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BEFORE THE CORPORATION COMMISSION
OF THE STATE OF OKLAHOMA

FILED
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CORPORATION COMMISSION
OF OKLAHOMA

<u>APPLICANT:</u>	APACHE CORPORATION)	
)	
<u>RELIEF SOUGHT:</u>	POOLING)	CAUSE CD NO.
)	201302581-T
)	
<u>LEGAL DESCRIPTION:</u>	SECTION 6, TOWNSHIP 14)	
	NORTH, RANGE 24 EAST,)	
	ROGER MILLS COUNTY,)	
	OKLAHOMA)	

REPORT OF THE OIL AND GAS APPELLATE REFEREE

This Cause came on for hearing before **Kathleen M. McKeown**, Administrative Law Judge for the Corporation Commission of the State of Oklahoma, on the 18th day of July, 2013, at 8:30 a.m. in the Commission's Courtroom, Kerr Building, Tulsa, 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: **Richard A. Grimes**, attorney, appeared on behalf of applicant, Apache Corporation ("Apache"); **Ron Barnes**, attorney, appeared on behalf of the First Presbyterian Church of Canadian, Texas ("Church"); and **Jim Hamilton**, Deputy General Counsel for Deliberations, filed notice of appearance.

The Administrative Law Judge ("ALJ") filed her Report of the Administrative Law Judge on the 2nd day of August, 2013, to which Exceptions were timely filed and proper notice given of the setting of the Exceptions.

The Appellate argument concerning the Exceptions was referred to **Patricia D. MacGuigan**, Oil and Gas Appellate Referee ("Referee"), on the 16th day of September, 2013. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

CHURCH TAKES EXCEPTION to the ALJ's recommendation that the fair market value options to participation should be 1) a cash bonus of \$2000 per net mineral acre with a 3/16th royalty; or 2) no cash bonus with a 1/4th royalty. The negotiations between Apache and owners in Section 32 for mineral rights leases involved fallout from a highly complex business transaction and occurred at a time when Apache was under duress due to a difficult set of circumstances. Additionally, the Section 32 leases covered all zones while the subject pooling covers only the Marmaton formation.

Church believes that the same terms offered by Apache for leases in the northeast offset to Section 6 (Section 32) should be included in any pooling order issued in this cause. The lease terms in Section 32 were a cash bonus of \$2500 per net mineral acre with a 26% royalty and a 2.5% overriding royalty interest.

CHURCH TAKES THE POSITION:

- 1) The ALJ Report is contrary to the law and to the evidence.
- 2) The ALJ Report is unreasonable and fails to affect the ends of prevention of waste and correlative rights as is required by the applicable laws of the State of Oklahoma.
- 3) The ALJ erred in concluding that the fair market value based on the evidence presented should be a cash bonus of \$2000 per net mineral acre with a 3/16th royalty or no cash bonus with a 1/4th royalty. The evidence established that Apache had paid \$2600 an acre with a total royalty of 26% in the offset, the said transaction also included a 2.5% override and payment of \$2500 bonus per net mineral acre. The explanation provided by Apache attempting to differentiate the offset transaction from the unit involved in this case was inadequate for such purpose. The well drilled in the offset substantiates a value equal to the amount paid in such adjoining unit be included within the subject section as fair market value.
- 4) Wherefore, Church requests that the Report of the ALJ should be reversed as to fair market value and that fair market value be established for purposes of the subject order at \$2500 per net mineral acre plus a 1/4th royalty and a 2.5% overriding royalty.

THE ALJ FOUND:

- 1) After taking into consideration all of the facts, circumstances, evidence and testimony presented in the cause, it is the recommendation of the ALJ that

the subject application of Apache be granted. The fair market value options to participation to be included in any order issuing from the cause should be 1) \$2000 per net mineral acre with a 3/16th royalty and 2) no cash bonus with a 1/4th royalty.

2) Apache presented expert testimony as to current fair market value in the subject unit and the surrounding eight units. As noted in *Miller v. Corporation Commission*, 635 P.2d 1006 (Okla. 1981), the concept of fair market value used to arrive at compensation under force pooling orders is defined as: "...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." It should be noted that at the first Section 6 pooling hearing on Nov. 27, 2012 it was determined that fair market value options to participation were 1) a cash bonus of \$1750 per acre with a 1/8th royalty; 2) a cash bonus of \$1500 per acre with a 3/16th royalty; and 3) no cash bonus with a 1/4th royalty. Now 10 oil and gas leases covering a total of approximately 30 acres in the nine-unit area have been taken by Apache. Of these 10 leases, 4 contained leasing terms for no cash bonus with a 1/4th royalty; the other 6 leases were taken for a \$2000 cash bonus per net mineral acre with a 3/16th royalty. While Church urges that the cash bonus, royalty and overriding royalty received from Apache in the offsetting Section 32 be considered fair market value for the 9-section area, Apache adequately distinguished the cash bonus, royalty and overriding royalty it paid in Section 32 from the fair market value it is requesting be established under the subject pooling in Section 6. The oil and gas lease terms offered by Apache in Section 32 are not an example of transactions between willing buyers and willing sellers. The position Apache occupied in Section 32 was that of a buyer compelled to lease interests covering all zones at almost any cost in order to retain operations on the existing wells in the unit. The price paid in Section 32, was much higher at the time than that found in the surrounding 8 units (including Section 6) and cannot, therefore, be considered to be fair market value.

3) Church was not familiar with the Oklahoma concept of fair market value as defined by the Oklahoma Supreme Court. Rather, Church believed that the payments in Section 32 are not distinguishable from anything that had occurred in Section 6 or any other unit surrounding Section 6. While testimony was presented that the Section 6 well initial production figures could be extrapolated to show a successful and valuable completion, no daily production figures were available and, while the ALJ finds that such extrapolation is highly speculative at best, the fact remains that focusing on well production figures is not a basis for any type of fair market value determination. Again, *Miller* further explains the basis for finding fair market value when it states: "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." Thus, in light of the aforementioned conclusions, it is the recommendation of the ALJ that the application of Apache Corporation in CD 201302581-T be granted. Any order issuing out of the cause should contain the recommendations of the ALJ set forth above.

POSITIONS OF THE PARTIES

CHURCH

- 1) **Ron Barnes**, attorney, appearing on behalf of Church, stated that the ALJ's report is contrary to the law, the evidence presented in this case, and is unreasonable in that it fails to prevent waste and protect correlative rights as required by Oklahoma law.
- 2) Church takes the position that a pooling order issued for Section 6 should include the same terms offered to Church by Apache for leases in the northeast offset section (Section 32). Specifically, the terms offered in Section 32 were a cash bonus of \$2500 per net mineral acre with a 25% royalty and an additional 2.5% overriding royalty.
- 3) Church recognizes that the circumstances under which Apache offered the terms for Section 32 were extenuating, but it argues that the same extenuating circumstances exist for this unit too.
- 4) The extenuating circumstances that prompted Apache to pay a cash bonus of \$2500 per net mineral acre with a 25% royalty and an additional 2.5% overriding royalty in Section 32 were as follows: a) Apache believed that it owned most of the interest in Section 32, so it drilled a well and began producing it; b) Later, Apache found out that it did not own any interest in Section 32, or at least that the leases it purchased had not been perpetuated by production as it originally believed; and c) Apache's land witness testified that Apache executives made the decision to pay whatever it would take to acquire the necessary interest in Section 32 so that Apache could own and operate the well it had drilled in Section 32.
- 5) Church argues that the circumstances under which Apache attempts to acquire Church's interest in Section 6 are similar to the circumstances under which Apache acquired Church's interest in Section 32. Specifically that prior to pooling Church, Apache had already drilled a well and started producing, without Church's interest and that as in Section 32, Apache decided to drill and produce the well before settling with Church.

6) Church takes the position that Apache did not need to pay the above fair market value prices for all of those leases in Section 32, even considering the position that Apache found itself in. Church argues that Apache only needed to pay above fair market value prices for enough of the leases in Section 32 as would give it a right to drill and operate, and then it could have pooled the rest at fair market value prices. However, by paying above fair market value for all of the leases in Section 32, Apache established the fair market value for, under similar circumstances, the adjoining unit (i.e. Section 6).

APACHE

1) **Richard Grimes**, attorney, appeared on behalf of Apache, explained the circumstances under which Apache agreed to pay Church above fair market value for Church's interest in Section 32 (i.e. a cash bonus of \$2500 per net mineral acre with a 25% royalty and an additional 2.5% overriding royalty). Prior to leasing Section 32, Apache acquired all the assets, including the leases in Section 32, of Cordillera Energy Partners III, LLC ("Cordillera") for approximately \$3.65 billion. The centerpiece of this acquisition was the Bombay well, located in Section 32. When Cordillera entered into the agreement with Apache, it represented to Apache that it owned 96% of the working interest in the Section 32 unit. After the acquisition closed, Apache discovered that the title opinions that Cordillera relied on to justify its conclusion that it owned 96% of the working interest were flawed. In fact, Cordillera (now taken over by Apache) only owned 1.5% working interest in the unit. As soon as Apache learned of the discrepancy, it shut in the Bombay #2-32 well. As soon as the public observed that Apache had shut-in its best well, there was a market reaction and Apache feared that its stock prices would be affected. Apache also feared that its competitors would learn that a significant portion of the interest believed to have been owned formerly by Cordillera (now Apache) was now open. Apache quickly approached the owners in Section 32 to whom it had been represented that their leases had been perpetuated by the Bombay and explained that their leases had not been perpetuated by the Bombay. Apache's executives gave the land men authority to "pay whatever it takes" to acquire the interests for Apache. The result was that Apache paid \$2500 per net mineral acre with a 25% royalty and an additional 2.5% overriding royalty for its interest in Section 32, including the interest owned by Church in Section 32.

2) Apache notes that the basis for finding fair market value is defined as: "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." *Miller v. Corporation Commission*, 635 P.2d 1006 (Okla. 1981).

3) Apache argues that distortive elements were present in Apache's decision to pay above fair market value prices for the leases in Section 32, namely the element of panic. Apache was faced with the potential of losing the centerpiece of its \$3.65 billion acquisition and Apache executives were willing to pay whatever was necessary to acquire the working interest in Section 32.

4) Apache points out that Church was not named in the pooling filed by Apache for Section 6 even though Church owned an interest. The reason Church was not named was because QEP Energy Company ("QEP") owned a lease on Church and QEP had assured Apache that QEP intended to renew its lease with Church.

5) After pooling the other interests in Section 6 (the values testified to were 1750 and the normal 1/8th), Apache learned that QEP had not renewed its lease of Church. This left Church's interest as the only unpooled interest.

6) Apache argues that this is the first thing that distinguishes Section 6 from Section 32. Unlike in Section 32, where Apache discovered that it only owned and controlled 1.5% of the working interest, in Section 6, Apache controlled and owned leases or the pooled interest in all of Section 6, minus only Church's interest. Unlike its position in Section 32 where it faced losing the centerpiece of a \$3.65 billion acquisition, Apache's position in Section 6 is simply that it needs to lease or pool Church's interest.

7) Unlike its position in Section 32, Apache's position in Section 6 is not such that, without Church's interest, it would lose operations of the unit or its competitors could potentially control 98.5% of the unit.

8) Apache attempted to negotiate with Church, but Church demanded the same terms offered in Section 32. Apache refused, explaining to Church that the current circumstances surrounding leasing Church's interest in Section 6 are starkly different than the circumstances surrounding leasing Church's interest in Section 32.

9) Apache then offered \$1,500 and 3/16ths and no cash and a 1/4th, but Church refused, again demanding the values paid in Section 32.

10) Since then, there have been ten new leases in this area. Six leases went for \$2,000 and 3/16ths. Four leases in the nine unit area went for no cash and a 1/4th.

11) The value paid for these leases includes the rights to all formations. But here, Apache is only pooling the Marmaton and is still willing to offer Church \$2,000 an acre and 3/16ths or no cash and a 1/4th for just the Marmaton rights.

12) Over the past year, Apache has acquired 63 leases in the relevant area totaling 1,957 net acres. The highest quarter transaction was no cash and a 1/4th.

13) Apache argues that, when assessing fair market value, the Commission should look at comparable lease transactions which are at arm's length—comparable in space, time and prospect. The circumstances that led Apache to pay above fair market value for the leases in Section 32 are not comparable to the circumstances that surround leasing in Section 6.

14) Apache reminds the Court that Church's petroleum land man witness, Bob Culver, testified that the values paid for leases in Section 32 should be the fair market value. However, the witness admitted that he was not familiar with pooling in Oklahoma, was not familiar with fair market value evaluation standards in Oklahoma, and was not an expert.

15) Mr. Culver attempted to use an analysis of what he thought the quality of the Bombay well would be to determine fair market value. In Oklahoma we don't use engineering analysis of reserves or quality of wells to determine fair market value. Apache argues that fair market value in Oklahoma is predicated upon actual transactions, not speculations and opinions of engineers or real estate appraisers.

REBUTTAL OF CHURCH

1) Church argues that the court, not an expert witness, is the ultimate decider of what fair market value is based on the testimony and evidence.

2) Church argues that when Apache executives decided to pay above fair market value for all of the leases in Section 32, not just enough of the leases to gain control of the unit, Apache established the fair market value. If Apache had only paid the above fair market value prices for enough of the Section 32 leases to gain control, then Apache would not have established the higher values as fair market value.

3) FBC argues that just because Apache has paid less than \$2500 per net mineral acre with a 25% royalty and an additional 2.5% overriding royalty (the value paid for leases in Section 32) since they bought leases in Section 32, doesn't negate or reduce the amount of the transaction that occurred before.

Just because the landowners who leased to Apache at lower values after Apache acquired the Section 32 leases at higher value doesn't make the lower offer right.

CONCLUSIONS

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

1) The Referee finds the ALJ's Report should be affirmed and the fair market value options be established as the ALJ recommends at: (1) a cash bonus of \$2000 per net mineral acre with a 3/16th royalty; or (2) no cash bonus with a 1/4th royalty under the Apache pooling application for the Marmaton formation underlying Section 6, T14N, R24W, Roger Mills County, Oklahoma. The Referee finds that the Report of the ALJ is supported by the weight of the evidence, in accordance with law and free of reversible error.

2) The Commission has determined fair market value of the rights in lieu of participation under 52 O.S. Section 87.1 based on the Law of Eminent Domain. "[F]air market value...means the money which purchaser willing but not obligated to buy property would pay to the owner willing but not obligated to sell it." *Grand River Dam Authority v. Bomford*, 111 P.2d 182, 183 (Okl. 1941).

3) The Supreme Court in *Miller v. Corporation Commission*, 635 P.2d 1006 (Okl. 1981) stated:

...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)

4) The testimony reflects that Apache's requested alternative to participation fair market values are based on ten leases covering all formations underlying approximately 30 acres that had been taken in the past year from the date of the hearing in the present case of July 18, 2013 in the nine unit area centered on Section 6. Six of the ten leases were taken at a cash bonus value of \$2,000 per net mineral acre with a 3/16th royalty with the remaining four leases taken for no cash bonus and a 1/4th royalty. The most recent lease in the nine section area was taken in February 2013 for no cash bonus and a 1/4th royalty.

5) Church believes that the same terms offered by Apache for leases in the northeast offset to Section 6 (Section 32) should be included in any pooling order issued in the present case. Apache argues that distortive elements were present in Apache's decision to pay above fair market value prices for the leases in Section 32, i.e. a cash bonus of \$2,500 per net mineral acre with a 25% royalty and an additional 2.5% overriding royalty. Prior to leasing Section 32, Apache acquired all the assets, including the leases in Section 32 of Cordillera for approximately \$3.65 billion. The center piece of this acquisition was the Bombay well located in Section 32. When Cordillera entered into the agreement with Apache it represented that it owned 96% of the working interest in Section 32. After the acquisition was obtained, Apache discovered that the title opinions that Cordillera relied on to justify its conclusion that it owned 96% of the working interest were flawed and in fact Cordillera only owned 1.5% working interest in the unit. As soon as Apache learned of this discrepancy it shut in the Bombay well. Apache was afraid of the market reaction to its shutting in its best well and feared that its stock prices would be affected. Apache also feared that its competitors would learn of the significant portion of the interest believed to have owned formerly by Cordillera would now be subject for purchase. Apache therefore quickly approached the owners in Section 32 and explained that their leases had not been perpetuated by the Bombay well and Apache's executives gave the landman authority to "pay

whatever it takes" to acquire the interest for Apache. Apache was faced with the potential of losing the center piece of its \$3.65 billion acquisition and Apache executives were willing to pay whatever was necessary to acquire the working interests in Section 32. The initial pooling of the Section 6 unit by Apache occurred in December 2012. Church was not named in the pooling filed by Apache even though Church owned an interest because QEP owned a lease on Church and QEP had assured Apache that QEP intended to renew its lease with Church. After pooling the other interests in Section 6 (the values testified to were \$1750 and the normal 1/8th), Apache learned that QEP had not renewed its lease with Church and this left Church's interest as the only unpooled interest. Over the past year Apache has acquired 63 leases in the relevant area totaling 1,957 net acres. The highest quarter transaction was no cash and a 1/4th.

6) The ALJ in her Report on page 4 states:

While the Church urges that the cash bonus, royalty and overriding royalty received from Apache in the offsetting Section 32 be considered fair market value for the 9-section area, Apache adequately distinguished the cash bonus, royalty and overriding royalty it paid in Section 32 from the fair market value it is requesting be established under the subject pooling in Section 6. The oil and gas lease terms offered by Apache in Section 32 are not an example of transactions between willing buyers and willing sellers. The position Apache occupied in Section 32 was that of a buyer compelled to lease interests covering all zones at almost any cost in order to retain operations on the existing wells in the unit; the price paid in Section 32, was much higher at the time than that found in the surrounding 8 units (including Section 6) and cannot, therefore, be considered to be fair market value.

7) As noted by Charles Nesbitt in his article, "*A Primer On Forced Pooling of Oil and Gas Interests in Oklahoma*", 50 O.B.J. 648 (1978):

...the amount and elements in the bonus are intended to equal the current fair market value of an oil and gas lease; that is, the bonus which would be paid for a lease between willing contracting parties, neither under compulsion.

In practice, this generally becomes an inquiry into the "highest price actually paid" for an oil and gas lease in the vicinity. Scant consideration is paid to transactions outside a nine section area of which the subject section is the center, or to a lease bonus paid during a past period of hot activity which since has cooled.

8) Church also offered testimony attempting to use an analysis of what they thought the potential quality of various Marmaton wells and the Section 6 well would be to determine fair market value. As stated in *Holmes-Stake Royalty Corporation v. Corporation Commission*, 594 P.2d 1207 (Okl. 1979):

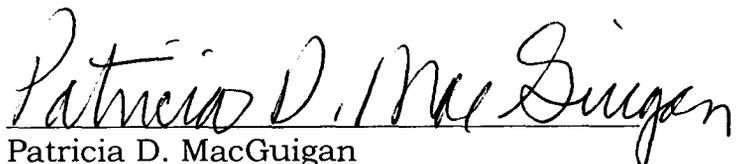
...Any conclusion reached relative to future production from the contemplated well derived from these tests remains problematical, conjectural, and depends in great part upon the expertise of the persons making the evaluation...

* * *

The future value of the well and the unit it is placed upon is thus pure speculation. The issue to be determined in this pooling proceeding is the present market value which, as is noted herein, is amply supported by testimony of market value determined by recent transactions and not future value reflected by the prospects of the contemplated well.

9) Certainly, one can see that the Section 32 transaction is an isolated transaction not given in the usual and ordinary circumstances of a free and open market. *Miller v. Corporation Commission*, supra. Therefore, the Referee finds the ALJ's recommendation to establish fair market value as she suggests in her Report, should be affirmed.

RESPECTFULLY SUBMITTED THIS 13th day of November, 2013.


Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Douglas
Commissioner Anthony
Commissioner Murphy
Jim Hamilton
ALJ Kathleen M. McKeown
Richard A. Grimes
Ron Barnes
Office of General Counsel
Michael L. Decker, OAP Director
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