encouraging the lessee to reasonably develop the lease. *Id.* at 756.

Second, *Mayo Foundation for Medical Education. v. Courson Oil & Gas, Inc.*, is directly on point. In *Mayo Foundation*, the court rejected exactly the same argument from parallel lease language in addressing "whether the [] lease provides for automatic termination of individual production units as they cease to produce, regardless of whether the lessee is continuing to drill wells on undeveloped acreage." 505 S.W.3d at 70. There, the continuous-development clause provided—like that in the MSB Leases—"that after [the] primary term, lessee could continue to

[32] In *Raymore*, the court referred to the depth-severance provision as a "horizontal Pugh clause." *See id.* at 754–55 ("[A] horizontal Pugh clause holds a lease only to the stratum or level from which production has been secured in the unit during the primary term of the lease and, thus, frees the mineral interests below that depth absent additional development.").

[33] MSB ignores that in the MSB Leases, of course, subparagraph (a) provides the additional phrase "whichever occurs later," leaving no doubt as to when a partial termination occurs.

develop such lease by drilling a well on the property each 180 days and that the lease would remain effective so long as such drilling by Lessee continued." *Id.* at 71. The retained-acreage clause provided—like that in the MSB Leases—that, "'notwithstanding the termination of this lease as to a portion or portions of acreage covered hereby,' lessee can designate production units that will 'remain in force and effect as to each Production Unit . . . so long as oil or gas is produced from such unit in paying quantities' or 'additional drilling or reworking operations are conducted . . . .'" *Id.* The retained-acreage clause further provided—again, like that in the MSB Leases—that:

> Lessee shall, *within sixty (60) days after the termination of this lease*, . . . execute and file for record . . . a written recordable instrument designating and describing all of the lands covered by this lease which, upon such termination, are properly included in a Production Unit . . . and *Lessee shall, at such time, further evidence such termination by releasing this lease as to all the lands originally covered hereby not properly included in such unit or units . . . .*

(Emphasis in original).[34]

The lessor in *Mayo*—like MSB here—contended that that lease language "bifurcate[d] the way that developed and undeveloped land is treated immediately after the end of the primary term," requiring the lessee "to designate production units and, in order to hold those production units, resume production in paying quantities, drill additional wells, or rework wells within sixty days of the cessation of oil or gas production as to each unit," regardless of continuous development. *Id.* at 70–71.

[34] Paragraph XI(b) contains virtually the exact language and works the same way, providing that "***[w]ithin sixty (60) days after any partial termination of this lease***," the lessee shall deliver "production units designated for wells ***then*** producing" and a release regarding "the acreage released" to be filed for record by the lessor. (Emphasis added). In addition, Paragraph IX defines the maximum acreage attributable to various types of "producing" wells at the expiration of the primary term and provides that each "such well" will hold the lease in force as to "the acreage to be attributed to such well by instrument filed for record . . . within sixty (60) days after the expiration of the primary term." That additional timing language does not apply to a later-drilled CD well. Finally, Paragraph IX contains no special limitation language, so there is no conflict with the clear retained-acreage clause set out in Paragraph XI.

The court rejected that argument, because retained-acreage clauses like these "typically do not take effect until after the continuous drilling or other savings provisions reach their end." *Id.* (citations omitted). "The effect of these provisions," the court held:

> . . . are that ***during the secondary period, [lessee] maintains all of the [] lease property by drilling a well on the property every 180 days*** . . . At the ***end*** of this secondary period, the lease calls upon [lessee] to designate production units . . . , and to simultaneously release all other property under the lease. These production units are ***then*** maintained so long as production in paying quantities continues or, if profitable production ceases, the production unit may be maintained by [lessee] either reworking the existing well or drilling a new well on the unit. We conclude that ***this is the only reasonable construction*** that can be given to the [] lease.

Id. at 73 (emphasis added).

Raymore and *Mayo Foundation* both preclude MSB's reading. In addition, MSB's reading cannot prevail because it would severely limit the grant to the lessee, which includes the right to drill to density "to continue this lease in force as to all the leased premises" under Paragraph VIII. Courts "will not hold the lease's language to impose a special limitation on the grant . . . unless limited by language so clear, precise, and unequivocal that no other conclusion could be reached." *Chesapeake Expl., L.L.C.*, 445 S.W.3d at 883. That is not the case here.

Thus, if there were any "indeterminacy of the provision's text," or even if "[b]oth sides' readings of the provision [were] reasonable," MSB's argument still must fail, because "it has long been the rule that contractual language will not be held to automatically terminate the leasehold estate unless that language can be given no other reasonable construction than one which works such result." *See Endeavor Energy Res., L.P.*, 615 S.W.3d at 154–55 (citation omitted). Under such circumstances, the language "***cannot*** operate as a special limitation." *Id.* (emphasis added). The retained-acreage clause therefore ***must*** be read in the manner that maintains the CD Leases.

IV. CONCLUSION

MSB's claims do not survive scrutiny. Texas law leaves no doubt that EP maintained all of the MSB Leases pursuant to their terms. EP appreciates this Court's willingness to quickly reach the merits of the case and the opportunity to remove the specter of termination that MSB seeks to create. This Court has bankruptcy jurisdiction over the alleged termination event at the heart of MSB's claims. And this Court thus has all necessary authority to adjudicate what is clear as a matter of bedrock Texas oil and gas law: MSB's claims are futile and should be dismissed with prejudice.

Respectfully submitted,

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Certificate of Service

I hereby certify that on April 23, 2021, a true and correct copy of the foregoing document was served by the Electronic Case Filing System for the United States Bankruptcy Court for the Southern District of Texas.

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