

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

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CORPORATION COMMISSION
OF OKLAHOMA

APPLICANT: ROYAL RESOURCES COMPANY,)
LLC)
)
RELIEF REQUESTED: DRILLING AND SPACING UNITS) CAUSE CD NO.
) 201300659-T
)
LEGAL DESCRIPTION: E/2 NW/4 OF SECTION 9,)
TOWNSHIP 14 NORTH, RANGE)
11 EAST, OKMULGEE COUNTY,)
OKLAHOMA)

REPORT OF THE OIL AND GAS APPELLATE REFEREE

This Cause came on for hearing before **Curtis M. Johnson**, Deputy Administrative Law Judge for the Corporation Commission of the State of Oklahoma, on the 7th day of May, 2014, at 8:30 a.m. in the Commission's Courtroom, Robert S. Kerr Office Building, 440 South Houston, Suite 114, 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: **Ron M. Barnes**, attorney, appeared on behalf of applicant, Royal Resources Company, LLC ("Royal"); and **Edward J. Clarke**, attorney, appeared on behalf of respondents, The Estate of William Gladstone Green, Lauren Green, Rose Rock Resources, Inc., Sean Thomas Langston, Kyle Shea Langston, and Maurine Margaret Gentis (collectively "Green").

The Administrative Law Judge ("ALJ") filed his Report of the Administrative Law Judge on the 25th day of June, 2014, to which Exceptions were timely filed and proper notice given of the setting of the Exceptions. A Corrected Report of the Administrative Law Judge was filed on July 9, 2014, to correct a typographical error.

The Appellate argument concerning the Oral Exceptions was referred to **Patricia D. MacGuigan**, Oil and Gas Appellate Referee ("Referee"), on the 5th day of September, 2014. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

ROYAL APPEALS the ALJ's recommendation to deny the application of Royal seeking to space the Prue, Bartlesville, Booch, Dutcher, Union Valley, Cromwell and Wilcox common sources of supply for oil on a 40 acre basis in the E/2 NW/4 of Section 9, T14N, R11E, Okmulgee County, Oklahoma.

Royal filed the subject cause seeking to space the above listed common sources of supply for oil on a 40 acre basis. Green, in the alternative, requested 10 acre spacing be established. Green was the prior operator of the lease. Prosperous Oil and Gas, Inc. ("Prosperous"), Royal's operating arm, obtained operations of the lease by filing a Commission Form 1073 which left the current operator of the lease on the form blank (see Exhibit #2). Royal alleged Green failed to produce the lease for one or two months, and as a result, Green's leases terminated. Royal therefore contends their top leases took effect giving them an interest in minerals in the subject lands or a right to drill. Green contends their leases are still valid, and therefore Royal owns no interest in the subject lands.

ROYAL TAKES THE POSITION:

- 1) The ALJ's Report is contrary to the law and contrary to the evidence.
- 2) Said ALJ Report is arbitrary, unreasonable, and discriminatory and fails to affect the ends of the prevention of waste and the protection of correlative rights of working interest owners and mineral owners in the E/2 NW/4 Section 9, T14N, R11E, Okmulgee County, Oklahoma, as required by applicable laws of the State of Oklahoma.
- 3) The ALJ erred in concluding that Royal owns no right to drill in the subject unit.
- 4) The ALJ erred in paragraph 3 of his conclusions in that he stated that Royal does not possess an interest in the minerals or the right to drill the subject lease as their top leases have not taken effect. Green failed to produce the lease for approximately two years. Green's bond was revoked in 2011 and as a result could not lawfully produce the lease.
- 5) IHS Reports show that none of the current wells in the 80-acres which are the subject of this application have produced since December 12, 2012. Further, Commission Form 1073 and Oklahoma Tax Commission Gross Production Request for Change Form for the McNeely #1B, McNelly #1E, McNeely #2E, McNelly #1D and McNeely #2D wells show Prosperous as

operator. Prosperous is the operating arm of Royal. Further, the Oklahoma Tax Commission Gross Production Request For Change Forms also shows Prosperous as operator and no operator of record listed with the Commission for the two years prior to Prosperous taking over operations.

6) Royal requests that the Report of the ALJ be reversed and that 40-acre drilling and spacing units be established for the Prue, Bartlesville, Booch, Dutcher, Union Valley, Cromwell and Wilcox common sources of supply and for any other relief the Court would deem necessary and proper.

THE ALJ FOUND:

1) After taking into consideration all the facts, evidence, Exhibits, and arguments of Counsel, it is the recommendation of the ALJ in Cause CD NO. 201300659-T seeking to space the Prue, Bartlesville, Booch, Dutcher, Union Valley, Cromwell and Wilcox common sources of supply for oil on a 40 acre basis in the E/2 NW/4 of Section 9, T14N, R11E, Okmulgee County, Oklahoma, should be denied.

2) There are only two issues for resolution in the Cause: whether Royal owns an interest in the proposed unit, and what is the proper size unit to establish for the named common sources of supply. In order to invoke the jurisdiction of the Corporation Commission under oil and gas conservation statutes, an applicant must have an interest in minerals or have the right to drill in a common source of supply affected by a proposed order. *Samson Resources Co. v. Oklahoma Corp. Com'n*, 859 P.2d 1118 (Okl.Civ.App. 1993); *Leede Oil & Gas, Inc. v. Corporation Commission of State of Oklahoma*, 747 P.2d 294 (Okla. 1987); and *May Petroleum, Inc. v. Corporation Com'n of State of Okl.*, 663 P.2d 716 (Okla. 1982).

52 O.S. Section 87.1(a) provides that an order " ...may be entered after a hearing upon the petition of any person owning an interest in the minerals in lands embraced within such common source of supply, or the right to drill a well for oil or gas on the lands embraced within such common source of supply..." Therefore, the issue becomes whether Royal owns an interest in minerals or possesses a right to drill in the lands and the common sources of supply which they seek to space. While the ALJ is well aware the District Court has jurisdiction to resolve issues concerning title, the ALJ is also cognizant of the fact the Commission does have authority to determine whether a party has an interest in minerals or a right to drill sufficient to confer jurisdiction on the Commission. (See *Samson Resources Co. v. Oklahoma Corp. Com'n.*, supra and 52 O.S. Section 87.1(a) supra.)

3) The ALJ contends Royal does not possess an interest in minerals or the right to drill in the subject lease. This recommendation is based upon the

conclusion Royal's top leases have never taken effect, because these leases do not become effective until the "...existing lease expires or is terminated." (See *Harding v. Shelton, Inc. v. Prospective Inv. and Trading Co., Ltd.* 123 P.3d 56 (Okl.Civ.App. 2005); 8 Williams & Meyers, Oil and Gas Law, 1115 (2004). Royal argued IHS as well as Gross Production Request For Change records (See Exhibit #2) established the lease failed to produce for one or two months, December 2012 to January 2013, before Prosperous, Royal's operating arm, took possession of the lease. However "...cessation of production during the secondary term of a lease is not in and of itself sufficient to automatically terminate a lease. Rather, a lease remains viable so long as the interruption of production in paying quantities does not extend for an unreasonable period which is not justifiable in light of all the circumstances" *Baytide Petroleum, Inc. v. Continental Resources, Inc.*, 231 P. 3d 1144 (Okl. 2010) and see *Stewart v. Amerada Hess Corp.*, 604 P.2d 854 (Okl. 1979). This lease was subject to Quiet Title Action filed in District Court and restraining orders were issued which prohibited operation of the lease. Also during the pendency of this legal action William Green, the Operator, passed away. Furthermore, no one presented any evidence this one or two month delay in production was unreasonable. Thus, the ALJ cannot conclude the cessation in production "...extend[ed] for an unreasonable period which is not justifiable in light of all the circumstances." (See *Baytide* and *Stewart* supra.) Based upon these facts, as well as the brevity of one month or at most two months cessation in production, the ALJ recommends Green's lease did not terminate. Accordingly, Royal's top leases did not take effect and Royal does not have an interest in the minerals or a right to drill. Therefore, the Commission does not have jurisdiction to hear the spacing application of Royal.

4) Thus, the ALJ denies the application of Royal in Cause CD NO. 201300659-T seeking to space the Prue, Bartlesville, Booch, Dutcher, Union Valley, Cromwell and Wilcox common sources of supply for oil on a 40 acre basis in the E/2 NW/4 of Section 9, T14N, R11E, Okmulgee County, Oklahoma, should be denied.

POSITIONS OF THE PARTIES

ROYAL

1) **Ron M. Barnes**, attorney, appearing on behalf of Royal, contends the ALJ got the facts incorrect regarding the restraining order. Royal believed the order to be against Green, when in fact it was against Royal. Therefore, the ALJ's belief that the restraining order was not a sufficient cause for cessation of production was incorrect. Cessation of production had occurred prior to the restraining order against Royal.

- 2) The last reported date of production was September 28, 2011. There was a single sale of oil sold on December 12, 2012, which was oil cleaned from the tanks, not from production. There had not been production for about 15 months. The Oklahoma Tax Commission also listed no production from December 2012, to January 2013. This was the period of time when the tank was cleaned. This was not an indication as to how much production had occurred prior to that. The injunction was issued March 22, 2013 and was quashed in May of 2013.
- 3) Prosperous, the operating arm of Royal, filed 1037 forms with the Commission to be designated the operator for each of the wells. The Commission noted there was no operator listed and approved the forms. The Oklahoma Tax Commission also checked the forms and noticed there had not been an operator for two years.
- 4) Electricity for these particular leases is in Royal's name and there was no electricity in the area prior to Royal taking over operations.
- 5) None of the other parties claiming to have been operators have surety with the Commission. Therefore, any party claiming to have been the operator previously could not have operated, because they did not have approval with the Commission to allow them to operate.

GREEN

- 1) **Edward J. Clarke**, attorney, appearing on behalf of the Green , stated the injunction that was entered prohibited both parties from operating in order to preserve the status quo. There was a need for the injunction because at the time Royal had filed forms at the Commission to take over operations without any due process or adjudication. The injunction was entered because of the improper actions of Royal who knew who the operator was when they filed the form 1073s which did not state that Green was the operator.
- 2) Mr. Andrews, a practicing geologist, testified that Royal's activities and filing 1073s was highly improper. Royal knew who the prior operator was, yet still signed an oath on the 1073s saying they had no information and did not know how to contact the operator.
- 3) The issue of operations on the lease was different than presented by Royal. Prior to Mr. Green's death, he owned the leasehold estate and his son, Mr. Henderson, was an operator and still is, under Henderson Operating Company, L.L.C. Mr. Henderson's son failed to fill out a form at the

Commission even though he had a cash CD on file with a bank and had for a long time.

4) When the mineral owners signed a second lease and gave it to Ms. Ashford, the owner of Royal, Green's duties ceased under the lease at common law. These actions fall within the doctrine of obstruction, and therefore Green does not need to produce under the lease as the effects of the lease had been repudiated.

5) Mr. Andrews, a mineral owner, testified as to the other mineral owners that they accepted leases from Royal and accepted royalty payments from Green.

6) Royal received its purported right to drill from the same people Green has leased. Once one mineral owner leases, he cannot then re-lease the same property. The second lease has no force and effect until the first lease is adjudicated, abandoned, or terminated. Ms. Ashford admitted through testimony, she was uncertain who had the right to drill out there. Royal will in District Court have very little chance of sustaining the viability of their top leases because of the lessor's accepting the benefits of Green's production. As a result, Royal merely has a possible right to drill.

7) Green had producing leases that had been paying royalties, and the mineral owners had all accepted the benefits, giving Green a vested constitutional property interest in those leases.

RESPONSE OF ROYAL

1) Not all the mineral owners accepted royalty payment. The only mineral owner to testify that he accepted royalty payment was Mr. Andrews who had also filed a lawsuit trying to cancel the leases at one point in time. Furthermore, the mineral owners could not have accepted any royalty for 15 months because there had not been any production.

2) There is nothing falsified or incorrect within the documents filed with the Commission. The Commission reviews the documents and their records to determine if there is an operator. There was no operator and no surety so the Commission signed off on the forms.

3) In this case there is evidence to support Royal has an interest, and that is all that is needed to move forward to decide spacing. The issue of who owns what interest should be taken up in District Court.

CONCLUSIONS

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

1) To invoke the jurisdiction of the Oklahoma Corporation Commission under the Conservation statutes, 52 O.S. Section 81 et. seq., Royal must be shown to have an interest in, or the right to drill for oil and gas under 52 O.S. Section 87.1(a). *Samson Resources Co. v. Oklahoma Corp. Com'n*, 859 P.2d 1118 (Okl.Civ.App. 1993); *Leede Oil and Gas Inc. v. Corporation Commission of State of Oklahoma*, 747 P.2d 294 (Okl. 1987); and *May Petroleum Inc. v. Corporation Commission of State of Oklahoma*, 663 P.2d 716 (Okl. 1982).

2) The Oklahoma Court of Civil Appeals states in *Samson Resources Company v. Oklahoma Corporation Commission*, supra, at 1119:

...under §87.1(a), the Corporation Commission has the power to receive evidence and determine whether an applicant owns minerals or has the right to drill in the subject unit. To hold the Commission does not have the authority to determine whether an applicant has standing and hence whether it has jurisdiction, would infringe upon the powers constitutionally and statutorily conferred upon it.

3) Determination of ownership of minerals or the right to drill is a finding of fact to be made by the Corporation Commission, whose findings must be supported by substantial evidence. *Sundown Energy, L.P. v. Harding & Shelton Inc.*, 245 P.3d 1226 (Okl. 2010) states:

The Commission has a wide discretion in the performance of its statutory duties, and this Court may not substitute its judgment upon disputed factual determinations for that of the Commission but is restricted to a determination of substantial evidentiary support for the order issued under authority of the statutes. *Union Texas Petroleum v. Corporation Com'n*, 1981 OK 86, ¶31, 651 P.2d 663; *In re: Application of Continental Oil Company*, 1962 OK 131, 376 P.2d 330. Searching a record for substantial evidence supporting the order appealed does not entail a comparison of the parties' evidence to determine that which is most convincing but only that the evidence supportive of the order be considered to determine whether it implies a

quality of proof inducing a conviction that the evidence furnished a substantial basis of facts from which the issue could be reasonably resolved. *Union Texas Petroleum v. Corporation Com'n.*, 1981 OK 86, ¶31, 651 P.2d 663, *Chenoweth v. Pan American Petroleum Corp.*, 1963 OK 108, 382 P.2d 743. Substantial evidence has been additionally outlined as something more than a scintilla; possessing something of substance and of relevant consequence carrying with it a fitness to induce conviction, but remains such that reasonable persons may fairly differ on the point of establishing the case. A determination of substantial evidentiary support does not require weighing the evidence but only a measurement of the supportive points to determine whether the criterion of substantiality is present. *Union Texas Petroleum v. Corporation Com'n.*, 1981 OK 96, ¶31, 651 P.2d 663 *Central Okla. Freight Lines v. Corporation Com'n.*, 1971 OK 877, 484 P.2d 877, 879.

4) The ALJ found that Royal did not possess an interest in minerals or the right to drill in the subject leases. The recommendation was based upon the conclusion Royals' top leases had never taken effect because these leases could not become effective until the "existing lease expires or is terminated." See *Harding & Shelton Inc. v. Prospective Investment and Trading Company, LTD*, 123 P.3d 56 (Okl.Civ.App. 2005).

5) The cessation of production during a secondary term of a lease is not in and of itself sufficient to automatically terminate a lease. Rather, a lease remains in effect as long as interruption of production in paying quantities does not extend for a time longer than reasonable or justifiable in light of all the circumstances involved. *Stewart v. Amerada Hess Corp.*, 604 P.2d 854 (Okl. 1979); *Baytide Petroleum Inc. v. Continental Resources Inc.*, 231 P.3d 1144 (Okl. 2010). The Supreme Court of Oklahoma in *Smith v. Marshall Oil Corporation*, 85 P.3d 830 (Okl. 2004) states:

In determining whether a failure to produce in paying quantities suffices to terminate a lease, we examine the facts and circumstances of the cessation on a case-by-case basis. *Barby v. Singer*, 1982 OK 49, ¶6, 648 P.2d 14, 16-17; *Stewart v. Amerada Hess Corp.*, 1979 OK 145, ¶10, 604 P.2d 854, 858. Indeed, we have held that "compelling equitable considerations" may save a lease from termination even with unprofitable well operations. *Barby*, ¶7, 648 P.2d at 17 (prospect of impending federal legislation,

The Natural Gas Policy Act, that might result in an increase in the price of natural gas was equitable consideration); *State ex rel. Commissioners of the Land Office v. Carter Oil Co of West Virginia*, 1958 OK 289, ¶¶ 43-44, 54, 336 P.2d 1086, 1095-96 (an implied covenant case in which the fact that lessees were unable to market product due to absence of pipeline in which to transport product was equitable consideration); *Cotner v. Warren*, 1958 OK 208, ¶¶ 8-9, 330 P.2d 217 (an implied covenant case wherein we held that five to six months of voluntary cessation of marketing where operator was attempting to resolve partnership differences during the time period was equitable consideration); *Hunter v. Clarkson*, 1967 OK 114, ¶10, 428 P.2d 210, 213 (an implied covenant case in which we held that a five month cessation of production and marketing without any circumstances to justify cessation was not equitable consideration and resulted in lease cancellation).

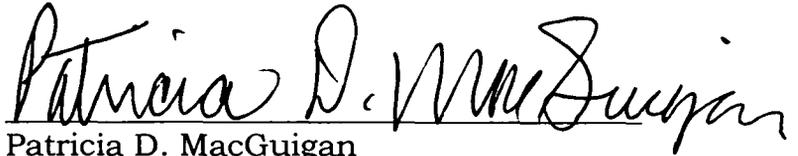
6) The Referee has reviewed the transcript of the contested hearing held on May 7, 2014, and listened to the audio recording of the hearing on May 7, 2014 held by ALJ Curtis M. Johnson. In the present case the McNeely #1-E well produced oil in 2011 until August of 2011. In 2012 it produced 61 BO in December. Royal alleges it obtained 38% interest in the property under the described lands (Royal states it owns 37% and its operating arm, Prosperous Oil and Gas, Inc. owns 1% of the subject property). Royal obtained their alleged interest in the subject property from their "top" leases obtained in August, September, October and November 2011.

7) The testimony reflected that Green's witness Jeff Andrews owned a royalty interest in the property and he testified he acquired his interest in the lease in 2005 with the most recent royalty check being received from the production on the lease in 2012. An injunction was imposed by the District Court as a result of a quiet title action and was issued on March 22, 2013 and was squashed in May of 2013. During the pendency of the legal action in District Court William Green, the operator, passed away.

8) After a thorough review of the record, the Referee believes the evidence supports the ALJ's finding that extenuating circumstances occurred that would justify Green's failure to produce in paying quantities for these time periods and Green's lease did not expire due to justifiable equitable considerations. Therefore, Royal's top leases did not take effect and Royal does not have a mineral interest or right to drill. The Referee finds the ALJ's Findings and Conclusions are sustained by law and substantial evidence. *El Paso Natural*

Gas Company v. Corporation Commission of the State of Oklahoma, 640 P.2d 1336 (Okl. 1981).

RESPECTFULLY SUBMITTED THIS 9th day of October, 2014.



Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Anthony
Commissioner Douglas
Commissioner Murphy
ALJ Curtis M. Johnson
Deputy General Counsel for Deliberations
Edward J. Clarke
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