IN THE SUPREME COURT OF TEXAS

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NO. 01-0261
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ANADARKO PETROLEUM CORPORATION, PETITIONER

v.

PHILLIP THOMPSON, ET AL., RESPONDENT

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ON PETITION FOR REVIEW FROM THE
COURT OF APPEALS FOR THE SEVENTH DISTRICT OF TEXAS
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ON MOTION FOR REHEARING

PER CURIAM

JUSTICE O'NEILL, JUSTICE SMITH and JUSTICE WAINWRIGHT did not participate in the decision on rehearing.

We deny the motion for rehearing but write to clarify our decision.[1]

In defining "capable of production" in our original opinion, we approved this definition from *Hydrocarbon Management, Inc. v. Tracker Exploration, Inc.*, 861 S.W.2d 427, 433-34 (Tex. App.–Amarillo 1993, no pet.):

> We believe that the phrase "capable of production in paying quantities" means a well that will produce in paying quantities if the well is turned "on," and it begins flowing, without additional equipment or repair. Conversely, a well would not be capable of producing in

[1] JUSTICE BAKER, author of the Court's original opinion, resigned effective August 31, 2002, and therefore did not participate on rehearing.

> paying quantities if the well switch were turned "on," and the well did not flow, because of mechanical problems or because the well needs rods, tubing, or pumping equipment.

___ S.W.3d ___, ___. In so doing, we did not overrule or otherwise call into question our prior decisions regarding the proper interpretation of "production in paying quantities." Specifically, we did not overrule or modify the longstanding requirement that for a well to produce in paying quantities, or to be capable of producing in paying quantities, there must be facilities located near enough to the well that it would be economically feasible to establish a connection so that production could be marketed at a profit. As we explained in *Clifton v. Koontz*, 325 S.W.2d 684, 691 (Tex. 1959), all the relevant circumstances must be considered in determining whether there are "paying quantities":

> In the case of a marginal well, such as we have here, the standard by which paying quantities is determined is whether or not under all the relevant circumstances a reasonably prudent operator would, for the purpose of making a profit and not merely for speculation, continue to operate a well in the manner in which the well in question was operated.
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> . . . .
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> The term "paying quantities" involves not only the amount of production, but also the ability to market the product (gas) at a profit. Whether there is a reasonable basis for the expectation of profitable returns from the well is the test. If the quantity be sufficient to warrant the use of the gas in the market, and the income therefrom is in excess of the actual marketing cost, and operating costs, the production satisfies the term "in paying quantities". In the Hanks case, [24 S.W.2d 5, 6 (Tex. Comm'n App. 1930, judgm't adopted)], the trial court found that the well completed by Hanks did not produce in paying quantities within the contemplation of the terms of the lease, and this Court upheld such finding, holding that there was no evidence showing that there were any facilities for marketing the gas or any near-by localities or industries which might have furnished a profitable market therefor. The Court went further and pointed out the complete failure of the evidence to show what the gas could have been sold for at any probable market, and that there was no evidence "tending to show that the well was situated in such proximity to any prospective market which would justify the construction of a pipe line for marketing same."

Id. at 691 (quoting *Hanks v. Magnolia Petroleum Co.*, 24 S.W.2d 5, 6 (Tex. Comm'n App. 1930, judgm't adopted)) (citations omitted); *see also Stanolind Oil & Gas Co. v. Barnhill*, 107 S.W.2d 746, 749 (Tex. Civ. App.–Amarillo 1937, writ ref'd). In the case before us today, the well was connected to pipeline facilities, and there was no question that it was capable of producing in paying quantities even though there were periods during which there was no production.

In our original opinion in this case, we also said,

> we reject Thompson's contention that allowing the capability of production to sustain the lease would allow the lessees to sustain the lease indefinitely—without actual production. Rather, the implied duty to manage and administer the lease as a reasonably prudent operator, which encompasses the implied duty to market the gas reasonably, would limit the lessees' ability to sustain the lease based on a well's capability of production.

___ S.W.3d at ____. But we did not intend to imply that the remedy for breach of an implied covenant to market production would be forfeiture or termination of a lease because we have 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." *Rogers v. Ricane Enters., Inc.*, 772 S.W.2d 76, 79 (Tex. 1989); *see also Rogers v. Ricane Enters., Inc.*, 884 S.W.2d 763, 767-68 (Tex. 1994); *Stanolind*, 107 S.W.2d at 748 (holding that "the failure of the lessee further to develop the property is, under the holdings of the courts, a breach of an implied covenant, the usual remedy for which is an action in damages"); *W.T. Waggoner Estate v. Sigler Oil Co.*, 19 S.W.2d 27, 32 (Tex. 1929) (refusing "to treat as a limitation or as a condition subsequent the implied covenant for reasonable development of premises leased for the mining of oil and gas"); *Mon-Tex Corp. v. Poteet*, 19 S.W.2d 32, 34 (Tex. 1929) (holding that a lease did not terminate when an implied covenant was breached but that there would be liability for damages sustained); *Tex. Co. v. Davis*, 254 S.W. 304, 308 (Tex. 1923) (reiterating that the implied covenant to explore and produce is not a condition subsequent that would give rise to the lease's termination if breached). The rationale for these holdings is to promote greater certainty about the continued existence of a lease:

> [I]f reasonable diligence in performing every one of the lessee's exploring, developing, producing, and marketing operations was the test, neither lessor nor lessee could at any time have clearly or certainly known whether the estate granted was alive or ended. Such a test must inevitably diminish—if not destroy—the value of the rights of all parties derived from a mineral lease.

W.T. Waggoner Estate, 19 S.W.2d at 30-31.

We meant in our original decision that, as a practical matter, a lessee will not sustain a lease based on a well's capability of production without actual production of the well because the payment of damages for the failure to reasonably market the gas would be a strong incentive to connect the well to facilities that would permit actual production. And, in an extraordinary case, when damages would not furnish an adequate remedy, a court could conditionally order termination if a connection and actual production were not commenced within a reasonable time. *See id.* at 32.

Finally, the motion for rehearing contends that several decisions of this Court and other courts compel a different result in this case. We disagree. The cases on which Thompson and the other Respondents rely are distinguishable because they involved different lease provisions, different facts, or both. The leases at issue in many of the cases said that the lease would remain in effect as long as oil or gas "is produced." *See Haby v. Stanolind Oil & Gas Co.*, 228 F.2d 298, 301 (5th Cir. 1955); *Samano* *v. Sun Oil Co.*, 621 S.W.2d 580, 581 (Tex. 1981); *Francis v. Pritchett*, 278 S.W.2d 288, 289 (Tex. Civ. App.–El Paso 1955, writ ref'd); *Sunray DX Oil Co. v. Texaco, Inc.*, 417 S.W.2d 424, 426-27 (Tex. Civ. App.–El Paso 1967, writ ref'd n.r.e.); *Woodson Oil Co. v. Pruett*, 281 S.W.2d 159, 162 (Tex. Civ. App.–San Antonio 1955, writ ref'd n.r.e.); *Hall v. McWilliams*, 404 S.W.2d 606, 607 (Tex. Civ. App.–Austin 1966, writ ref'd n.r.e.); *Wainwright v. Wainwright*, 359 S.W.2d 628, 629 (Tex. Civ. App.–Fort Worth 1962, writ ref'd n.r.e.). But in this case, the lease said "is or can be produced." As we explained in our original opinion, "can be produced" does not mean actual production.

Only two decisions relied on by Thompson and the other Respondents involved leases that contained a "can be produced" provision. *Davis*, 254 S.W. at 305; *Hanks*, 24 S.W.2d at 7, *affirming Hanks v. Magnolia Petroleum Co.*, 14 S.W.2d 348, 349 (Tex. Civ. App.–Eastland 1929). But the facts were very different from the facts in the case before us today. In *Davis*, the lessee abandoned all operations on the lease after the wells it had drilled ceased to produce, and there was no production for about fourteen years. 254 S.W. at 305. There was also evidence that the lessee had expressly released the lease. *Id.* This Court held the lease had terminated. *Id*. at 309. In *Hanks*, the lessee drilled a successful well and then capped it. 24 S.W.2d at 5. The court held that there was no evidence that the well could produce in paying quantities because "[t]he record is wholly devoid of evidence showing that there were any facilities for marketing the gas or any nearby localities or industries which might have furnished a profitable market therefor," and "[n]o attempt was made to show what the gas could have been sold for at any probable market, nor was there any evidence tending to show that the well was situated in such proximity to any prospective market which would justify the construction of a pipe line for marketing same." *Id.* at 6. As noted above, that is not the situation in this case.

Accordingly, we deny the motion for rehearing.

OPINION DELIVERED: January 30, 2003