

BEFORE THE OIL AND GAS CONSERVATION COMMISSION
OF THE STATE OF COLORADO

APPLICATION OF PARADISE VALLEY) CAUSE NO:
MINERALS, LLC AND PARADISE VALLEY)
MINERALS II, LLC FOR AN ORDER) DOCKET NO:
DETERMINING WHETHER THE)
COMMISSION HAS JURISDICTION OVER)
APPLICANT'S ROYALTY)
UNDERPAYMENT CLAIMS AGAINST)
URSA OPERATING COMPANY, LLC)
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APPLICATION

Paradise Valley Minerals, LLC ("PVM") and Paradise Valley Minerals II, LLC ("PVM II") (collectively "Applicants"), through their attorneys, Dorsey & Whitney, LLP, make application to the Oil and Gas Conservation Commission of the State of Colorado ("the Commission") to determine whether the Commission has jurisdiction over the disputed royalty underpayment claims asserted by Applicants against Ursa Operating Company, LLC ("Ursa") under a certain oil and gas lease covering lands located in Garfield County Colorado, as more fully described below. Applicants seek an Order from the Commission determining that the Commission does not have jurisdiction over Applicants' royalty underpayment claims against Ursa under the applicable oil and gas lease, for the reasons set forth below. In support of this Application, Applicants state as follows:

INTRODUCTION

In a series of cases against Ursa that are virtually identical to this one, the Commission has already ruled that it lacks jurisdiction to hear the dispute. *See Airport Land Partners, Ltd. v. Ursa; Richard N. Casey v. Ursa; Limbach v. Ursa; Shidleler Energy v. Ursa, Shuster v. Ursa.* Specifically, this case, like those, involves issues of contract interpretation that remove it from the jurisdiction of the Commission. In light of those cases Applicants asked Ursa to stipulate that there was an issue of contract interpretation, so that the parties could efficiently, and effectively, resolve the claims in the District Court. Ursa refused. Accordingly, Applicants file this Application and request that the Commission hold an expedited hearing on whether it has jurisdiction to resolve the parties' contradictory interpretations of the Lease language at issue in this case.

DISCUSSION

1. Applicants are citizens of the State of Colorado.
2. PVM is the lessor of a certain oil and gas lease for property located in Garfield County, Colorado more fully described in the Lease dated May 24, 2007 by and between Battlement Mesa Partners as Lessor, and Antero Resources II Corporation, as Lessee (the "2007 Lease"). (**Exhibit 1**). Ursa is the assignee of the rights of Antero Resources II Corporation, as Lessee. PVM is the assignee of the rights of Battlement Mesa Partners.
3. The 2007 Lease provides for payment of royalties based on the following royalty clause:

Lessee shall pay to Lessor the royalties free of all costs of any kind, including, but not limited to, costs of gathering, production, treating, compression, dehydration, processing, marketing, truck or other expense, directly incurred by Lessee, whether as a direct charge or a reduced price or otherwise. In this regard, Lessee agrees to bear one hundred percent (100%) of all costs and expenses incurred in rendering hydrocarbons produced on or from the Leased premises marketable and delivering the same into the first interstate pipeline.

This is an extremely strong "no costs" provision.

4. Under the terms of the 2007 Lease, PVM has had, and continues to have, the right to be paid royalties on all of the hydrocarbons which have been obtained from the wells subject to the 2007 Lease. PVM also owns an overriding royalty interest.
5. PVM II is the owner by assignment of a 1% overriding royalty interest that is coextensive with, and paid on the same terms as, the royalty found in the 2007 Lease.
6. With respect to the hydrocarbons obtained from the gas wells at issue, Ursa breached its royalty payment obligations to Applicants, as referenced above, by failing to pay royalties to them based upon the selling price which Ursa received on their sale of hydrocarbons to third persons at the delivery points where such residue gas was sold to such third persons. Ursa facilitated their royalty underpayments to Applicants on the hydrocarbons by improperly deducting costs from the hydrocarbons' selling price to third persons in calculating royalties, in contradiction to the applicable royalty payment provisions of the 2007 Lease, which expressly prohibit such deductions.

7. On December 20, 2017, Applicants filed their complaint in Denver County District Court, claiming breaches by Ursa of the 2007 Lease and the ORRI based on its consistent underpayment of royalties and improper deduction of various costs (the " Complaint"). A copy of the Complaint is attached as **Exhibit 2**.
8. Ursa filed a motion to dismiss the Complaint for failure to exhaust administrative remedies with the Commission, arguing the royalty underpayment issues should first be brought before the Commission for a determination pursuant to § 34-60-118.5, C.R.S of the Act. A copy of the motion to dismiss is attached as **Exhibit 3**.
9. Applicants filed a Memorandum in Opposition to Ursa's motion to dismiss, relying on the Commission's prior rulings that the resolution of post-production cost royalty underpayment disputes are matters of contract interpretation which are not within the Commission's jurisdiction, and relying on *Grynberg v. Colorado Oil and Gas Comm'n*, 7 P.3d 1060 (Colo. App. 1999). In *Grynberg*, the Colorado Court of Appeals upheld the Commission's determination that it had no jurisdiction over a similar post-production cost deduction dispute, holding that post-production cost royalty underpayment disputes are matters for the courts to decide. A copy of Applicants' Memorandum in Opposition is attached as **Exhibit 4**. A copy of the *Grynberg* decision is attached as **Exhibit 5**, and copies of the Commission's prior jurisdictional rulings are attached as **Exhibits 6 and 7**.
10. By Order dated April 24, 2018, Judge Elizabeth Starrs of the Denver County District Court granted Ursa's Motion to Dismiss, without prejudice (the "District Court Order"). A copy of the District Court Order is attached as **Exhibit 8**. Judge Starrs ruled that Applicants should first have exhausted any administrative remedy with the Commission. Judge Starrs therefore concluded that the District Court had no subject matter jurisdiction, and dismissed Applicants' Complaint without prejudice. (Ex. 8).
11. Although Applicants are hereby conditionally submitting their Form 38 - Payment of Proceeds Hearing Request to the Commission for both PVM and PVM II (collectively, **Exhibit 9**), it has been, and remains, Applicants' position that the Commission does not have jurisdiction to resolve Applicants' royalty underpayment claims against Ursa, for the reasons discussed below. Applicants therefore request that the Commission first address the threshold question of whether the Commission has jurisdiction to resolve Applicants' improper cost deduction and royalty underpayment claims against Ursa, in accordance with its established procedures.

12. The Colorado Court of Appeals' decision in *Grynberg* is dispositive of the jurisdictional issue before the Commission with respect to the claims of Applicants against Ursa. In *Grynberg*, the royalty owners filed an Application with the Commission pursuant to C.R.S. § 34-60-118.5, as it existed prior to the 1998 amendments, to have the Commission decide their claim that the *Grynberg* operators had underpaid the royalties owed to them by deducting post-production costs in the calculation of their royalties. The Commission, *sua sponte*, determined that it did not have jurisdiction over the parties' post-production cost royalty underpayment dispute (Ex. 6), and stated, in pertinent part:

37 – Historically, the Commission has interpreted its statutory authority to include the regulation of oil and gas to protect against resource waste, to protect correlative rights and to protect the public health safety and welfare in oil and gas operations. § 34-60-102, C.R.S. The Commission has not interpreted this authority to grant the Commission authority to decide private party contractual disputes. (emphasis added).

Ex. 6, ¶ 37

38 – While the Commission recognizes that ensuring timely payment of proceeds falls within its jurisdiction, that obligation is limited to those instances when the Payee is legally entitled to the proceeds. When a dispute regarding the propriety of deductions arises it requires interpretation of the contract(s) creating the interest. This determination may also require the application of principles relating to marketability set forth in Garman. Garman, 886 P.2d at 559. (emphasis added).

Ex. 6, ¶ 38

40 – Because section 118.5 is intended to ensure timely payment of proceeds due to payees who are legally entitled to payment, and does not create in the Commission authority to adjudicate private disputes related to the legality of specific deductions, the Commission will not exercise jurisdiction over the Application. (emphasis added).

Ex. 6, ¶ 40

13. After the Commission entered its Order dismissing the royalty owners' application for lack of subject matter jurisdiction, the *Grynberg* operators sought judicial review of the Commission's Order that it had no subject matter jurisdiction over the royalty owners' claims against the *Grynberg* operators. *Grynberg*, 7 P.3d at 1062. The Denver District Court affirmed the Commission's Order. *Id.* The *Grynberg* operators appealed to the Colorado Court of Appeals, which affirmed the Denver District Court's judgment that the

Commission did not have subject matter jurisdiction over the royalty owners' royalty underpayment claims against the *Grynberg* operators. *Id.* at 1062-65. The Court of Appeals' holding and rationale clearly confirm that the Commission does not have subject matter jurisdiction over Applicants' royalty underpayment claims against Ursa in this case:

Section 34-60-118.5 does not create an entitlement to proceeds; it presumes the existence of such an entitlement and imposes deadlines for the payment to those legally entitled to receive payment. The statute demonstrates the General Assembly's intent to grant to the Commission jurisdiction only over actions for the timely payment of proceeds and not over disputes with respect to the legal entitlement to proceeds under the terms of a specific royalty agreement.

Moreover, the General Assembly clarified its intent to exclude contractual disputes from the Commission's jurisdiction when it amended § 34-60-118.5 in 1998. See Colo. Sess. Laws 1998, ch. 186 at 636. The amended provisions now provide that the Commission shall have jurisdiction, but not exclusive jurisdiction, only "[a]bsent a bona fide dispute over the interpretation of a contract for payment," § 34-60-118.5(5), C.R.S.1999...

Under this amendment, therefore, the Commission does not have jurisdiction to interpret any royalty agreement to determine the propriety of disputed post- production deductions.

The language of the amendment demonstrates the General Assembly's intent merely to clarify any ambiguity that may have existed in the former version of the statute. Indeed, the statute as originally enacted and the amendment both provide evidence of the General Assembly's intent to exclude the resolution of contractual disputes from the jurisdiction of the Commission.

The parties' real dispute here is not with respect to the timeliness of any payments under § 34-60-118.5. It relates, rather, to plaintiffs' liability for payments that would have been made, but for plaintiffs' deduction of certain post-production costs. Consequently, it is the extent of defendants' legal entitlement to further payments under the royalty agreement that is at issue. The Commission properly concluded that § 34-60-118.5 gave it no jurisdiction over that question.

Id. at 1063. (emphasis added). (See Ex. 5).

In further explaining the legal basis for its decision, the Court of Appeals emphasized that the Colorado Oil and Gas Conservation Act ("the Act") (C.R.S. § 34-60-118.5) reserves the determination of contractual disputes between royalty owners and producers for a district court:

Section 34-60-118.5 confers jurisdiction upon the Commission to calculate the amount of proceeds due a payee and to enforce the timely payment of those proceeds, but it leaves to the courts the authority to decide contractual disputes, such as a determination of a potential payee's legal entitlement to proceeds. These types of disputes may involve not only contractual interpretation, but the application of complex legal principles if, for example, a payor is claiming the right to deduct post-production costs. See *Garman v. Conoco, Inc.*, 886 P.2d 652 (Colo.1994); *Rogers v. Westerman Farm Co.*, 986 P.2d 967 (Colo. App.1998). Thus, by reserving the determination of contractual disputes for the courts, § 34- 60-118.5 promotes the state's legitimate interest in ensuring the proper and consistent resolution of complex legal questions.

Id. at 1064. (emphasis added). (See Ex. 5).

14. Thus, in *Grynberg*, the Court of Appeals determined that: (1) under the Act, the Commission does not have jurisdiction over disputes with respect to the legal entitlement to proceeds under the terms of a specific royalty agreement. *Id.* at 1063; (2) under the 1998 amendments to the Act, which added the words "[a]bsent a bona fide dispute over the interpretation of a contract for payment" to § 34-60-118.5(5), the Commission does not have jurisdiction to interpret any royalty agreement to determine the propriety of disputed post-production deductions. *Id.*; (3) the Commission properly concluded that § 34-60-118.5 does not give the Commission jurisdiction over disputes related to a royalty payee's "legal entitlement to further payments" under a royalty agreement. *Id.*; and (4) instead, § 34-60-118.5 leaves to the courts the authority to decide contractual disputes involving a royalty owner's "legal entitlement to proceeds." *Id.* at 1064. (Ex. 5). These determinations by the Court of Appeals are directly on point to the issue presented here, and confirm that the Commission has no jurisdiction over Applicants' claims against Ursa for royalty underpayments based upon improper deduction of post-production costs.

The Court of Appeals' decision in *Grynberg* has never been overruled, modified, or contradicted by any subsequent appellate court decision, and therefore constitutes binding precedent which the Commission must follow.

15. The appellate court decisions which have been issued since *Grynberg* was decided in 1999 have consistently confirmed its holding. In a decision issued two years ago, in which Antero was a party, *Grant Brothers Ranch, LLC v. Antero Resources Piceance Corporation*, No. 15CA2063, 2016 WL 7009138 (Colo. App. December 1, 2016), the Court of Appeals confirmed its holding in *Grynberg* that the Commission lacks jurisdiction to resolve a contractual dispute over whether oil and gas operators are entitled under a lease to deduct post-production expenses in computing royalties due to royalty owners. The Court of Appeals specifically stated that in *Grynberg* it had determined that the Commission "lacked jurisdiction to resolve a contractual dispute over whether operators were entitled under a lease to deduct post-production expenses in computing royalties due to (royalty) owners." *Id.* at *5. The Court of Appeals also held, in accordance with the *Grynberg* decision, that "the Act provides a remedy for claims for the payment of proceeds where the parties have no contract addressing the issue," *Id.*, in contrast to this case, where the parties do have contracts addressing the issue.

Moreover, in another decision issued last year, *Lindauer v. Williams Production RMT Company*, 381 P.3d 378 (Colo. App. 2016), the Court of Appeals stated, in accordance with *Grynberg*, that the Act:

... prescribes the timing of when royalty payments must be made, and the information that must be provided by the payer. It does not address the propriety of deduction of expenses. See *Grynberg v. Colo. Oil & Gas Comm'n*, 7 P.3d 1060, 1063 (Colo. App. 1999) (section 34-60-118.5 does not create an entitlement to proceeds; it presumes the existence of such an entitlement and imposes deadlines for the payment to those legally entitled to receive payment.) *Id.* at 386 (emphasis added).

Finally, the Tenth Circuit Court of Appeals, in a 2000 decision issued after *Grynberg* was decided, cited to *Grynberg* in holding that "a Colorado litigant alleging a breach of an oil and gas royalty agreement...must assert his claim in a court of law..." *Atlantic Richfield Co. v. Farm Credit Bank of Wichita*, 226 F.3d 1138, 1157 (10th Cir. 2000).

The decisions in *Grant Brothers*, *Lindauer*, and *Atlantic Richfield* confirm the holding in *Grynberg*, and also confirm that the Commission does not have jurisdiction over Applicants' claims against Ursa.

16. Critically, this Commission's recent decisions in the *Airport Land Partners, Ltd. v. Ursa* (171000694), *Richard N. Casey v. Ursa* (171200789), *Limbach v. Ursa* (171200790), *Shidleler Energy v. Ursa* (171200791), and *Shuster v. Ursa* (171200792) cases make clear that the Commission lacks jurisdiction to resolve the parties' dispute. Specifically, in those cases this Commission found that Ursa's dispute with its lessors over whether certain costs were

properly deducted, or whether payments were properly made, turned on issues of contract interpretation. As a result, this Commission ruled that it lacked jurisdiction to resolve the contract interpretation disputes presented.

17. Some of the leases in the foregoing cases included “no costs” provisions similar to the one at issue here, and the Commission held that the parties’ disputed interpretations of those provisions defeated jurisdiction in this forum.
18. Likewise, although some judges have issued orders dismissing royalty owners’ royalty underpayment claims against gas producers for failure to exhaust remedies with the Commission, other Colorado district court judges, in accordance with *Grynberg*, have reached the opposite result, and have ruled that royalty owners are not required to exhaust their administrative remedies with the Commission. In three recent Colorado district court decisions, the district court denied the oil and gas producers’ motions to dismiss the royalty owners’ post-production cost royalty underpayment claims for failure to exhaust administrative remedies with the Commission. Those decisions are attached hereto as **Exhibits 10, 11, and 12.**
19. As previously determined by the Commission and confirmed in *Grynberg*, the Commission’s jurisdiction extends to determining the date a royalty payment is due based on reported production dates, when there is no dispute regarding the amounts of royalties due and owing. The Act does not authorize the Commission to examine competing arguments regarding the propriety of various post-production cost deductions, even where the post-production cost deductions are expressly prohibited. The Commission has long held this type of contract analysis and interpretation exceeds the scope of Commission jurisdiction (Exs. 6 and 7), and the *Grynberg* decision affirms the Commission’s ruling. (Ex. 5).
20. Indeed, in the twenty years which have elapsed since the Commission entered its Order in November 1997 determining that it had no jurisdiction to resolve the *Grynberg* post-production cost contract dispute, the Commission has never issued any order which contradicts its jurisdictional determination in *Grynberg*, and has never accepted jurisdiction to decide a post-production cost royalty underpayment dispute between a royalty owner and a gas producer.
21. Notwithstanding Applicants’ jurisdictional position in connection with this Application, Applicants provided to Ursa advance notice pursuant to § 34-60-118.5 (7), C.R.S., a copy of which is attached as **Exhibits 13.**

WHEREFORE, for the foregoing reasons, Applicants request that the Commission enter its Order finding that the Commission does not have jurisdiction over Applicants' royalty underpayment claims against Ursa, and that such royalty underpayment claims should be determined in a district court lawsuit. Applicants also request that an expedited hearing on this issue be scheduled at the earliest possible date. If the Commission decides to exercise jurisdiction over Applicants' royalty underpayment claims against Ursa as set forth in Applicants' Complaint (Ex. 2), then Applicants will request the Commission to compel Ursa, and certain third parties to produce relevant documents and electronic data, sit for depositions, and to set the parties' dispute for a hearing. Applicants estimate that a hearing on the merits of this royalty underpayment claims would take approximately five full days.

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