

# THE MEANING OF CESSATION OF PRODUCTION: HOYT V. CONTINENTAL OIL

By John S. Lowe

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The Oklahoma Supreme Court may have fashioned a club for lessors to use to bludgeon lessees from what most lessees thought was a shield for their protection in its decision in *Hoyt v. Continental Oil*,<sup>1</sup> regarding the interpretation of the cessation of production clause in an oil and gas lease. There can be legitimate dispute, however, as to the rule of law the court intended to adopt.

In *Hoyt*, the Oklahoma Supreme Court had before it a typical cessation of production clause that provided in relevant part that:

"If after expiration of the primary term . . . production shall cease from any cause . . . [the] lease shall not terminate provided . . . lessee resumes operations for drilling within 60 days."<sup>2</sup>

The plaintiff, Hoyt, sued for cancellation of an oil and gas lease alleging cessation of production in paying quantities after expiration of the primary term. Each month for a period of more than a year operating revenues had totalled less than operating expenses, while the defendant renegotiated a gas sales contract and studied a completion attempt in a new formation. The plaintiff argued that the cessation of production clause gave Continental Oil sixty days after cessation of production in paying quantities to act to hold the lease by drilling operations.<sup>3</sup>

Continental Oil, on the other hand, argued that the cessation of production clause in the lease referred to a complete cessation of production, not to a cessation of production in paying quantities.<sup>4</sup> The Oklahoma Supreme Court found in favor of the plaintiff, Hoyt, holding that the reference to production in the cessation of production clause

meant production "in paying quantities" after the primary term. The court said the lease had terminated because defendant had failed to resume operations within sixty days as required by the terms of the clause.<sup>5</sup>

The Supreme Court reasoned that, during the primary term of the lease, the cessation of production clause modifies the drilling clause of the lease, so that there is no cessation of production during the primary term of the lease unless production ceases entirely. The court then stated that after the primary term has expired, the cessation of production clause modifies the habendum clause of the lease.<sup>6</sup> The cessation of production clause is triggered, therefore, by a failure of production in paying quantities in the secondary term.

The *Hoyt* case may be interpreted as having the effect of transforming a clause that was intended as a shield to protect the lessee against premature termination of his producing lease into a club with which a lessor can beat his lessee. This view results from a literal reading of the words of the court in *Hoyt*:

". . . where, as here, the primary term has expired . . . the effect of the provision is to modify the habendum clause. In such a situation there is a cessation of production if the habendum clause requires production in paying quantities and such requirement is not met. [Citations omitted.] . . . the record clearly demonstrates production in paying quantities was not obtained for an uninterrupted period far in excess of the 60 day provi-

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## JOHN S. LOWE

Professor of Law and Associate Director of the National Energy Law and Policy Institute of the University of Tulsa, is a member of the Bars of Ohio and Oklahoma and edits the Mineral Law Section Newsletter of the O.B.A. He received a B.A. in Economics from Denison University and a LL.B. from Harvard University. He is a Trustee of the Rocky Mountain Mineral Law Foundation and a member of the Legal Committee of the Oklahoma Independent Petroleum Association.



sion in the lease executed by the parties. Where the parties have bargained for and agreed on a time period for a temporary cessation clause that provision will control over the common law doctrine of temporary cessation allowing a 'reasonable time' for resumption of drilling operations."<sup>7</sup> [Citations omitted.]

This, and the text that follows, suggest that the Oklahoma Supreme Court may see the cessation of production clause as supplanting the time-flexible standard of "in paying quantities."<sup>8</sup>

Continental Oil, in its petition for rehearing, spelled out the implications of such a view:

"This application of the cessation of production clause would be especially difficult in light of the fact that production figures for a particular month are normally not available for 15 to 20 days after the close of the month. By the time the production figures were obtained from the well, and the profits and losses figured, the 60 day period would have run. Even if it had not yet run, it would be virtually impossible to secure a drilling rig and a drilling crew and have it on location within the time provided in order to preserve the lease . . . ."<sup>9</sup>

Another view of the case, one less threatening to lessees and probably more in harmony with the scanty case law in the area, is that *Hoyt* holds that the cessation of production clause applies only after it has been established that there has been a cessation of production in paying quantities for more than a reasonable period of time. According to this interpretation, after the lease is extended to

the secondary term, the lessee would be entitled to hold the lease for a reasonable time during which there was not production in paying quantities plus an additional sixty days (or whatever period was provided for by the clause).

Using this view of *Hoyt*, the cessation of production clause can do the lessee no additional harm where production costs exceed production revenues for more than a reasonable period. On the other hand, it does the lessee little good either, for he cannot know when the sixty day period begins to run. The operator will not be informed of the trier of fact's determination until long after the facts have established that his production ceased in paying quantities and long after any grace period provided for in the cessation of production clause has run.

It is this writer's opinion that a cessation of production clause similar to that before the court in *Hoyt* should be interpreted to apply only where there has been a **total** cessation of production; that is, the reference to production in the cessation of production clause ought not to be interpreted as a reference to production in paying quantities. By this view, the cessation of production clause would simply be inapplicable to the *Hoyt* situation. Where operating costs exceeded operating revenues for an unreasonable period of time, the lease would terminate without reference to the cessation of production clause.

The purpose of a cessation of production clause is to bring a higher degree of certainty to an area

of the law otherwise couched in terms of reasonableness. It saves both the lessee and the lessor from having to argue about whether production has been shut down for an impermissibly long period. It permits the lessee to take action to re-establish production from a lease from which production has ceased with substantial assurance that he will not be later held to have invested his funds in a lease that has already terminated.

Such a certain result would be desirable where there was no total cessation, but merely a cessation of paying quantities. Because the concept of paying quantities is inherently imprecise, however, that is impossible. The intent of the parties, therefore, in including a cessation of production clause in the lease is likely to be that the cessation of production clause apply only where there has been a total cessation of production.

Though this writer is convinced that reference to cessation of "production" in the *Hoyt* cessation of production clause should have been interpreted to mean total cessation, it is clear that that interpretation was rejected by the Oklahoma Supreme Court. Because of the risk that the Supreme Court meant that cessation of production clauses that refer to "if . . . production shall cease" are triggered by a single accounting period loss after the end of the primary term, lease draftsmen would be well advised to use formulations that clearly state that the reference to cessation of "production" in the cessation of production clause is to total cessa-

tion. The following language from a Colorado form should suffice:

"6. If at any time or times after the Primary Term or before the expiration of the Primary Term all operations, and if production, all production shall cease for any cause, this Lease shall not terminate if Lessee commences or resumes any drilling or re-working operations, or production, within ninety (90) days after such cessation; provided that payment of rental as herein provided for shall be resumed if such cessation occurs during the Primary Term, which rental shall be in addition to any royalty paid."<sup>10</sup> (Emphasis added.)

Not to do so is to risk being clubbed with one's shield.

1. 606 P.2d 560 (Okla. 1980). For a somewhat different view of *Hoyt*, See Note, The Cessation of Production Clause and less than Paying Production in the Secondary Term, 16 Tulsa L.J. 301 (1981)

2. *Id.* at 562.

3. *Id.*

4. *Id.* at 563.

5. *Id.* at 564.

6. *Id.* at 563.

7. *Id.*

8. *Clifton v. Koontz*, 160 Tex. 82, 325 SW 2d 684, 10 O. & G. R. 1109 (1959).

9. Appellant's brief in support of petition for rehearing, at 15.

10. Form 681, approved for use in Colorado by the American Association of Petroleum Landmen, published by Kraftbilt Products, Tulsa.

## STUDENT LEGAL RESEARCH SERVICES

A permanent research service organized and operated by individual students at Oklahoma University College of Law. Research rate: \$12.00/hr. Director: Steve Mullins.

Include: (1) facts (2) questions to be explored (3) cost ceiling, (4) date needed — 3 weeks unless otherwise agreed.

**Legal Research Board**  
300 Timberdell, Norman 73019  
(405) 329-8800

## LAW DAY EVENT SET IN LAWTON

As a special Law Day event, Cameron University in Lawton is sponsoring a debate on the "Holy City" issue at 10 a.m. on Friday May 1 in Shepler Center. Stephen L. Pevar, attorney for record for the suit filed March 11, 1981 in the United States District Court, District of Columbia, Civil Action No. 810580, will argue for removal of all religious symbols and Teree E. Foster, OU College of Law faculty, will argue for retention of the Holy City as it currently exists claiming that it does not violate the Constitutional amendment for the separation of church and state.

**John D. Hastie**, of the Oklahoma City firm of Hastie & Kirschner will be on the teaching faculty of the ABA National Institute of "Financing Real Estate During the Inflationary '80s" to be held May 4 and 5 at the Beverly Hilton in Beverly Hills, Calif., and May 28-29 at the New York Hilton, New York. His topic will be "Joint Ventures, Including Those With Lending Institutions, Non-taxpayers, Foreign Entities, Pension Funds and Preferred Equity Transactions."

# BENCH & BAR BRIEFS

## MID-YEAR MEETING SET BY PT&C SECTION

June 12-14 are the dates of the Mid-Year Continuing Legal Education Conference set by the OBA's Patent, Trademark and Copyright Section. For registration at the event to be held at Shangri-La Lodge, Afton, contact James R. Duzan, P.O. Box 1431, Duncan 73536.

**R. N. Dunagan, III**, formerly Vice-President and General Counsel, Energy Decisions, Inc., has become a member of the law firm of Pierson, Ball & Dowd, concentrating his practice in the areas of energy law and taxation. He will divide his practice between the firm's Washington, D.C. and Oklahoma City offices which are located at 204 N. Robinson Avenue, 750 City National Bank Tower.

## OCU LAW SCHOOL ADDS TO FACULTY

**John D. McCord III**, presently enrolled in the LL.M. program at the University of Georgia School of Law, Athens, Ga., will join Oklahoma City University's School of Law faculty in August as an Associate Professor of law specializing in the area of property. Mr. McCord, a graduate of Emory University, Atlanta, Ga., graduated cum laude from the University of Georgia School of Law. He previously was a partner in the firm of Rogers & McCord in Ashburn, Ga., and also served as General Counsel for the First Federal Savings & Loan Association of Turner County, Ashburn, Ga.

**John Terry Bado**, formerly Vice-President and General Counsel for Alpha Energy of Oklahoma City, and **Barbara K. Arentz Bado**, formerly Senior Law Clerk for United States District Court Judge Lee R. West, of the United States District Court for the Western District of Oklahoma, Oklahoma City, announce the formation of a partnership to practice law under the firm name of Bado and Bado, with offices at Suite 502 Canyon Park, 1600 East Nineteenth Street, Edmond 73034, (405) 340-1500.

## OKLAHOMA ASSOCIATION OF MUNICIPAL ATTORNEYS PLAN CONFERENCE

Registration will begin at 9 a.m. in the OU Law Center, 300 Timberdell Road, in Norman on Friday, May 8, for the 1981 Spring Conference of the Oklahoma Association of Municipal Attorneys. The opening session is set for 9:30 a.m. and at 10 a.m. Jim L. Lindsey, Tulsa, will talk on "Increase of Municipal Liability in General."

James G. Hamill, Oklahoma City, will present the "Legislative Committee Report" at 11 a.m. Luncheon will be at 11:30 a.m. and at 12:30 p.m. Russell D. Bennett, Lawton, will talk on "Liability Under 42 USC Sec 1983".

At 1:30 p.m. David K. Petty, Guymon, will speak on "Liabili-

ty Based on 42 USC Sec 1981"; at 2:30 p.m. Loyd L. Benson, Frederick, will talk on "Liability Based on Nuisance" and at 3:15 the "General Counsel's Report" will be given by Maurice H. Merrill, General Counsel, and Lynn C. Rogers, Assistant General Counsel. After the 3:30 p.m. adjournment a short Directors meeting will follow.