

May 18, 2020

**Shut-In and Cessation of Production: Current Considerations for Oil & Gas Producers***By David Ammons, Austin Elam, Michael A. Freeman and Michelle Scheffler*

With the recent significant decline in commodity prices, and physical transportation and storage curtailments, due in large part to reduced demand related to the COVID-19 pandemic, producers are evaluating many of their producing oil and gas wells to determine whether some level of reduced production is appropriate. In this alert, we attempt to highlight certain legal issues and considerations related to shutting-in or cycling wells, as well as potential risks associated with these actions. Finally, we identify and outline recent governmental and regulatory orders related to the current pricing crisis.

Please keep in mind that this alert provides only a general overview of significant issues (and may not address all issues relevant to a particular lease), and application of any of the items addressed will be highly dependent on the individual circumstances surrounding each lease and well, including the specific laws of the relevant legal jurisdiction and the agreements or documents governing a particular lease and well. Additionally, a single well may maintain multiple leases, and each affected lease may have differing provisions impacting the analysis. Further, many leases may have multiple wells, with each such well having its own economic characteristics, and therefore one well may hold a lease even though the same lease has multiple wells not then producing.

***Producing in Paying Quantities to Hold Leases***

The commonly understood rule in virtually all United States jurisdictions, including under federal leases, is that, unless a lease specifically provides otherwise, wells that are producing in paying quantities will be sufficient to maintain oil and gas leases beyond the primary term of the lease. Generally, to determine if a well is “producing in paying quantities” (“**PPQ**”), courts consider the following three factors: (1) whether the well has yielded a profit over operating costs over a reasonable period of time, (2) whether the well has a history of economic production (meaning operating revenues are greater than operating expenses, which may be exclusive of an operator’s capital expenses, including acquisition, drilling and completion expenses), and (3) whether a reasonable and prudent operator would continue to operate the well. Notably, Texas courts have traditionally declined to draw a bright line on the period of time over which to evaluate these factors but have, instead, analyzed whether the period of time is “reasonable under the circumstances.” *Clifton v. Koontz*, 325 S.W.2d 684 (Tex. 1959). Using this concept, Texas courts have held on multiple occasions that one year (and as much as two years) is probably too short of a time frame to analyze in determining PPQ. See e.g., *BP America Prod. Co. v. Laddex, Ltd.*, 458 S.W.3d 683, 686–87 (Tex. App.—Amarillo 2015), *aff’d and remanded*, 60 Tex. Sup. Ct. J. 542, 513 S.W.3d 476 (Tex. 2017); *Pshigoda v. Texaco, Inc.*, 703 S.W.2d 416, 419 (Tex. App.—Amarillo 1986, writ ref’d n.r.e.). Thus, there may be a wholistic analysis of activity and production under a lease (or leases), including a time-based component to the determination, with the implication that the determination will not necessarily be made over a relatively short period of time of limited or even no production.

Further, under many leases, a single well PPQ is sufficient to maintain any acreage under the lease covered by that well. For instance, if one of three wells on a lease is PPQ and the other two are shut-in or abandoned, the entire lease may still be held by production. More modern leases include a Pugh Clause or Freestone Rider, which provides that after the primary term, following cessation of continuous drilling by the lessees, acreage not included within the producing unit (or within the productive vertical zone) for any producing well located on the lease shall be released.

## ***Implied Covenant – Prudent Operator Standard and the Duty to Market***

Generally, an oil and gas lessee has an implied obligation to do everything a reasonably prudent operator would do in operating, developing, and protecting the property, with due consideration being given to the interests of both the lessor and the lessee. This is known as the “prudent-operator standard,” which is necessarily an important concept in a lessee’s analysis of well shut-in or production curtailments because the vast majority of jurisdictions will apply this standard in testing lessee performance of implied covenants.

One such implied covenant is the “duty to market,” and lessees are typically subject to this duty upon discovery of oil or gas on a leasehold (*i.e.*, the duty to produce from a well capable of production and then sell the resulting production). Therefore, if a lessee desires to cease or choke production under a lease, and a lessor challenges this decision, courts will usually apply the prudent operator standard to determine whether there is a breach of this implied duty to market.

Whether a lessee has complied with this standard often requires a case-by-case analysis based on the given facts of a particular situation. Courts will usually consider several factors, including (1) the local market and demand for production, (2) the usages of the lessee’s production, (3) the cost of drilling, equipping, and operating the wells, (3) the costs of transportation and storage, (4) the prevailing market price for production, and (5) the general market conditions as influenced by supply and demand or by regulation of production through governmental agencies.

Unless a lease expressly disavows a duty to market, most jurisdictions will read in or imply such a duty, even absent an express marketing clause. This implied duty to market may require that a lessee use diligent efforts to market oil or gas, including beginning to market production within a reasonable time after completion of the well. But the obligation is not absolute. Rather, the standard merely requires action that a reasonably prudent operator would take, which is a lower standard of care to the lessor than that of a fiduciary.

In the event a producer shuts-in a well, courts may not view a lessee’s duty to market as indefinitely relieved or suspended. A lessee must still act as a reasonably prudent operator in attempting to market the oil or gas production and should continually evaluate any voluntary decision to shut-in a well. Continuing to shut-in a well after oil prices rebound could give rise to a claim of breach of the duty to market. Conversely, producers may risk claims under this duty if they fail to act as a reasonably prudent operator, continuing to produce instead of choosing to shut-in a well when market conditions require. See *e.g.*, *Smith v. McGill*, 12 F.2d 32 (8th Cir. 1926).

## ***Curtailing Production and Maintaining Leasehold***

With the current market environment forcing temporary decreases in production, producers may seek solace in lease-savings clauses such as cessation of production, shut-in, and force majeure to save their leasehold absent PPQ. However, even without an adequate savings clause, a lease may, nonetheless, survive temporary cessation under the common law in some circumstances. Finally, producers may seek to cycle production to avoid a PPQ challenge instead of relying on a savings clause.

### **(a) Shut-in Clauses**

Shut-in clauses in leases are generally intended to allow a lessee to preserve a lease where there is no market for production by shutting in a qualifying well and paying the lessor a specified amount of money. The language contained in shut-in clauses may be specific to the particular lease so a detailed analysis of the particular provision,

taken together with any intent of the parties that can be derived, is important to determine any obligations or limitations with respect to shut-in under the lease. This alert discusses a few key considerations.

A threshold issue with shut-in provisions is determining the type of well that is eligible under the particular provision. Under the lease forms historically used in some jurisdictions, shut-in provisions have typically extended only to gas wells. Further, the lease form may contain language applying the shut-in provision only where there is a "well capable of producing gas in commercial quantities." Despite limitations in lease forms, certain states' administrative rules may permit a state lessee to request shut-in status for an oil well. Shutting-in by a state lessee under administrative rules, traditionally, may not provide for lease perpetuation. However, in the current climate, states may be assessing relief for lessees who temporarily cease production. In fact, the North Dakota Department of Trust Lands and the New Mexico State Land office have each indicated that it will freely grant shut-in at this time under state leases without effect on the lessee's lease term (see also the discussion below regarding the Oklahoma Corporation Commission's ruling on temporary cessation to avoid waste).

Another factor to consider when a well is shut-in during the secondary term of the lease is the potential result if the lessee fails to strictly comply with the shut-in provision under the lease, including failure to timely remit shut-in royalty payments. Jurisdictions vary on the result, although the general rule in most instances is that the remedy for failure to comply does not terminate the lease (in the absence of a specific provision of the lease to that effect) but, rather, is a breach of contract action, where recourse to the lessor is necessarily limited to monetary damages. See *Wagoner Oil & Gas Co. v. Marlow*, 278 P. 294, 306 (Okla. 1929). This general rule is predicated on the concept that the lease provision will be construed as a covenant and not a condition subsequent, which terminates the duty of a party to perform, as forfeiture is generally disfavored.

Alternatively, some jurisdictions may take the position that such non-compliance results in automatic termination of the lease. Generally, courts will allow for automatic termination where the lease provision is construed as a condition subsequent (and not a covenant). Notably, Texas courts have construed "unless" leases as containing a condition subsequent, where a failure to comply with the shut-in provision results in a termination of the lease. See *Blackmon v. XTO Energy, Inc.*, 276 S.W.3d 600, 606 (Tex. App.—Waco 2008, no pet.) ("In 'unless' leases, failure to pay shut-in royalties, if they are provided for, after the expiration of the primary term operates indirectly as a special limitation if the well which has been capped is the only well on the tract. The shut-in royalty is a substitute for production; a cessation of shut-in royalty payments is a cessation of 'production' under the habendum clause, and the lease terminates.") (citation omitted); *Gulf Oil Corp. v. Reid*, 161 Tex. 51, 56, 337 S.W.2d 267, 271 (1960) (finding the lease, which "followed substantially the usual 'unless' form," "lapsed as a matter of law, there being no gas produced from the premises on the last day of the primary term, and the [shut-in] royalty not having been paid on or before that date."). Additional factors that may impact the result of non-compliance with a shut-in provision is whether the well is capable of producing in paying quantities at the time of shut-in (although this does not necessarily require that a shut-in well be continuously kept in turn-key condition) and whether the lessee is acting as a reasonably prudent lessee under the circumstances in securing actual production.

Since the analysis will be specific by jurisdiction, the safest course would be to (1) strictly comply with all aspects of shut-in provisions on the assumption that a failure to do so could result in lease termination, and (2) maintain shut-in wells in as close to capable production as possible.

The following are additional questions to consider when evaluating shut-in provisions:

- (i) Does the well have to be on the leased premises, or can it be on land pooled or unitized with the lease?

- (ii) Are the circumstances limited in which the lessee can rely on the provision (e.g., specified timeframe, only where no market, government restrictions etc.)?
- (iii) When does the provision begin protecting the lease?
- (iv) What payments are required to the lessor?
- (v) How much of the lease does the provision save and for how long?
- (vi) Other than making payments, is the lessee required to do anything else?
- (vii) Is a state, federal or Indian lease implicated? If so, operators should review the relevant land management policies for the applicable jurisdiction.

## (b) Cessation of Production Clauses

Most leases also include an express cessation of production (“**COP**”) clause, and most of these COP clauses will allow for cessation of production for a period of usually 60-90 days without specifying any reason for the cessation. A temporary cessation of production should not implicate any of the traditional implied lease covenants and may be what a reasonably prudent operator would do, both to mitigate short-term losses and preserve economic value for both working interest owners (each, a “**WOI**”) and lessors by waiting to produce and/or sell volumes into a less volatile price environment. That said, risks to consider with cessation of production including the following:

- (i) *Shortened Time Periods.* Most COP clauses cover 60 or 90 days without production. However, although the exception, some leases contain shorter periods (possibly as short as 20 or 30 days). Under these COP clauses, the lease will not expire if the lessee commences additional drilling or reworking operations within the specified period of permitted cessation of production, also typically requiring the lessee to diligently prosecute these operations during the window to restore production.
- (ii) *Express Limitations.* Some leases may include a COP clause that could expressly limit the reasons for the cessation of production to mechanical and technical failures affecting the well, although no Texas case has squarely addressed that particular form of COP clause. The closest Texas case is *Anadarko Petroleum Corp. v. Thompson*, 94 S.W.3d 550 (Tex. 2002). In that case, the lessor’s claim of lease termination arose when production from its lease ceased during its lessee’s renegotiations of midstream contracts. Of importance to the court’s analysis, the lease contained an atypical habendum clause providing for maintenance of the lease as long as a well was “capable of production,” rather than the typical “as long as oil and gas is produced” habendum clause. The court in *Thompson* reasoned that, because the well at issue was capable of production and the cessation was voluntary, the habendum clause was satisfied without reference to the lease’s COP clause, which would only apply if the well technically or mechanically lost its capacity to produce. As such, *Thompson* is a case involving a COP clause that would only apply to mechanical and technical reasons for loss of production, but only because the pertinent lease’s unusual habendum clause would maintain the lease in the event of voluntary cessations of production. The holding in *Thompson* is, therefore, likely limited to its facts.
- (iii) *Specific Remedies.* Even for leases that do not expressly limit the approved reasons for temporary cessation of production, many COP clauses state that a lease “will not terminate due to cessation of production if the lessee begins operations to drill or rework within x days.” It may be argued that the COP clause only covers mechanical and

technical failures where the lease includes a specification as to a mechanical or technical remedy. This, in fact, was argued in *Smith v. Steckman Ridge, LP*, a decision from the United States Court of Appeals for the Third Circuit that applied Pennsylvania law, where the court held that COP clauses only apply to involuntary well stoppage, whereas shut-in clauses apply to voluntary stoppages. 590 Fed. Appx. 189, 191 (3<sup>rd</sup> Cir. 2014). However, the Third Circuit's opinion does not appear to be a majority held view (and there is no decision applying Texas law analogous to *Smith*).

## **(c) Common Law Temporary Cessation Doctrine**

Absent an express COP provision, the leasehold may still be shielded by the common law doctrine of temporary cessation of production, but the doctrine has strict boundaries. Factors to consider in applying the doctrine are the rationale for the cessation, the length of time of the cessation and the diligence and intent on the part of the operator (*i.e.*, the operator may need to be able to demonstrate a good faith intent to continue to operate). Two key elements courts look to in deciding whether to uphold a lease under the temporary cessation of production doctrine are the cause of the temporary cessation and the operator's efforts to regain production. See *e.g.*, *Ridge Oil Co. v. Guinn Investments, Inc.*, 148 S.W.3d 143, 161 O.&G.R. 1135 (Tex. 2004); *Landover Production Co., LLC v. Endeavor Energy Resources, LP*, 2014 Tex. App. LEXIS 11990 (Tex. App.—Eastland Oct. 31, 2014). Jurisdictions differ in the emphasis of these elements and, notably, Texas seems to emphasize the actual cause of the cessation, whereas Oklahoma seems to emphasize the duration of the cessation. Compare *Midwest Oil Corp v. Winsauer*, 323 S.W.2d 944 (Tex. 1959); with *Beatty v. Baxter*, 258 P.2d 626 (Okla. 1953), *Cotner v. Warren*, 330 P.2d 217 (Okla. 1958).

## **(d) Force Majeure Clauses**

Another lease provision that may operate to hold acreage in the secondary term if there is a curtailment of production is the force majeure clause. A force majeure clause simply states that failure of production will not work to terminate a lease if such failure is due to certain specified conditions such as acts of God, government orders, rules or regulations, inability to obtain materials, or strikes. The application of a force majeure provision is highly dependent on the wording of the clause itself. Courts will typically only apply force majeure where the clause specifically enumerates an event, or the event satisfies a catch-all provision and is unforeseeable. Without a specific provision, the current market downturn is unlikely to trigger a lease's force majeure provision as courts have held that market downturns are foreseeable as a matter of law. See *TEC Olmos, LLC v. ConocoPhillips Co.*, 555 S.W.3d 176 (Tex. App.—Houston [1st Dist.] 2018, pet. denied). That said, producers should look at each clause individually to determine potential applicability. For example, actions by government agencies, such as regulatory bodies' actions on proration, as discussed below in more detail, might fall within a force majeure clause. The Oklahoma Corporation Commission's recent emergency order declaring COVID-19 "unforeseeable" seems to be an attempt to trigger lease force majeure provisions.

## **(e) Cycling of Wells / Production**

In cycling well production an operator rotates production among its wells in a field causing a staggered and intermittent cessation of production among its wells during a production month (but production from all wells is taken at some point during the month). Cycling wells for economic reasons may draw more lessor questions or challenges than would continuous production that has been choked back, but assuming a profitable history for the wells prior to a cycling election, the expectation would be that a few months of intermittent production is unlikely to result in lease termination.

The primary risk posed by cycling is a PPQ challenge given that the principal motivation for cycling is that production from a well, at then market prices, might not be economic for the operator (see discussion above regarding PPQ, noting that PPQ and the particular operator's own economics are related but ultimately different metrics). The longer cycling continues, the greater the risk may be with respect to a PPQ challenge. An additional risk may be related to top lessees, who often identify potential acreage through public records showing a sudden cessation of production. Producers should be prepared for those that question the reduction, however, including providing talking points to any call-center or owner-relations personnel to enable them to provide a cogent explanation for a reduction in royalties.

Despite risks associated with well cycling, including the potential business risks noted above, such risks may be partially mitigated by (1) preparing to address lessor questions in advance, (2) limiting the period of time for cycling wells, and (3) structuring the cycling to avoid any well not producing in a given month.

## ***Other Risks and Obligations***

### **(a) Contractual Risks**

In addition to the risks under a lease, if production from a well falls below 100% of production capacity, any or all of the following business risks, among others, could be implicated:

- (i) *MVC Obligations.* Reductions in production could cause a company to fail to satisfy its minimum volume commitment ("**MVC**") obligations under gathering and other midstream agreements or generate a force majeure dispute.
- (ii) *Credit Facilities.* Reductions in production could cause a company to breach a financial leverage ratio or other maintenance covenants or affect other obligations under its credit facilities, including hedge limitations.
- (ii) *Reserves Reporting.* Securities and Exchange Commission registrants should consider whether and to what extent a reduction in production could affect their reported proved reserves. Further, any impact on a producer's reserve reports may trigger reporting requirements under its credit agreement and may also impact the producer's borrowing base.

### **(b) Operator's Duty to Notify of Shut-In**

In many jurisdictions, there is not a judicial or codified duty to notify lessors or joint interest owners in the event of a shut-in or other cessation of production. However, with respect to joint interest owners, this obligation is often established under a Joint Operating Agreement ("**JOA**") or other express agreement between the parties. Where there is no JOA or other express agreement between the parties (which is common in some producing jurisdictions), operators will likely be subject to the general standard of care owed to non-operators in forced-pool situations. To the extent there is an industry standard that may inform the application of this standard of care, it is likely reflected in the form JOAs. The 1982, 1989, and 2015 Model Form JOAs all provide similar language setting out an operator's obligation to non-operators when shutting-in a well.

By way of example, the pertinent language in the 1989 Model Form states that an operator will be jointly liable for the loss of a leasehold interest for non-payment of a shut-in royalty payment resulting from the operator's failure to promptly notify the non-operators that a well has been shut-in. It states in relevant part:

“Operator shall notify Non-Operators of the anticipated completion of a shut-in well, or the shutting in or return to production of a producing well, at least five (5) days (excluding Saturday, Sunday, and legal holidays) prior to taking such action, or at the earliest opportunity permitted by circumstances, but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-Operators, the loss of any lease contributed hereto by Non-Operators for failure to make timely payments of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article IV.B.3”

Even in the absence of judicial or statutory authority, due to the potential risk associated with a failure to notify under a JOA or other applicable agreements, operators may reduce risk by notifying non-operating WOI's of any anticipated shut-in.

## ***Temporary Abandonment***

As discussed above, shut-in wells are wells that are producing but may periodically be taken out of service due to mechanical issues or market conditions. That is, subject to limitations or obligations in the lease or at law, an operator can simply "turn the valve" and essentially take the well out of production (see the discussion above regarding legal and contractual issues related to shut-in wells and effects on the status of the lease). Shut-in status is temporary in nature and the well is often put back into production after a period of months. By contrast, although a shut-in well may ultimately be treated as temporarily abandoned, more often, operators may seek temporary abandoned status for idle wells by the applicable regulatory authority.

### **(a) Idle Wells**

Idle wells are oil and gas wells that are not in use for production, injection, or other purposes, and no longer produce at an economical rate, but have not been permanently sealed. An operator may choose to stop production and cap the well (to potentially allow the well to remain idle indefinitely) but not fully and more permanently decommission the well by plugging it (which is more expensive and permanent).

Idle wells are not generally permitted to remain idle indefinitely. Instead, after a certain period of time (“**well idle time**”) and subject to limitations under the relevant lease or at law, operators have a choice as to whether they start producing again, temporarily abandon the well, or decommission it. A significant number of jurisdictions impose limits on well idle time, which range from one month on Bureau of Land Management (the “**BLM**”) lands to up to twenty-four months in Arkansas and Ohio (for reference, Texas permits wells to be idled for twelve months). In addition, many jurisdictions, including Texas, do not provide for extensions of well idle time.

### **(b) Temporary Abandonment; Qualifications**

During the well idle time, if an operator does not start producing from that well and does not desire to more permanently decommission the well by plugging and abandoning, the operator can often delay those two decisions with temporary abandonment. Substantially all jurisdictions regulate the length of temporary abandonment, which can range from six months (in Colorado and Texas), to 60 months in Oklahoma and New Mexico, and to 300 months in California. However, jurisdictions that regulate the duration for temporary abandonment also typically allow for extensions (Texas and Oklahoma allow for unlimited extensions, while New Mexico, as the exception, does not allow for extensions). Temporary abandonment, therefore, is technically a transitory state, where the well might return to production or be decommissioned in the future. However, in practice, wells can remain temporarily abandoned indefinitely in certain jurisdictions and under certain circumstances.

To qualify for temporary abandonment status, regulators may require an operator to satisfy requirements under one or more of the following:

- (i) notification;
- (ii) approval, and/or
- (iii) inspection

Although some jurisdictions may only require notice, most jurisdictions with a formalized temporary abandonment process tend to require either some form of inspection or approval from the regulatory authority. As part of the approval process, many regulators require operators to show some future usefulness of wells that are temporarily abandoned before they are granted an extension, ostensibly to protect against wells remaining in a status of temporary abandonment only for operators to avoid decommissioning costs and without any intention of returning the wells to active status.

In Texas, the Texas Railroad Commission (the “**RRC**”) requires an operator to provide a report from a licensed geoscientist or petroleum engineer certifying that a temporarily abandoned well has future utility (and pay an annual fee of \$100 per well covered by the report). The report must include, among other things, a cost calculation for decommissioning the well and a determination that the expert reasonably expects the well to have future economic value in excess of decommission costs. 16 Tex. Admin. Code §1.3.3.15.j.

## ***Current Updates – Prorationing and Waste***

### **(a) Prorationing**

States historically set limits on the amount of oil that could be produced from each well in a given field from the 1930s to 1970s. After Dad Joiner’s discovery of the East Texas Field in 1930, flooding the market with oil that significantly dropped the price, states began regulating the amount of production from each field to match market demand. In an effort to prevent bootleg production crossing state lines, Congress passed the Connolly Hot Oil Act and created the Interstate Oil and Gas Compact Commission to help producing states coordinate production.

Since Texas was home to the largest producer of oil at the time, the RRC led the charge on regulating production. The RRC set statewide limits to match market demand, with individual limits per oilfield and even per well (these proration regulations would later become a model for the Organization of the Petroleum Exporting Countries (OPEC)). Many states still have proration statutes on their books dating back to the 1930’s, but have not used them since the 1970s, when production in the U.S. first peaked and foreign production of oil began to set market prices.

The primary objectives of proration are typically to (1) prevent waste, and (2) protect correlative rights.

Consistent with these objectives, statutory authority in Texas grants the RRC power to implement rules or orders where the RRC determines that there will be “waste,” which is defined as, among other things, the production of oil in excess of “reasonable market demand.” Texas law generally gives the RRC the power to limit the production of oil and prorate allowable production.

Recent oversupply of world oil markets has led to a renewed interest by some producers to reimpose proration to better match lowered demand created by the COVID-19 virus pandemic. This issue has been hotly contested in many producing states in recent weeks and at least the RRC has signaled its fear of legal challenges if it were to

enact proration. As discussed in more detail below, talk of proration has now officially died in Texas, but it remains to be seen what regulators in other jurisdictions such as Oklahoma and North Dakota will do.

## **(b) Texas Railroad Commission**

In response to a motion for a request for a market demand meeting filed by Pioneer Natural Resources USA Inc. and Parsley Energy Inc., the RRC held a virtual open meeting on April 14, 2020 to consider the motion and, in particular, the proration of production. At the April 14 hearing, the RRC heard testimony from operators, land owners, pipelines and other interested parties.

The RRC discussed oil prorationing further at a second virtual open meeting on April 21, 2020. At that meeting, a commissioner indicated that he was ready to vote in favor of a proration proposal for a 20% cut on Texas oil production starting on June 1 (applied on an operator-by-operator basis), dependent on an additional 4 million barrels of oil per day production cut by other U.S. states, Canada and OPEC+ countries. However, the other two commissioners indicated that they would defer voting on this proposal, pending the RRC gathering additional information, including further research into the RRC's legal ability to affect the proposed prorationing order, and further discussions with other oil producing states and countries.

At the RRC's meeting on May 5, 2020, efforts by certain producers promoting proration were rejected. It remains to be seen what regulatory relief, if any, the RRC will be able to provide to Texas producers.

## **(c) Oklahoma Corporation Commission**

On April 22, 2020, the Corporation Commission of the State of Oklahoma (the "**OCC**") issued an emergency order intended to help operators avoid lease termination by deeming that temporary cessation of production from producing well precludes the lease being deemed "uneconomic."

The OCC's order was intended to help operators whose "leasehold could be jeopardized without an order from th[e] Commission granting permission to shut in a well which they believe[ ] would be wasteful to continue to produce." Given the unprecedented nature of the OCC's order, producers can expect challenges by lessors to shut-ins. A few of the more-interesting notes and findings from the OCC's order:

- (i) There is an "oversupply situation that is out of operators'/producers' control" based on "collapse in demand for oil" caused by the "unforeseeable COVID-19 pandemic" and the "crude oil price war that substantially increased the supply of oil."
- (ii) In light of current prices/volatility, some properties might be "temporarily uneconomical to produce" and production from such properties would be "economic waste," which is prohibited by statute.
- (iii) "This action is warranted based upon the current volatility of low oil prices along with the intervening circumstances of the COVID-19 pandemic and is intended to be temporary in nature until such time as conditions improve, or the Commission determines otherwise. This order does not relieve any operator of otherwise complying with other existing Commission orders and rules or contractual terms of their oil and gas leases."

At the meeting on May 11, 2020, the OCC heard several hours of testimony on proposals for relief for oil and gas producers. However, the OCC declined to vote on such proposals and as of the date of this alert has not set a

date or plan for future decisions. As a result, the OCC's emergency order issued on April 22, 2020, which stands for a period of 90 days from the issuance (until July 21, 2020 or until the issuance of a new or superseding order), currently remains in effect.

**(d) North Dakota Industrial Commission**

In response to a recent motion of the North Dakota Industrial Commission (the "**NDIC**"), the NDIC has called a hearing for May 20, 2020 to consider how to determine the oil price at which the production of oil in excess of transportation or marketing facilities or in excess of reasonable market demand constitutes waste. The hearing will also consider consequences of making a determination that waste is occurring and will determine what relief may be appropriate and necessary to prevent the waste of North Dakota crude oil production.

***Issues related to production reduction, cessation and abandonment, and orders and rulings by various jurisdictions are rapidly changing and evolving at this time. Additional alerts will follow addressing further issues, updates and other jurisdictional approaches.***

At Haynes and Boone, lawyers from our energy teams frequently advise clients on the agreements and issues discussed above. For more information, please contact one of our lawyers listed below.

David Ammons (Partner, Energy Litigation Practice Group): [david.ammons@haynesboone.com](mailto:david.ammons@haynesboone.com)

Austin Elam (Partner, Co-Chair Oil and Gas Practice Group): [austin.elam@haynesboone.com](mailto:austin.elam@haynesboone.com)

Michael A. Freeman (Partner, Chair Energy Private Equity Committee): [michael.freeman@haynesboone.com](mailto:michael.freeman@haynesboone.com)

Michelle Scheffler (Partner, Co-Chair Oil and Gas Practice Group): [michelle.scheffler@haynesboone.com](mailto:michelle.scheffler@haynesboone.com)