

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

IN THE MATTER OF THE PAYMENT OF PROCEEDS)	CAUSE NO. 1
TO RICHARD N. CASEY FROM PRODUCTION OF OIL)	
AND GAS AS ESTABLISHED BY SECTION 34-60-118.5,)	DOCKET NO. 171200789
C.R.S., MAMM CREEK FIELD, WILLIAMS FORK)	
FORMATION, GARFIELD COUNTY, COLORADO)	TYPE: GENERAL
)	ADMINISTRATIVE
)	
)	ORDER NO. 1-206

REPORT OF THE COMMISSION

The Commission heard this matter on July 30, 2018, at the Colorado Oil and Gas Conservation Commission ("Commission" or "COGCC"), 1120 Lincoln Street, Suite 801, Denver, Colorado, upon application for a hearing on the Commission's jurisdiction over a payment of proceeds dispute between Richard N. Casey, as Applicant, and Antero Resources Corporation and Ursa Operating Company LLC, as Protestants.

FINDINGS

The Commission finds as follows:

1. Mr. Richard N. Casey ("Casey" or "Applicant"), as the applicant herein, is an interested party in the subject matter of the above-referenced hearing.
2. Antero Resources Corporation ("Antero") and Ursa Operating Company LLC (Operator No. 10447) ("Ursa") (collectively "Protestants"), as the protestants herein, are interested parties in the subject matter of the above-referenced hearing.
3. Due notice of time, place, and purpose of the hearing has been given in all respects as required by law.
4. As a threshold issue, the Commission is required by § 34-60-118.5(5.5), C.R.S. to first determine if it has jurisdiction over this matter. The Commission has authority to promulgate the hereinafter prescribed order pursuant to the Oil and Gas Conservation Act ("Act"), §34-60-101, *et seq.*

PROCEDURAL AND FACTUAL HISTORY

5. This matter is a payment of proceeds dispute. Casey claims that Antero and Ursa have not properly paid royalties due to Casey.
6. This matter did not begin in front of the Commission. Casey first filed a complaint alleging royalty underpayments in Garfield County District Court (17CV30071). Protestants filed a motion to dismiss for failure to exhaust administrative remedies, which the District Court granted without prejudice on August 17, 2017.
7. Casey's Application, filed on October 5, 2017, requests that the Commission enter an order finding that the Commission does not have jurisdiction over the instant dispute.

Protestants request that the Commission deny Casey's request and decide this issue on the merits.

8. On June 18, 2018, the Hearing Officer required the submission of Expanded Prehearing Statements ("EPS") from each party, in order to clarify the specific arguments, and the legal basis relied upon for same. Casey submitted his EPS on June 25, 2018, and the Protestants' Response was filed on July 2, 2018. No reply was authorized.

9. A Final Prehearing Conference ("Final PHC") was held at the Commission on July 16, 2018. All parties were present and represented by legal counsel.

10. Following the Final PHC, the Hearing Officer issued a Final Prehearing Order which, among other things, set forth stipulated facts, identified the disputed issue and provided the parties with 15 minutes each to argue the disputed issue.

11. The Stipulated Facts in the Final Prehearing Order identified a lease, the Casey Lease, between Casey and Antero as the applicable agreement in this matter. Stipulated Fact No. 5, Final Prehearing Order.

12. The parties also stipulated that Ursa is successor-in-interest to the Casey Lease. *Id.*, at Stipulated Fact No. 4.

13. The parties stipulated that the Casey Lease provides for payment of royalties based on the following provision:

Lessee shall pay royalties to Lessor...twenty percent (20%) of all gas and oil, including coal-bed methane gas, casinghead gas, hydrocarbons and other gas products or gaseous substances of whatever kind or nature, produced and saved from the Land, at the then prevailing market price for the product, whether or not such product is sold by Lessee and whether sold at the wellhead, in the pipeline or otherwise, free of production costs, gathering costs, dehydration costs, compression costs, manufacturing costs, processing and treating costs, marketing costs, transportation costs and free of any and all other costs, except taxes and conservation charges assessable to Lessor by law. Accrued royalties shall be paid not less often than quarterly. The market price as stated above shall be either the fair and reasonable value thereof at the place where sold or used or the selling price if sold under bona fide contracts of sale with third persons, third persons being defined as any person or entity, not a subsidiary or affiliate of Lessee, with whom Lessee deals at arms' length and with whom Lessee has no processing contract involving production from the Land or any other arrangement involving an exchange of production from the Land for other production, or any reciprocal allowance for discount on such production, or any reciprocal advantage, direct or indirect resulting from any contract or arrangement[.]

Id., at Stipulated Fact Nos. 5 and 6.

14. On July 18, 2018, the Hearing Officer issued a Recommendation recommending that the Commission dismiss Casey's Application without prejudice, for lack of jurisdiction.

APPLICABLE LAW

15. Generally, the Commission does not have the jurisdiction to interpret contracts. *Chase v. Colorado Oil and Gas Conservation Comm'n.*, 284 P.3d 161, 168 (Colo. App. 2012) (holding that the Act does not specifically provide the Commission has an express or implied power to interpret a lease, and that the Commission's determination that it lacked jurisdiction to interpret a lease was reasonable).

16. Section 34-60-118.5 of the Act defines the Commission's jurisdiction over disputes regarding the payment of royalties. The Commission has jurisdiction to decide: 1) the date upon which payment is due to a payee; 2) whether there is a justifiable delay in payment; and 3) the amount of proceeds due to a payee from a payor. §34-60-118.5(5)(a) – (c), C.R.S. However, before the Commission may decide any of the above three issues, it must “determine whether a bona fide dispute exists regarding the interpretation of a contract defining the rights and obligations of the payer and payee.” §34-60-118.5(5.5), C.R.S. “If the commission finds that such a dispute exists, the commission shall decline jurisdiction over the dispute and the parties may seek resolution of the matter in district court.” *Id.*

17. The Commission has discretion to interpret the Act. See *Colorado State Personnel Bd. v. Department of Corr.*, 988 P.2d 1147, 1151 (Colo.1999) (deference is given to an agency's reasonable interpretation of its statute when it “lighten[s] the agency's workload and mak[es] its decision-making process more efficient” as long as it is consistent with the intent and purpose of the statute).

18. The interpretation of a contract is a question of law. *Fed. Deposit Ins. Corp. v. Fisher*, 292 P.3d 934, 937 (Colo. 2013). The primary goal in contract interpretation is to ascertain and implement the intent of the parties. *Id.* Black's Law Dictionary defines interpretation as “the ascertainment of a text's meaning; specif., the determination of how a text most fittingly applies to particular facts.” *Black's Law Dictionary* (10th ed. 2014).

19. Under Section 118.5(5.5), the Commission must not only determine if a dispute regarding the interpretation of a contract exists, the Commission must also decide if the dispute is “bona fide.” *Black's Law Dictionary* (10th ed. 2014), defines “bona fide” as follows: “In or with good faith; honestly, openly, and sincerely; without deceit or fraud. . . . Real, actual, genuine, and not feigned.”

20. The Commission does not have jurisdiction to decide whether a royalty owner is entitled to payment under a lease or other contract. *Grynberg v. Colorado Oil & Gas Conservation Comm'n*, 7 P.3d 1060 at 1063 (Colo. App. 1999) held:

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.

21. The legislature removed disputes that require the interpretation of a contract from the Commission's jurisdiction in order to preserve the state's interest in consistent resolution of complex legal questions. In *Grynberg*, the Court of Appeals discussed purpose of Section 118.5:

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. 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.

7 P.3d at 1064.

22. The Commission has jurisdiction to decide if and when payment is due where there is no contract between the parties. In *Grant Brothers Ranch, LLC v. Antero Resources Piceance Corporation, et al.*, the Colorado Court of Appeals found that the Commission had jurisdiction over a royalty payment dispute because, as the plaintiff had been statutorily pooled, there was no contract between the parties to interpret. 409 P.3d 637 (Colo. App. 2016). In reaching its conclusion, the Court found that the Commission has “primary jurisdiction over disputes for the payment of proceeds such as the one before us.” *Id.* at 644.

23. The Colorado Supreme Court has defined “marketability” for purposes of calculating royalties when a lease is silent and held that the determination of whether gas is marketable is a question of fact. In *Garman v. Conoco, Inc.*, the Colorado Supreme Court ruled that the implied covenant of marketability is included in every oil and gas lease. 886 P.2d 652 (Colo. 1994). When a lease is silent as to the deduction of costs from a royalty, the implied covenant of marketability requires “the lessee to incur those post-production costs necessary to place gas in a condition acceptable for market.” *Id.* at 659.

24. In *Rogers v. Westerman Farm Co.*, the Colorado Supreme Court defined “marketability”:

In sum, in defining marketability under the implied covenant to market, we look to the first-marketable product rule for guidance. Gas is marketable when it is in the physical condition such that it is acceptable to be bought and sold in a commercial marketplace, and in the location of a commercial marketplace, such that it is commercially saleable in the oil and gas marketplace. The determination of whether gas is marketable is a question of fact, to be resolved by a fact finder.

29 P.3d 887, 904 (Colo. 2001)

SUMMARY OF THE PARTIES' POSITIONS

25. Casey asserts the following allegations in his EPS: 1) the Protestants failed to pay royalties based upon the prices received for the then prevailing market prices for residue gas, and five natural gas liquid products; 2) as to the condensate, Casey appears to argue that the Protestants breached the lease by failing to pay royalties on same, and instead have transferred the condensate to outside parties who perform the gathering and processing; and 3) the Protestants improperly made excessive severance and ad valorem tax deductions. See Casey EPS, at 1, ¶¶ 1-2; at 2, ¶¶ 4-5.

26. As support for these assertions, Casey states that the above-quoted section of the Lease is controlling. *Id.* at 3, ¶¶ 1-2. See ¶ 13, *supra*. Casey relies on the Protestants' written response to his notice of failure to make timely payments, which response stated the royalties were calculated on the fair and reasonable value of the hydrocarbons where they were sold or used. *Id.* at 4, ¶ 3. Finally, Casey asserts that the excessive taxes withheld were in violation of C.R.S. §§ 39-7-102 and 39-29-111(1)(a). *Id.* at 4, ¶ 4.

The Protestants argue that Casey failed to identify a contractual dispute, and instead has raised an allegation that the Protestants have failed to comply with the terms of the Lease by not paying royalties based on market price. *Id.* at 2, ¶¶ 2-3. According to the Protestants, "[m]arket price is a defined contract term[,] [t]herefore, it is a factual question within the Commission's jurisdiction as to what the prevailing market price is in this case." *Id.*, ¶ 4. "In summary, Applicant does not point to any terms in the 2005 Lease that it claims raises a "bona fide dispute...regarding the interpretation of a contract." *Id.*, ¶ 7.

HEARING

27. On July 30, 2018, the Commission heard oral argument on the Commission's jurisdiction over this matter.

28. The parties agreed that, in the interests of time, all arguments made in Docket No. 171200788 would be treated as though they were made in full in this matter.

29. Prior to the argument in Docket No. 171200788, Commissioner Jolley disclosed that he had previously been a plaintiff in two royalty payment suits against operators. He stated that those lawsuits had been resolved and that the Protestants were not parties to those lawsuits. Commissioner Jolley stated that he could be impartial and that he intended to participate in these matters. No Commissioner, party, or member of the public objected to Commissioner Jolley's participation in Docket No. 171200789.

30. Casey argued that under Paragraph 3 of the Casey Lease, royalties for the sale of gas must be paid on the market price, and free of all costs. Paragraph 3 also defined "market price" as the fair and reasonable value, or the selling price if sold under bona fide contracts of sale with third persons. Paragraph 3 also defined third persons. Casey's position as stated at hearing is that no costs may be deducted from royalty payments and the royalty must be based on the market price for all gas products.

31. Casey summarized the Protestant's position based on statements made in response to Casey's demand for payment. Casey alleged the Protestant's position is that they have paid on fair and reasonable value of the gas at the place where sold or used, and that the Casey Lease allows for limited deductions for processing and transportation taken after gas was marketable and for purposes otherwise permissible under the lease. Casey cited to Bates Nos. 231-232.

32. Protestants argued that the "market price" is a factual issue based on a contract term that is clear. Protestants further argued that Casey is not disputing the meaning of any of the terms of the Casey Lease, but Casey is only disputing how the language of the Casey Lease applies to the facts.

33. Casey responded that their position is that the specific terms of the Casey Lease, such as the no cost provisions, must control over the more general "fair and reasonable"

language. Casey also argued that Paragraph 3 provides that no costs may be deducted until the gas is at the market, and the term "market" is undefined in the Casey Lease. Casey further argued that no matter what price is used, no costs may be deducted under Paragraph 3.

34. Co-Vice Chair Boigon asked the parties about the definition of market price in the Casey Lease. The Casey Lease provides that "[t]he market price as state above shall be either the fair and reasonable value thereof at the place where sold or used or the selling price if sold under bona fide contracts of sale with third persons,..." Paragraph 3 of the Casey Lease. Co-Vice Chair Boigon asked which of these prices were to be used since the Lease does not appear to provide for a way to decide between the two. Protestants responded that if there was a sale to a third party, then that is the price that must be used under the Casey Lease.

35. Chairman Benton asked Casey if there was an issue with the gas sale contract under which Protestants sold gas. Casey's counsel responded that there was an issue as the gas sale contract transfers gas from Protestants to the purchaser without any payment for that gas. Casey argued that this transfer without payment was a cost that was not permitted under the lease.

36. The parties agreed that Paragraph 3 of the Casey Lease was applicable and controlled the issue of royalty payments.

37. Upon inquiries from the Commission in Docket No. 171200788, counsel for Airport stated that, in order prove the point of marketability, Airport would need to put on its own witnesses for factual testimony, as well as expert witnesses on the location of the commercial market, the method of marketing natural gas, when NGLs are first marketable, and accounting practices. Protestants stated that the presentation would be less complex, and would only require an expert on marketability, an accountant to explain accounting practices, and lay witness to explain how payments were actually made.

38. Upon inquiries from the Commission in Docket No. 171200788, counsel for Airport asserted that discovery would be necessary, could take up to a year, and would involve thousands of pages of documents. Protestants claimed that discovery would be much less involved.

39. The Commission closed the record and deliberated.

COMMISSION DELIBERATIONS

40. The Commissioners applied their comments from Docket No. 171200788 to this matter.

41. In Docket No. 171200788, Co-Vice Chair Boigon stated that this matter was a highly contested case that was likely to involve significant discovery and that the Commission does not have the expertise, process, or resources to be immersed in these type of royalty disputes.

42. In Docket No. 171200788, Commissioner Hawkins stated that he would be hard-pressed to provide the Commission with expertise in the midstream issues raised in this case.

43. In Docket No. 171200788, Co-Vice Chair Holton stated that this matter was too complex for the Commission to resolve.

44. Following deliberations, the Commission voted unanimously to dismiss Casey's Application for lack of jurisdiction.

COMMISSION CONCLUSIONS

45. Based on the statements and descriptions of the dispute from the parties at hearing, the Commission finds that the parties have a bona fide dispute regarding the interpretation of Paragraph 3 of the Casey Lease. Specifically, it appears that Casey believes the language of Paragraph 3 prohibits all deductions of costs, no matter what price is used to calculate the royalty. Protestants, on the other hand, appear to take the position that costs may be deducted if the royalty is calculated based on the sale price for a sale to a third party.

46. Further, Applicants allege that the Protestants are transferring gas to a third party in exchange for services, rather than selling the gas. Applicants allege this is a cost that is prohibited under the Casey Lease. Protestants appear to allege that if they are paying on the sale price, then they have complied with the Lease.

47. Finally, the Commission finds that the Casey Lease is ambiguous as to which price, the fair and reasonable price, or the sale price to a third party, should apply. Paragraph 3 of the Casey Lease only provides that either may apply.

48. The Commission thus concludes that there is a bona fide dispute regarding the interpretation of a contract. Specifically, Casey claims that no costs may be deducted under Paragraph 3, while Protestants claim that as long as the royalty is paid based on the sale price, costs may be deducted. To resolve this dispute, the Commission would be required to interpret the Casey Lease and decide if the no cost provisions controlled over the requirement that the royalty be paid based on the market price for the gas. Accordingly, a bona fide contract dispute exists, and the Commission must decline jurisdiction pursuant to C.R.S. 34-60-118.5(5.5).

49. Further, the Commission concludes that the legislature did not intend for the Commission to have jurisdiction over royalty disputes where the rights and obligations of the parties are determined by a contract, particularly where resolving the dispute would involve the application and interpretation of complex legal principals. "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. 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." *Grynberg*, 7 P.3d at 1063.

50. The purpose of Section 118.5 was to provide royalty owners with a simple and easy process to obtain payment when an operator delays payment. See Commission Order No. 1-73 ("[Section 118.5] is intended to prevent unscrupulous operators from delaying the payment of proceeds and wrongfully withholding or using funds that are attributable to a Payee's interest.") (Citing testimony by Representative Jerkey on House Bill 1113 before the House Agricultural Committee, January 25, 1989).

51. Section 118.5 originally provided that the Commission had "exclusive" jurisdiction over payment of proceeds, but was amended in 1998 to remove the word "exclusive"

and clarify the Commission's jurisdiction. "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,'" *Grynberg*, 7 P.3d at 1063. "Indeed, 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." *Id.* (emphasis supplied). The Commission thus does not have exclusive or primary jurisdiction over this dispute. *Grant Bros.* only holds that the Commission has primary jurisdiction over royalty disputes where there is no contract between the parties.

52. The Commission's jurisdiction over payment of proceeds disputes is narrow. The Commission only has jurisdiction to make three types of decisions: 1) the date upon which payment is due to a payee; 2) whether there is a justifiable delay in payment; and 3) the amount of proceeds due to a payee from a payor. §34-60-118.5(5)(a) – (c), C.R.S. The Commission interprets these three decisions to be only related to calculation of a royalty amount, and not to include a determination of how the royalty amount is to be calculated.

53. Further, Protestants admitted at hearing that their interpretation of the Commission's jurisdiction could lead to a situation where a court would submit factual questions on royalty disputes to the Commission, while the court retained decision-making authority over legal issues or issues of contract interpretation. The Commission concludes the legislature did not intend for Section 118.5 to result in such a complex procedure. As stated above, the purpose of Section 118.5 is to provide royalty owners with a simple process to obtain payment.

54. The Commission finds that resolving this matter would require significant discovery and hearing time and concludes that the Commission does not have the process or resources to conduct such complex and involved royalty disputes. The Commission meets approximately eight times a year, and meetings have historically lasted for one or two days. Seven of the nine Commissioners are volunteers and the other two are the Executive Directors of the Colorado Department of Natural Resources and Colorado Department of Public Health and Environment. §34-60-104(2)(a)(I), C.R.S.

55. The Commission further finds it does not have the expertise necessary to resolve this dispute. The Act does not require that any of the Commissioners have a legal background, or have a background in midstream operations. The Commission's expertise is in the technical and scientific aspects of the production of oil and gas. While three members of the Commission are required to have "substantial experience in the oil and gas industry," two of those Commissioner must have a "college degree in petroleum geology or petroleum engineering." *Id.* Further, only one Commissioner is required to be a royalty owner, and that Commissioner must also be involved in agriculture. *Id.*

ORDER

IT IS HEREBY ORDERED:

1. Casey's Amended Application is DISMISSED WITHOUT PREJUDICE as the Commission lacks jurisdiction to hear the dispute.

2. The Commission also hereby ADOPTS the Hearing Officer's Recommendation.

IT IS FURTHER ORDERED:

1. The provisions contained in the above order shall become effective immediately.
2. The Commission expressly reserves its right, after notice and hearing, to alter, amend or repeal any and/or all of the above orders.
3. Under the State Administrative Procedure Act the Commission considers this Order to be final agency action for purposes of judicial review within 35 days after the date this Order is mailed by the Commission.
4. An application for reconsideration by the Commission of this Order is not required prior to the filing for judicial review.

ENTERED this 29th day of August, 2018, as of July 30, 2018.

OIL AND GAS CONSERVATION COMMISSION
OF THE STATE OF COLORADO


By 
Julie Spence Prine, Secretary

CERTIFICATE OF SERVICE

On August 29, 2018, a true and correct copy of the foregoing was sent by electronic mail to the following:

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