

July 14, 2017

VIA PERSONAL DELIVERY

Colorado Oil and Gas Conservation Commission
1120 Lincoln Street, Suite 801
Denver, CO 80203

Re: Form 38 Payment of Proceeds Hearing Request

Dear Hearing Officer:

Our firm represents owners (the "Payees") of mineral rights in T3N-R67W-Sec 7: N2NE (the "Minerals"). This cover letter is sent with the Payees' Form 38s to assist with your analysis of the hearing request and to invite the Commission to provide further guidance to the parties. This letter was previously sent to the Payers at issue, Kerr-McGee Oil & Gas Onshore LP ("KMOG") and SRC Energy ("SRC"), who are also copied hereto.

Factual Timeline and Background

11/2013	Application for an order to pool the interests in two Wellbore Spacing Units ("WSUs") for the Berry Farms 31C-8HZ and Berry Farms 31N-8HZ wells ("Wells"), containing 400 acres described as T3N-R67W-Sec 7: E2NE, Sec 8: N2, filed by KMOG.
01/2014	KMOG withdrew its pooling application under protest by the Payees for failure to provide notice and offer an opportunity to lease or participate in the Wells. KMOG refused to offer a lease to the Payees, citing title issues. As a result, Payees began preparing a quiet title action.
01/2014	KMOG filed declarations of pooling, so as to voluntarily pool all interests within the WSUs except the Payees'.
02/2014	The Commission approved KMOG's Applications for Permit to Drill and the proposed WSUs.
04/2014	KMOG spud the Wells.
05/2014	Payees filed a quiet title action as to their interests in the Minerals.
11/2014	KMOG began producing oil and gas from the Wells. According to Commission records, the Wells bottom hole 50 to 75 feet from the Minerals.
06/2015	Payees entered into agreements to lease to SRC, pending a quiet title decree.
10/2015	Quiet title decree confirms Payees' title ownership of Minerals. Payees adhere to contracts to lease with SRC and begin executing leases
03/2017	Demand for Payment from Payees to KMOG, pursuant to C.R.S. § 34-60-118.5.
05/2017	Demand for Payment from Payees to SRC, pursuant to C.R.S. § 34-60-118.5.
07/2017	Application for an order to pool the interests in the WSUs, filed by SRC.

The Payees could not protect their interests when their title ownership was in dispute. Thus, upon KMOG's urging, the Payees pursued an 18-month quiet title action. While the action was pending, SRC committed to leasing the Payees' interests, subject to title confirmation. Upon entry of the quiet title decree, the Payees were contractually obligated to lease to SRC, which became responsible for protecting the Payees' interests pursuant to their leases. KMOG's Wells have been draining the Payees' Minerals since they were completed in 2014, and SRC's application to pool the Minerals currently on file, which seeks an effective date years after the Wells' first production, is insufficient to ensure the payment of proceeds fully owed to the Payees from the Wells.

Issue: The Wells have been draining the Minerals and KMOG has failed to hold in suspense Payees' proportionate share of proceeds from production within the WSUs.

KMOG has taken the position that no proceeds need to be apportioned to the Payees until the Minerals are actively pooled because the rule of capture applies, irrespective of the Commission's approval of the WSUs, and has therefore failed to hold any proceeds from production in suspense for Payees.

KMOG's position is contrary to the law. It is settled that Commission spacing regulations supplant the rule of capture within a spacing unit. Because spacing units, i.e. the WSUs, limit the drilling of wells in a unit and so preclude a mineral owner in the unit from drilling offset wells, the rule of capture cannot apply here, despite KMOG's urging. *INB Land & Cattle, LLC v. Kerr McGee Rocky Mt. Corp.*, 190 P.3d 806 (Colo. App. 2008); C.R.S. 34-60-116; *Cowling v. Board of Oil, Gas & Mining, Dep't of Natural Resources*, 830 P.2d 220, 228 (Utah 1991); *Ward v. Corporation Commission*, 501 P.2d 503, 507 (Okla. 1972) (because of the drilling limit in a unit, a nonconsenting mineral owner is not at liberty to drill a second well, so a vested right to some compensation is therefore essential to prevent the regulatory legislation from unconstitutionally depriving the nonconsenting mineral owner of his property without compensation.).

Clearly, irrespective of pooling, KMOG owes proceeds from the drainage and production of the Payees' Minerals contained within the WSUs. At minimum, the amount owed is 12.5% of Payees' proportionate share of proceeds from the date of first production to the date Payees' ownership interests were confirmed and their lease agreements with SRC became operational. C.R.S. 34-60-116(7)(c) (an unleased "owner of a tract in a **drilling unit** ... shall be deemed to have a landowner's proportionate royalty of twelve and one-half percent"); *Bennion v. Utah State Board of Oil, Gas & Mining*, 675 P.2d 1135, 1142 (Utah 1983) (affirming determination that non-consenting owner's right to 12.5% pooling royalty vested prior to the pooling order). Thereafter, Payees are entitled to 18% of their proportionate share, pursuant to their leases with SRC.

Issue: The retroactive date of SRC's pooling application must extend back to before the date of first production from the Wells

SRC has taken the position that it can only request a pooling order retroactive to the date of its pooling application under Commission Rule 530. However, such a position ignores factors that permit the pooling order to be retroactive to an earlier date and fails to correct the Payers' wrongs.

Indeed, KMOG filed a pooling application in November, 2013 for these same WSUs. Such is a satisfactory retroactive date for the pooling order that is prior to first production from the Wells and aligns with the plain language of Rule 530.

In addition, the Commission approved KMOG's WSUs in February, 2014. Such is likewise a satisfactory retroactive date for the pooling order that is prior to first production and consistent with persuasive authority. *Cowling*, 830 P.2d at 228. ("Because [the pooling statute] authorizes pooling orders to be entered only with respect to established drilling units and because a pooling order that pools working interests must take into account the costs of drilling, by implication the statutory scheme contemplates that pooling orders shall be retroactive to the date of first production, but only if a spacing order was then in effect." (Citation omitted)).

Alternatively, KMOG entered into voluntary pooling with all of the other owners within the WSUs in January, 2014, but failed to provide Payees the opportunity to participate. This, too, would be a satisfactory retroactive date for the pooling order that is prior to first production and aligned with the just and reasonable principles of C.R.S. § 34-60-116.

Also, costs were first incurred for the drilling of the Wells when the Wells were spud in April, 2014. This, too, would be a satisfactory date for the pooling order that is prior to first production and compliant with common Commission precedent. See, e.g., Order No. 407-805 ("all interests in two approximate 640-acre drilling and spacing units ... are hereby pooled, ... effective as of the earlier of the date of the Application, **or the date that any of the costs specified in C.R.S. §34-60-116(7)(b)(II) are first incurred** for the drilling of the [wells].").

Unlike SRC's proposed retroactive date, any of the foregoing retroactive dates would result in a pooling order that complies with the Act, which states any pooling order must be "upon terms and conditions that are just and reasonable, and that afford to the owner of each tract or interest in the drilling unit the opportunity to recover or receive, without unnecessary expense, his just and equitable share." C.R.S. § 34-60-116(6). Furthermore, a stated goal of the Act is to protect correlative rights. Failure to make a pooling order retroactive to the date of the Wells' first production or prior thereto would allow KMOG to have continued to violate Payees' correlative rights through the date to which the pooling order is made retroactive.

Accordingly, Payees are entitled to their proportionate share of proceeds from the Wells since first production, and the Form 38s enclosed herein are submitted pursuant thereto. Enclosed, please find the following: (1) Form 38s for each Well for each Payee, and (2) proof of written demands for payment under C.R.S. § 34-60-118.5.

Unless relief is granted, the Payees' Minerals were drained from November, 2014 to November, 2015 without compensation from KMOG and from November, 2015 to today without compensation from SRC or KMOG. Meanwhile, KMOG has allocated to itself an unjust and unreasonable share of proceeds from the WSUs in contravention of the Act. Allowing KMOG's voluntary pooling to negate the Act's requirement for the opportunity to receive each owner's just share within an established unit is inconsistent with the stated goal of the Act.

Very truly yours,

A handwritten signature in black ink, appearing to read "Steven Louis-Prescott", with a long horizontal flourish extending to the right.

Steven Louis-Prescott

Enclosures

cc: Brian Tooley, Esq. (for KMOG)
Jillian Fulcher, Esq. (for SRC)