

BEFORE THE CORPORATION COMMISSION
OF THE STATE OF OKLAHOMA

FILED

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CORPORATION COMMISSION
OF OKLAHOMA

APPLICANT: CANYON EXPLORATION CO.)
)
RELIEF SOUGHT: POOLING) CAUSE CD NO.
) 201001864
)
LEGAL DESCRIPTION: SECTION 27 AND THE S/2)
NW/4 OF SECTION 27,)
TOWNSHIP 1 NORTH, RANGE)
24 ECM, BEAVER COUNTY,)
OKLAHOMA)

REPORT OF THE OIL AND GAS APPELLATE REFEREE

This Cause came on for hearing before **Michael Porter**, Administrative Law Judge for the Corporation Commission of the State of Oklahoma, on the 18th day of August, 2010, at 8:30 a.m. in the Commission's Courtroom, Jim Thorpe Building, Oklahoma City, Oklahoma, pursuant to notice given as required by law and the rules of the Commission for the purpose of taking testimony and reporting to the Commission.

APPEARANCES: **Karl F. Hirsch**, attorney, appeared on behalf of applicant, Canyon Exploration Company ("Canyon"); **Russell J. Walker**, attorney, appeared for Courson Oil and Gas, Inc. ("Courson"); **Ronald F. Barnes**, attorney, appeared for Unit Petroleum ("Unit"); **James Roller**, landman, appeared for Stephen Production Company ("Stephen"); and **Jim Hamilton**, Assistant General Counsel for the Conservation Division, filed notice of appearance.

The Administrative Law Judge ("ALJ") filed his Report of the Administrative Law Judge on the 6th day of October, 2010, to which Exceptions were timely filed and proper notice given of the setting of the Exceptions.

The Appellate argument concerning the Oral Exceptions were referred to **Patricia D. MacGuigan**, Oil and Gas Appellate Referee ("Referee"), on the 29th

day of November, 2010. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

COURSON FILED EXCEPTIONS to the Report of the ALJ which recommended that the application be granted with the fair market value established as \$250 an acre and a 3/16 royalty.

Canyon filed an application to pool various formations in Section 27 and the S/2 of NW/4 of Section 27, T1N, R24E, Beaver County, Oklahoma. Courson opposed the application because of the proposed fair market values sought by Canyon. Canyon proposed \$250 an acre and a 3/16th royalty as the fair market value. Courson believes \$110 and a 1/4th royalty should be in addition to the \$250 an acre and a 3/16th royalty as an option to participation. Canyon also requested 365 days to commence the well. Courson was not in favor of the 365-day time frame and proposed 180 days as the proper time frame to commence the unit well. The ALJ granted the 180 day time frame to commence the unit well.

COURSON TAKES THE POSITION:

(1) The ALJ failed to recognize a transaction into which Canyon entered with Courson at a previous date, which transaction established fair market value, being \$110 an acre and 1/4th royalty.

(2) In making his recommendation, the ALJ misunderstood argument by counsel for Courson concerning the implications of commerciality for the greater royalty.

(3) Courson respectfully requests that the recommendation that the Commissioners grant the pooling application filed by Canyon in so far as said application sets fair market value as \$250.00 per acre and a 3 /1 6th royalty be denied and that the recommendation made by Courson be adopted.

THE ALJ FOUND:

(1) After taking into consideration all the facts, circumstances, testimony and evidence presented in the cause the ALJ recommended that the application be granted with the fair market value established as \$250 an acre and a 3/16 royalty.

(2) The evidence showed no 1/4 royalty leases have been taken in the nine section area for over a year. The evidence did reveal a letter agreement between two oil companies that was to be consummated in May of 2009. That "closing" never occurred. Thus any agreed-upon-bonus money or royalty was not paid. In addition, the underlying pooling cause for that letter agreement, was ultimately dismissed by Canyon. The letter agreement terms were discussed at the hearing for the earlier pooling and the ALJ in that cause accepted the evidence that it was not an indicator of fair market value.

(3) The ALJ agreed that this letter agreement is not an indication of fair market value. In this cause, the unfulfilled agreement is too remote in time to be relevant. Additionally, the conditions that caused Canyon to seek the agreement are no longer present. Thus there is no need to privately pay the one time premium to gain operations. As recited in the letter agreement in paragraph 2, the \$12,000 was to reimburse Courson for its leasehold position, implying Courson had paid that amount to gain its position in the unit. There was no evidence presented to explain this value or evidence of when Courson got this interest, whether it was part of a multi-section transaction, or some other reason for setting this value.

(4) In spite of the fact oil and gas prices are higher than they were in 2009, the evidence was uncontroverted that Canyon has taken leases in the past year for \$125 an acre and a 3/16 royalty. There is another company offering \$250 an acre and 3/16 royalty in an offsetting unit, thus establishing a new fair market value.

(5) There were some exchanges between Canyon's witness and Courson's attorney regarding the economic impact a bonus of \$110 an acre and 1/4th royalty would have on the economics of a well. Upon review of the mathematics offered by Courson's attorney and the witness for Canyon, this ALJ finds the mathematical calculations to be misleading. The actual increase between a 3/16th (18.75%) royalty and a 1/4th (25%) royalty is an additional 6.25% or 33% of the total, rather than 1% agreed to during the hearing. [Transcript page 31, lines 8-16]. With 428 acres not under lease, this increase in royalty could affect the economics of any proposed well. It is accurate to say there is a \$60,000 difference between \$250 an acre and \$110 an acre for the unleased 428 acres. How that compares to an increase in royalty payments over the life of the well is unknown. These are factors operators use to make a decision regarding drilling a well. Whether or not these factors makes the well uneconomic or not is not for this forum to decide.

(6) The ALJ also recommended that Canyon be given 180 days from the date of the order issuing in this cause to commence the unit well.

POSITIONS OF THE PARTIES

COURSON

1) **Russell Walker**, attorney, appearing on behalf of Courson, stated this case concerns the fair market value in this pooling matter. There were two issues presented in the case. The first being the time which Canyon could start a well. Canyon wishing to have 360 days and Courson arguing for 180 days. The ALJ recommended 180 days. The second issue involves the fair market value. Canyon has testified to a \$250 and a 3/16th royalty. Courson recommended \$110 an acre and 1/4th royalty. The parties came to an agreement which was close to \$110 per acre and 1/4th royalty. Canyon then took the matter before the ALJ and testified to a royalty provision that did not include the arrangement they made with Courson.

2) A third party saw the order did not incorporate the arrangement with Courson as fair market value and moved to reopen the case. Canyon moved also to reopen and dismiss the case. That motion was granted. Canyon waited over a year to file a new pooling action contending the arrangement made with Courson previously doesn't represent fair market value. Courson states nothing had changed during the previous year except that the price of oil had gone up about 40% and the price of gas had gone up about 25%. Courson believes the Commission uses an arbitrary cutoff of a nine-section area when calculating the fair market value of a tract and Canyon is taking advantage of this cutoff. Courson points out the contradicting testimony made by the landman who calculated the fair market value.

3) Courson also points out that Canyon contends paying a quarterly royalty will ruin their economics. Courson owns about 1/6th of the acreage in this section. The difference between 3/16th's royalty and a quarter royalty is 6.25%. Therefore, if Courson was the only one to elect to the quarter royalty, they would be getting about 1% extra royalty. Canyon contends this will ruin their economics. Courson claims Canyon is trying to wait over a year so they can argue an arms length transaction is not applicable. Courson requests Courson's recommended fair market value of \$110 an acre and a quarter royalty be approved.

CANYON

1) **Karl F. Hirsch**, attorney, appeared on behalf of Canyon, stated in April 2009, before the prior hearing, Canyon and Courson entered into a letter agreement which provided for the higher values, high bonuses, and royalty amounts. Canyon states there was discussion of the letter agreement at the hearing by a witness who disclosed the terms of the letter agreement. Canyon argues the consideration given from Canyon to Courson was to settle the protest and obtain operations for Canyon so Canyon could drill a well at the location Canyon wanted, which was different from where Courson wanted to drill the well. Therefore, the \$110 per acre cash bonus and the 1/4th royalty were not only an acquisition of leasehold, but an acquisition of operations. Canyon urges this is not the definition of fair market value.

2) EOG filed a motion to reopen the case and Canyon dismissed the application stating that if the price for acquisition of acreage went up to a quarter and \$110 an acre, then it was no longer an economic project. The order was then vacated and application dismissed. Canyon also points out there was no objection to the fair market value that was recommended in that cause in 2009, which is the same amount that Canyon is recommending today.

3) Canyon argues it does not matter if Courson disagrees with the economics of Canyon's position. Canyon's economic decisions are Canyon's decisions to make, not Courson's decisions. At the hearing in 2009 and again in 2010 on the second application, the evidence disclosed there were no transactions for a quarter royalty in the nine-section area. Canyon points out even Courson's witness said he did not know of any one-quarter royalty transactions, other than this letter agreement between Courson and Canyon. Further, the amount was never paid from Canyon to Courson. Canyon never acquired that interest. Canyon argues it never was fair market value because it wasn't for the purchase of the lease by itself but also for operations. The transaction never consummated and there was nothing to support it other than the letter agreement.

4) Canyon argues that it is important that the transaction is an isolated transaction that occurred a year ago. Canyon believes that it's not fair market value because there are no transactions occurring on the ground to match it.

RESPONSE OF COURSON

- 1) Courson argues the issue of operations no longer existed when EOG entered into the case. Courson argues Canyon had owned or had the right to own enough acreage to assure that they would have operations.
- 2) Courson argues the reason Courson did not show up at the hearing was because there was already a deal in place. Courson argues that when the statute talks about forced pooling it is only applicable when there is no arrangement made with the other party. Courson states there was already an arrangement made and therefore both were precluded from litigating any forced pooling.
- 3) Courson points out the Commission should determine fair market value, then Canyon can make a decision. Courson argues that there need not be a lot of transactions to establish fair market value, one will suffice. The transaction only needs a willing buyer and a willing seller under no compulsion to sell or buy.
- 4) Courson further argues that substantial evidence is not an issue at this point in this proceeding. Substantial evidence becomes an issue on appeal to the Oklahoma Supreme Court. Courson states the Commission should be looking at the best evidence at this point. Courson argues the reason for dismissal the first time was because Canyon wanted to wait over a year so they could fit it into their definition of fair market value and not have to pay the original value to Courson.

CONCLUSIONS

The Referee finds the Report of the Administrative Law Judge should be affirmed.

- 1) The Referee finds the ALJ's recommendation to establish fair market value at \$250 per acre with a 3/16th royalty is supported by substantial evidence and free of reversible error. As stated by the court in *Miller v. Corporation Commission*, 635 P.2d 1006 (Okl. 1981):

The measure of compensation for forcibly pooled minerals is their "fair-market value"-the level at which this interest can be sold, on open-market negotiations, by an owner willing, but not obliged, to sell to a buyer willing, but not obliged, to buy. Evidence of

comparable terms and prices previously paid for leases in the same area is relevant to, but not always conclusive of, the fair-market value. Other factors may command or merit additional consideration. The difference in lease terms, the distance from other leaseholds subject to forced pooling and the nature of formations within different leaseholds-to name but a few variants-may be of great moment.

The value to be arrived at is that paid for comparable leases in the unit. It is best extracted from transactions under usual and ordinary circumstances which occurred in a free and open market. The price levels reached under free and open market conditions are deemed to be barren of the distortive elements which are generally present in panic, auction or speculative sales. The latter so often reflect either depressed or inflated prices. An open market transaction contemplates face-to-face negotiations between two or more parties, dealing at arm's length, for the purpose of arriving at an agreed level.

(Footnotes omitted)

2) The ALJ is the trier of fact. It is the ALJ's duty as the trier of fact to observe the demeanor of the witnesses, assess their credibility and assign the appropriate weight to their opinions. *Grison Oil Corp. v. Corporation Commission*, 99 P.2d 134 (Okla. 1940). It is clear the ALJ performed said function in this proceeding.

3) The evidence clearly reflected that no 1/4th royalty leases have been taken in the nine section area for over a one year period. There was apparently a letter agreement between Courson and Canyon in May of 2009. The terms were that Canyon would pay Courson \$12,000 and give them a 1/4th royalty, if Courson would not protest the Canyon pooling hearing in CD 200900391. Canyon wanted operations and was willing to pay Courson the \$12,000 and give a quarter royalty if they agreed not to protest the hearing. However the \$12,000 consideration was never paid to Courson as Courson never delivered the assignment to Canyon. The incentive for Canyon to buy a lease from Courson was to gain operations. Thus the \$110 and acre and a 1/4th royalty was not part of ordinary consideration for an arms-length transaction. Certainly, one can see that the Canyon/Courson transaction is an isolated transaction not given in the usual and ordinary circumstances of a free and open market. Where the ALJ as the trier of fact found the evidence to be compelling and supported a determination of \$250 an acre with a 3/16th

royalty as fair market value, the Referee can find no reason to reverse that determination.

4) Consequently, the Courson/Canyon letter agreement transaction of \$110 an acre and a 1/4th royalty cannot be said to be an arms-length transaction between "an owner willing, but not obliged, to sell to a buyer willing, but not obliged, to buy" that occurred under usual and ordinary circumstances in a free and open market. *Miller v. Corporation Commission*, supra, 635 P.2d at 1007. The evidence by Courson reflected that Courson would be overpaid by Canyon to assure that Canyon would get operations of the well. In addition the Courson/Canyon letter agreement was never consummated.

RESPECTFULLY SUBMITTED THIS 4th day of February, 2011.


Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Murphy
Commissioner Cloud
Commissioner Anthony
Jim Hamilton
ALJ Michael Porter
Karl F. Hirsch
Russell J. Walker
Ronald F. Barnes
James Roller
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