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**BEFORE THE CORPORATION COMMISSION
OF THE STATE OF OKLAHOMA**

COURT CLERK'S OFFICE - OKC
CORPORATION COMMISSION
OF OKLAHOMA

<u>APPLICANT:</u>	FULCRUM EXPLORATION, L.L.C.)	
)	
<u>RELIEF SOUGHT:</u>	POOLING)	CAUSE CD NO.
)	201304288
)	
<u>LEGAL DESCRIPTION:</u>	NW/4 SECTION 14, TOWNSHIP 1 NORTH, RANGE 20 WEST, JACKSON COUNTY, OKLAHOMA)	
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REPORT OF THE OIL AND GAS APPELLATE REFEREE

This Cause came on for hearing before **Michael Norris**, Administrative Law Judge for the Corporation Commission of the State of Oklahoma, on the 11th day of September, 2013, 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: **John E. Lee, III**, attorney, appeared on behalf of applicant, Fulcrum Exploration, L.L.C. ("Fulcrum"); **Gregory L. Mahaffey** and **Clayton Henry**, attorneys, appeared on behalf of the Henry Family ("Henry"); and **Jim Hamilton**, Deputy General Counsel for Deliberations, filed notice of appearance.

The Administrative Law Judge ("ALJ") filed his Report of the Administrative Law Judge on the 21st day of November, 2013, to which Exceptions were timely filed and proper notice given of the setting of the Exceptions.

The Appellate argument concerning the Oral Exceptions was referred to **Patricia D. MacGuigan**, Oil and Gas Appellate Referee ("Referee"), on the 17th day of January, 2014. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

HENRY TAKES EXCEPTION to the Report of the ALJ wherein the ALJ recommended that the application of Fulcrum be approved and that the values established by Fulcrum of \$125 an acre and a 1/8th royalty and \$100 an acre and a 3/16th total royalty be accepted as the fair market values.

Fulcrum filed a pooling application for the NW/4 of Section 14, T1N, R20W, Jackson County, Oklahoma to pool the interests and adjudicate the rights and equities of oil and gas owners in the White Horse Group, El Reno, Enid, Pontotoc and Cisco common sources of supply. Henry appeared as protestant. The primary issue in this cause is fair market value.

Fulcrum established values based upon a survey of the surrounding area. Fulcrum is the only party that is leasing in the area and is the only party who has leased in the nine section area since 2005. Fulcrum has acquired five or six leases since the date of their proposal letter. The most recent lease was acquired August 9, 2013. All the leases were acquired at the values established by Fulcrum for this area. These values were based on their prior leases within the last 12 months. Henry disputed the values and attempted to demonstrate alternative values in other parts of Jackson County and farther south into Texas.

HENRY TAKES THE POSITION:

1) Henry asserts that the ALJ's Recommendations and Conclusions deprives them of their 5th Amendment right provided under the U.S. Constitution for just compensation. The U.S. Supreme Court interprets "just compensation" as fair market value. The Oklahoma Supreme Court in *Miller v. Corporation Commission*, 635 P.2d 1006 (Okla. 1981) has defined fair market value for forcibly pooled minerals 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." (See *Miller* p.1008) *Miller* further distinguishes fair market value as 1) "...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." (See *Miller* p. 1008), and 2) "A compulsory sale of an owner's interest in realty, when taken by eminent domain, is the most common example of a sale not made in the open market. It is said to be affected by special circumstances which do not exist in open market transactions." (See *Miller* p. 1008)

2) The ALJ's recommendation of fair market value is based on an arbitrary "contiguous 9 section area." Use of this arbitrary cut-off area conveniently excludes Henry's evidence of "fair market value" for the minerals, which should have been given greater weight over Fulcrum's evidence of "fair market value", as Henry's evidence better represents and fits the definition of "fair market value" as provided in *Miller*. The royalties and bonus payments negotiated and paid for in Wilbarger County, Texas that Henry presented were negotiated on an open market where neither an owner or buyer were obligated to sell or buy and the threat of eminent domain or pooling is not present. Consideration of "fair market value" should have also been given that Henry did not accept Fulcrum's offer to lease Section 15.

3) Fulcrum's evidence of fair market value is based on lack of good faith negotiation and a company-imposed cut-off of what Fulcrum will pay or otherwise face the threat of forced pooling. Further the ALJ wrongfully assumes that nine sections does not reach into Texas. No evidence was presented that a "9 section area" in this part of Oklahoma does not reach into or touch Texas, which was testified to as 11 miles away from the section being forced pooled.

4) Additionally, the ALJ removes consideration of the leasing activity in western Jackson County based upon Fulcrum's testimony that this leasing activity is a different play because it is at a greater depth, the geology is different, and it differs structurally. Henry asserts if depth and geology is indicative or a consideration of "fair market value", Henry's pooled minerals should be confined to the zone the Fulcrum offer is based on and seeks to drill in its application to pool.

5) Henry notes that Fulcrum started out in 2011 offering 3/16th and \$50 and to clean-up the smaller interests increased its offer to the price it is paying \$100 and 3/16th. But Fulcrum has previously forced pooled other mineral interest holders at the Commission in other sections. Fulcrum dismissed the Schmedts, a mineral holder in a forced pooling application by Fulcrum, to continue to negotiate with the Schmedts to lease their minerals. Fulcrum did not disclose the consideration discussed or considered by Fulcrum to lease the Schmedts' mineral interest. Fulcrum is still in negotiations with this other mineral owner that was dismissed from a forced pooling proceeding, making it premature for Fulcrum to assert or state regarding fair market value that 3/16th and \$100 is the highest amount it has paid or will pay for an oil and gas lease.

6) Fulcrum was not aware of or knowledgeable about what other minerals were leasing for in Jackson County, Oklahoma west of where he was leasing or in Wilbarger County, Texas.

7) Fulcrum contacted Mr. Robert H. Henry to lease minerals Henry owned in Section 15 and could not lease these minerals from Henry based upon Fulcrum's offers of 3/16th and \$50 or \$100 and 3/16th.

8) Fulcrum never negotiated with Henry concerning the minerals owned by Henry in Section 14. For Section 14, Fulcrum made only a final offer, and negotiated only with Henry under the threat of forced pooling.

9) Fulcrum, after receiving the Henry protest to Fulcrum's application to pool, told Robert H. Henry that Fulcrum was being generous and could have just given him a 1/8th and \$25 an acre lease. Fulcrum proceeded with its forced pooling and chose to ignore the Henry offer to lease minerals in Section 14, which was based on what he and others had recently leased minerals in Wilbarger County, Texas at a 20% royalty and \$175 an acre bonus.

10) In the transcript there is a disclosure that Fulcrum has the working interest in the production of the SW/4 of Section 14, joining this tract being forced pooled. Fulcrum's application does not identify what that working interest percentage is. Fulcrum is not being forthright by saying this is the highest percentage they will operate and the lease terms being offered are not being exceeded.

11) Henry conceded to accept a 25% royalty and no bonus payment in lieu of 20% royalty and \$175 an acre bonus to settle this matter with Fulcrum. No offers to settle or resolve this matter with Henry were made by Fulcrum.

THE ALJ FOUND:

1) After taking into consideration all the facts, circumstances, evidence and testimony presented in this cause, it is my recommendation that the application of Fulcrum in this cause be granted

2) That the values described by Fulcrum of \$125 an acre with a normal 1/8th royalty and \$100 an acre with a 3/16th royalty be established as the fair market value in this application. These values were demonstrated by consummated leases within one year and within the contiguous nine section area. There were no higher values within this area.

3) The protestant competently represented the Henry interests and offered alternative values they considered relevant and acceptable. These values were not established within the area. They were either values desired by Henry or paid in Texas 11 miles to the south and approximately 30 miles from the Henry land.

POSITIONS OF THE PARTIES

HENRY

1) **Gregory L. Mahaffey**, attorney, appearing on behalf of Henry, stated this is about fair market value. Fair market value is a negotiation between a willing seller and a willing buyer, both operating without obligation. Leases taken without competition and under threat of forced pooling are not representative of fair market value.

2) There is only one company taking leases in this nine unit area, Fulcrum. Pooling based on pricing offered from only one buyer is not competitive pricing representative of fair market value, rather it is a quasi-condemnation of property rights without just compensation.

3) The ALJ gave insufficient weight to the testimony of Mr. Clayton Henry, family representative for the Henry family mineral interest. Mr. Henry stated that just over the Red River, some 11 miles away, over 100,000 acres had been leased for values of \$175 an acre and a 1/5th royalty. Henry believes that this amount reflects fair market value for our area in here. There, the threat of forced pooling does not exist to the same extent it does in Oklahoma which allows for a more competitive environment and therefore represents a more accurate reflection of fair market value.

4) Henry asks that the ALJ order be amended to show prices of \$175 per acre and 1/5th royalty or no bonus and 1/4th royalty.

FULCRUM

1) **John E. Lee, III**, attorney, appearing on behalf of Fulcrum, stated this is about fair market value. Fair market value is a negotiation between a willing seller and a willing buyer, both operating without obligation.

2) The values suggested by Henry are not established within the nine unit area surrounding Section 14. Rather those values reflect Henry's desire or leases taken in Texas on land nearly 30 miles south of this pooling location.

3) Fulcrum, has over 80% under lease in this 160 acre quarter section and has taken leases from willing sellers on 130 acres in this 160 acre pooling unit, and over 100 leases in the nine unit area over the past four years. Those leases reflect prices from \$50 per acre and a 1/8th royalty, rising to \$125 an

acre and 1/8th royalty or \$100 an acre and 3/16th royalty. Those are the highest values in this nine unit area and represent fair market value.

4) All of the mineral owners in this area are sophisticated owners. They are willing sellers and Fulcrum is a willing buyer. The lease price increases over the past four years represent the sophistication of the sellers and the negotiations between willing buyers and sellers.

5) The Miller v. Corporation Commission, 635 P.2d 1006 (Okl. 1981) cited by Henry, says that only when "extraordinary circumstances" exist should the Commission deviate from established norms to determine fair market value. We have no extraordinary circumstances here.

6) Distance makes a difference. The nine unit area reflects fair market value for this pooling location. Lease prices offered 30 miles to the south in Texas are not indicative of fair market values here.

RESPONSE OF HENRY

1) This case is about a difference of opinion. The opinions being what constitutes fair market value.

2) Henry believes that values offered without the threat of condemnation by the police powers of the state, i.e. pooling, are reflective of fair market values. To find those values you need only to look 11 miles south just over the Red River to Texas where leases are sold for \$175 per acre and 1/5th royalty. There you have a willing seller and a willing buyer neither obligated to participate.

3) There was no negotiation between Henry and Fulcrum for this unit, Section 14. Henry only received the pre-pooling offer letter indicating values which Henry believes are not representative of fair market values. This lack of willingness to negotiate, followed by a forced pooling order from the Commission, represents a condemnation of Henry's property rights without just compensation.

4) Fulcrum is the only company buying leases in this part of Oklahoma, and as such is able to dictate what the price should be in this section. That is not fair market value, that is not a willing seller and a willing buyer because if Fulcrum does not get the price asked, they simply force pool under Oklahoma rules.

CONCLUSIONS

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

1) The Referee finds that the ALJ's Report should be affirmed and the fair market value options be established as the ALJ recommends at \$125 an acre with a 1/8th royalty and \$100 an acre with a 3/16th royalty under the Fulcrum pooling application for the Whitehorse Group, El Reno, Enid, Pontotoc, and Cisco common sources of supply in the NW/4 of Section 14, T1N, R20W, Jackson County, Oklahoma.

2) Fulcrum has acquired over 100 oil and gas leases over the last three year period under these terms. In this particular quarter section there's one lease that covers almost 120 acres. Fulcrum has 80% under lease in this quarter section, 130 some odd acres. Henry has a working interest of 7.5 acres. Fulcrum is the only party that is leasing in the area and is the only party that has leased in the nine section area since 2005. Fulcrum has acquired in T1N, R19W and R20W some 75 leases none of which have been more than the suggested fair market value by Fulcrum.

3) Henry testified that they own minerals in Wilbarger County in Texas where he has agreed to lease his minerals for a three year lease of \$175 an acre and a 20% royalty. Henry testified that he believes that would be a fair offer for the minerals in Section 14 and should constitute fair market value. He also has asserted that a fair market value should be offered of no bonus and a quarter royalty. These values suggested by Henry have not been established within the subject nine section area surrounding Section 14. These leases were taken in Wilbarger County, Texas, across the Red River, which is 12 to 11 miles from the subject Section 14, and these values were given as a bonus for land leased by Henry some 30 miles away from Section 14. Henry's testimony was also that he has never executed an oil and gas lease for no bonus and a quarter royalty.

4) "[F]air market value....means the money which a 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). The Supreme Court in *Miller v. Corporation Commission*, 635 P.2d 1006 (Okl. 1981) states:

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)

- 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) The Supreme Court in *Coogan v. Arkla Exploration Company*, 589 P.2d 1061 (Okl. 1979), which was cited by *Miller*, supra, states:

...and the majority rule, adhered to in this State is that the value of land or interest in realty at a particular

time may as a general rule be proved by evidence of voluntary sales of similar property in the vicinity made at or about the same time.

7) *North American Royalties, Inc. v. Corporation Commission of Oklahoma*, 683 P.2d 539 (Ok.Civ.App. 1984) also cites the *Miller* case, supra, and states that the measure of compensation to be paid to working interest owners who do not wish to participate in the drilling of a unit well is the "fair market value of the interest". At 539. Lastly, the Supreme Court in *Ranola Oil Company v. Corporation Commission of Oklahoma*, 752 P.2d 1116 (Okl. 1988) states that:

Fair market value of an oil and gas lease 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."

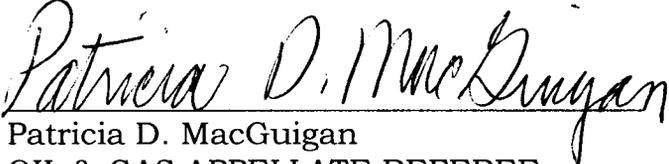
8) These cases all establish the prevailing rule of law in Oklahoma regarding determination of fair market value for lease bonus and royalty provisions to be included in a forced pooling order. There is no agency precedent, practice or policy to be followed in this or any other forced pooling dispute regarding the issue of fair market value except the previously outlined case law from Oklahoma appellate courts.

9) As stated above Fulcrum's evidence was that their values were demonstrated by consummated leases within one year and within a contiguous nine section area and there were no other higher values within this area. The testimony given by Henry was that there were other alternative values they considered relevant and acceptable, however these values were not established within the nine section area. They were either values desired by Henry or paid in Texas approximately 30 miles south of Section 14. Although there may be conflicting evidence as to fair market value in a proceeding, the evidence cannot be weighed upon review, but only that the evidence tending to support the order "implies a quality of proof which induces the conviction that the order was proper or furnishes a substantial basis of facts from which the issue tendered could be reasonably resolved." *Cameron v. Corporation Commission*, 414 P.2d 266 (Okl. 1966). See also *Texas Oil and Gas Corporation v. Rein*, 534 P.2d 1280 (Okl. 1974); *Texas County Irrigation and Water Res. v. Dunnett*, 527 P.2d 578 (Okl. 1974); *Centurion Oil, Inc. v. Stephens Production Company*, 857 P.2d 821 (Ok.Civ.App. 1993). Thus, the Referee agrees with the conclusion of the ALJ as it is supported by substantial evidence.

10) Therefore, based upon the substantial evidence presented and based upon the law as established within the State of Oklahoma, the Referee finds

that the ALJ's recommendation to establish fair market value as he suggests in his Report should be affirmed.

RESPECTFULLY SUBMITTED THIS 26th day of February, 2014.


Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Douglas
Commissioner Anthony
Commissioner Murphy
Jim Hamilton
ALJ Michael Norris
John E. Lee, III
Gregory L. Mahaffey
Clayton Henry
Office of General Counsel
Michael L. Decker, OAP Director
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