

STATEMENT OF THE CASE

DYNAMIC TAKES EXCEPTION to the ALJ's recommendation that the application of Devon be granted with fair market values established as \$900 per acre with a 1/8th royalty, \$850 per acre with a 3/16th royalty, or \$825 per acre with a 1/5th royalty.

Devon filed an application to pool Order No. 602064 640-acre spacing unit in Section 17, T27N, R5W, Grant County, Oklahoma for the production of hydrocarbons from the Tonkawa, Cottage Grove, Cleveland, Oswego and Cherokee and a 640 acre horizontal drilling and spacing unit for the production of hydrocarbons from the Mississippian, Woodford and Hunton common sources of supply. Devon was unable to reach an agreement with Dynamic. The primary dispute concerns an overburdened interest. Dynamic believes fair market value should include the party's current ownership interests. Devon disagrees and maintains fair market value does not include what a party's interests might be in a unit.

DYNAMIC TAKES THE POSITION:

1) The ALJ erred and fails to give fair market value for the interest to Dynamic. The ALJ erroneously treated the leasing transaction by Dynamic as being two separate transactions: (a) a lease from the mineral owner for \$750 with a 1/5th royalty; and (b) a conveyance of a 1% override to Dynamic's broker. However, it was the undisputed testimony of Mr. Gerald Graham that Dynamic had an agreement with their lease broker to acquire interest in this unit and in the adjacent area for a 79% net revenue and payment of bonus due the mineral owner. Even though this transaction was documented with two separate pieces of paper, an oil and gas lease was taken in June of 2011 and assignment of the contractually due 1% override in October of 2011, such documents merely memorialized the arms-length trade of \$750 and a 21% royalty given by Dynamic for 160 acres in this unit.

2) Devon testified that fair market value was \$900 per acre for 1/8th royalty, \$850 per acre for 3/16th royalty, and \$825 per acre for a 1/5th royalty, but no value for a lease that was burdened with more than a 1/5th royalty. It was the testimony that Dynamic owned approximately 136 acres out of the 160 acre lease (Three Energy has the other 24 acres) and Dynamic can deliver approximately 79.9% net revenue interest. Under the ALJ's ruling, to the extent Dynamic does not participate it will get nothing for its 136 acres because it is 1/10th of a percent of a revenue point shy of being able to deliver 80% net revenue which would result in Dynamic receiving \$825 per acre.

3) Requiring Dynamic to relinquish its interest for no consideration is unjust, unreasonable, and likely unconstitutional since there is no showing by Devon that a lease hold interest at 79.9% has negative or no value. Oklahoma pooling statute 52 O.S. Section 87.1(e) requires:

All orders requiring such pooling shall be made after notice and hearing, and shall be upon such terms and conditions as are just and reasonable and will afford to the owner of such tract in the unit the opportunity to recover or receive without unnecessary expense his just and fair share of the oil and gas.

4) An Order giving Dynamic no compensation for its 79.9% net revenue interest is not just or reasonable and does not afford Dynamic an opportunity to receive the fair market value for its interest.

5) Dynamic recommended that the pooling order also contain an option for \$750 an acre and a 21% royalty or no cash and 1/4th royalty. Certainly if an acre is worth \$850 for 3/16th royalty or \$825 for a 1/5th royalty, it is worth \$750 an acre for a 79% net revenue, i.e., a 21% royalty.

6) It was the undisputed testimony that Devon had purchased Vitruvian's acreage in this area for \$350 million at a 78% net revenue. Obviously a 79% net revenue interest has value to Devon as they will pay substantial dollars for 78% net revenue. Mr. Graham further testified that although there were no 1/4th transactions to his knowledge in the nine section areas centered on the subject Section 17, he was aware of numerous 1/4th transactions in the area. The fact that a no-cash and 1/4th royalty is common in this Mississippi play and that Sandridge had recently completed two good wells in the offset Section 19 warrants a no-cash and 1/4th royalty. Otherwise, Dynamic's affiliate, Three Energy, which can only deliver a 76% net revenue on its 24 acres, will receive no consideration for its interest.

7) Wherefore, Dynamic requests that the Report of the ALJ be reversed and modified to add additional fair market value considerations of \$750 per acre and a 21% royalty or no-cash and a 1/4th royalty.

THE ALJ FOUND:

1) The undisputed evidence shown in Section 17 and the eight surrounding sections were actual lease transactions for \$300 an acre bonus and a 3/16th royalty. The evidence was one recent lease was for a \$500 an acre bonus with a 3/16th royalty. In the past year, there have also been poolings in adjacent sections, one by Devon and three by Sandridge for the values testified to by the witness for Devon. Those values are \$900 per acre for a 1/8th royalty, \$850 per acre for a 3/16th royalty, or \$825 per acre for a 1/5th royalty.

2) There was a transaction for a 1/5th royalty between Dynamic and an individual, in June 2011, **two years prior to this hearing**. The transaction was for \$750 an acre and a 1/5th royalty. After a June 2011 transaction, there was another transaction executed in October 2011 between Dynamic and Mr. Creighton where an 1% override was given. The net result of Dynamic's activities was to reduce their net revenue interest to less than 80%. The witness for Devon based his fair market values upon recent leasing transactions and the recent poolings in the surrounding eight sections. These pooling values were higher than actual transactions, but Devon is willing to pay those values. There was no recommendation by Devon for a bonus for net revenue interests of less than 80% given. There are no transactions for a 79% revenue interest in the past year, nor in poolings in the surrounding sections. Dynamic did not present sufficient evidence of transactions occurring in Section 17 or surrounding sections **in the past year** to support a bonus payment for net revenue interests of less than 80%. The values are based upon transactions and recent poolings, not upon ownership positions.

3) After taking into consideration all the facts, circumstances, testimony, and evidence presented in this cause, the ALJ recommends the application in CD 201302979 be granted with fair market value established as \$900 per acre with a 1/8th royalty, \$850 per acre with a 3/16th royalty, or \$825 per acre with a 1/5th royalty. Other terms and conditions relating to elections, well costs, subsequent well operations, and saltwater disposal are recommended as testified to during the hearing.

POSITIONS OF THE PARTIES

DYNAMIC

1) **Gregory L. Mahaffey**, attorney, appeared on behalf of Dynamic and stated that this is about fair market value. The wells in the nine section area around the unit in question are all productive. This is not a wildcat area, but a proven play. The other producing wells in the area indicate that this well will be a productive well.

2) Fair market value is what a willing buyer will pay to a willing seller, neither being under compulsion to buy or sell. However, when there are no transactions, other evidence may be used.

3) Dynamic can deliver 79.9% net revenue interest in the pooling unit for its 136 acres owned. That is only 0.1% shy of the 80% outlined by the ALJ order for acreage bonus to be paid. That is not just or reasonable. Dynamic has interest in a total of 160 acres due a separate lease agreement for 24

additional acres. That lease provides Dynamic with a 3% overriding royalty. This is how it is able to bring its total interest up to 79.9%.

4) Dynamic acquired this acreage in 2011 at a cost of \$750 per acre and 1/5th royalty. As part of this transaction a 1% overriding royalty was paid to the land broker assisting Dynamic in obtaining lots of leases in the area, reducing Dynamic to 79%. This is one transaction, not multiple transactions as the ALJ concluded.

5) The ALJ erred when it agreed with Devon's testimony that fair market value for leases in this area are \$850 an acre for 3/16th royalty or \$825 an acre for 1/5th. There is evidence in this play that shows no bonus and 1/4th. Under the ALJ's ruling, if Dynamic does not participate in the well, they will get no compensation for their interest.

6) Devon has purchased large blocks in the area where they received 78% interest, so obviously 79% interest has some value.

7) Fair market value for a 79.9% interest in the unit should be \$750 per acre and a 21% royalty or at a minimum a 20.1% royalty. This is the transaction that Dynamic has on record in this unit.

8) Under the ALJ's recommendations, Dynamic receives no compensation for its leased acreage unless it chooses to participate in the well. That is not just or reasonable.

DEVON

1) **David E. Pepper**, attorney, appearing on behalf of Devon, stated that it is not the obligation of the Commission to ensure that each respondent in a pooled unit gets some compensation.

2) The transactions that Dynamic would have us refer to are their own transactions in acquiring leases in the area. These transactions are two years old, and do not reflect current fair market value. There are no current transactions in the nine unit area showing values that Dynamic is demanding.

3) The large blocks of land that Devon acquired were part of a company acquisition and are not to be included in assessing fair market value. Large acquisitions of thousands of acres are not indicative of fair market values on small leaseholds.

4) Dynamic created the burden on its leases by assigning the 1% overriding royalty. Dynamic acquired the acreage in July 2011 for \$750 per acre and 1/5th royalty. Then in October 2011 it assigned a 1% overriding royalty to the land broker that assisted in the acquisitions. Dynamic created the burden on the lease. There are no transactions in the past two years to support Dynamic's requested payment. There is no evidence of a transaction with no bonus and 1/4th royalty as suggested by Mr. Mahaffey.

5) Initial production of wells in the area is not the correct way to determine fair market value of this pooling section. Testimony in the record indicates that initial production levels are not indicative of total recovery for a well.

6) Dynamic created its own burden. The ALJ did not err. The recommendations of the ALJ should be affirmed.

RESPONSE OF DYNAMIC

1) The Dynamic lease purchase in July 2011 was one of many lease purchases by Dynamic in the area during the course of that year. There was an agreement between the land broker and Dynamic in March 2011 which granted the land broker a 1% overriding royalty on all leases that he assisted Dynamic in acquiring. The July 2011 lease for this acreage was a single transaction and not two separate transactions.

2) Dynamic acquired this acreage for \$750 and 21% royalty. The 20% to the mineral owner and 1% to the land broker, leaving Dynamic with a 79% interest in the minerals. The paperwork was filed as two leases, but it was all one transaction.

3) With other interests that Dynamic has in this unit, it can produce 79.9% interest in the minerals and should be allowed just and reasonable compensation.

4) The producing wells in the area have done nothing to diminish the fair market value of leases in this nine section area, and the transactions that occurred two years ago should still represent a fair market value for a working interest of 79.9%. There is no testimony on the record that the agreement between Dynamic and its land broker was not an arms length transaction. As such, it should be included in the valuation of the leases in the area and a fair market value should be set at \$750 per acre and 20.1% royalty.

CONCLUSIONS

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

1) The Referee finds that the ALJ should be affirmed in establishing fair market value at \$900 per acre with a 1/8th royalty, \$850 per acre with a 3/16th royalty, or \$825 per acre with a 1/5th royalty. The ALJ should be affirmed in rejecting a transaction for \$750 an acre and a 1/5th royalty between Dynamic and an individual in June 2011 which was two years prior to the merit hearing held on July 31, 2013. Dynamic acquired the acreage in July 2011 for \$750 per acre and a 1/5th royalty and then in October 2011 assigned a 1% overriding royalty to the land broker that assisted in the acquisitions. Dynamic therefore created the burden on the lease. There are no transactions within the past two years which support Dynamic's requested fair market value.

2) As stated by the Court in *Miller v. Corporation Commission*, 635 P.2d 1006 (Okla. 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)

3) The evidence reflected that there was a recent lease for a \$500 an acre bonus with a 3/16th royalty and in the past year there have also been poolings in adjacent sections, one by Devon and three by Sandridge for the values testified to by the witness for Devon.

4) The ALJ in his report on page 7 states:

There was a transaction for a 1/5th royalty between Dynamic and an individual, in June 2011, **two years prior to this hearing**. The transaction was for \$750 an acre and a 1/5th royalty. After a June 2011 transaction, there was another transaction executed in October 2011 between Dynamic and Mr. Creighton where an one percent override was given. The net result of Dynamic's activities was to reduce their net revenue interest to less than 80 percent. The witness for Devon based his fair market values upon recent leasing transactions and the recent poolings in the surrounding eight sections. These pooling values were higher than actual transactions, but Devon is willing to pay those values. There was no recommendation by Devon for a bonus for net revenue interests of less than 80 percent given. There are no transactions for a 79 percent revenue interest in the past year, nor in poolings in the surrounding sections. Dynamic did not present sufficient evidence of transactions occurring in Section 17 or surrounding sections **in the past year** to support a bonus payment for net revenue interests of less than 80 percent. The values are based upon transactions and recent poolings, not upon ownership positions.

5) 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.

6) There was no evidence presented of any transaction with a no bonus and a 1/4th royalty fair market value as requested by Dynamic. Dynamic's witness testified that although there were no 1/4th royalty transactions to his knowledge in the nine section area centered on the subject Section 17 he was aware of numerous 1/4th royalty transactions in the area. His testimony also reflected that there was a no cash and a 1/4th royalty given commonly in this Mississippian play and that Sandridge Exploration Company had recently completed two good wells in the offset Section 19 which warranted a no cash and a 1/4th royalty. To focus upon the expected value of the production to be had from proposed wells is an error. As stated in *Home-Stake Royalty Corp. v. Corporation Commission*, 594 P.2d 1207 (Okl. 1979):

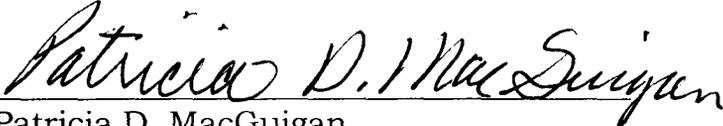
...Any conclusion reached relative to future production from the contemplated well derived from these tests remains problematical, conjectural, and depends in great part upon the expertise of the persons making the evaluation . ***¶ The future value of the well and the unit it is placed upon is thus 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...

7) Therefore, the evidence would warrant that the fair market values as established by the ALJ are reasonable and in accordance with the evidence presented, and the Findings and Conclusions of the ALJ are sustained by the law and substantial evidence. See *Central Oklahoma Freight Lines Inc. v.*

Corporation Commission, 484 P.2d 877 (Okl. 1971); *G.M.C. Oil and Gas Company v. Texas Oil and Gas Corporation*, 586 P.2d 731 (Okl. 1978).

8) Therefore, thus, under the law as established within the State of Oklahoma, the Referee would affirm the establishment of fair market value as recommended by the ALJ as it is based upon the weight of the evidence presented.

RESPECTFULLY SUBMITTED THIS 11th day of February, 2014.


Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Douglas
Commissioner Anthony
Commissioner Murphy
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ALJ Michael J. Porter
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