

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

IN THE MATTER OF THE PAYMENT OF PROCEEDS) CAUSE NO. 1
TO AIRPORT LAND PARTNERS, LTD. FROM)
PRODUCTION OF OIL AND GAS AS ESTABLISHED BY) DOCKET NO. 171200788
SECTION 34-60-118.5, C.R.S., MAMM CREEK FIELD,)
WILLIAMS FORK FORMATION, GARFIELD COUNTY,) TYPE: GENERAL
COLORADO) ADMINISTRATIVE
)
) ORDER NO. 1-205
) CORRECTED

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 Airport Land Partners, as Applicant, and Antero Resources Corporation and Ursa Operating Company LLC, as Protestants.

FINDINGS

The Commission finds as follows:

1. Airport Land Partners ("Airport" 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. Airport claims that Protestants have not properly paid royalties to Airport.
6. This matter did not begin in front of the Commission. Airport first filed a complaint alleging royalty underpayments in Garfield County District Court (16CV30259). Protestants filed a motion to dismiss for failure to exhaust administrative remedies, which the District Court granted without prejudice on July 31, 2017.

7. Airport's Amended Application, filed on April 2, 2018, 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 Airport's request and decide this matter 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 bases relied upon for same. Airport submitted its 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 1994 Lease Agreement, an amendment thereto, and a 2007 Overriding Royalty Agreement as the applicable agreements in this matter. See Stipulated Fact No. 6, Final Prehearing Order.

12. The parties also stipulated that Ursa is successor-in-interest to the 1994 Lease Agreement, the amendment thereto, and the 2007 Overriding Royalty Agreement ("Airport Agreements"). *Id.*

13. The parties stipulated that the Airport Agreements provide for payment of royalties based on the following royalty clause:

[t]o pay lessor one-eighth (1/8) of the gross proceeds each year, payable quarterly, for the gas from each well where gas only is found, while the same is being used off the premises, and if used in the manufacture of gasoline a royalty of one-eighth (1/8), payable monthly at the prevailing market rate for gas.

Id., at Stipulated Fact No. 7.

14. The parties stipulated the first paragraph of the Addendum to the 1994 Lease Agreement states that "[a]nything to the contrary notwithstanding, Paragraph 3 of the printed form regarding the one-eighth royalty paid shall be amended to read a 15.00% royalty in lieu of the one-eighth royalty." Stipulated Fact No. 8, Final Prehearing Order.

15. The parties stipulated the 2007 Overriding Royalty Agreement states that the royalties payable "shall be calculated and paid in the same manner as the landowner's royalty in each Lease on which the [Overriding Royalty Interest] burden is calculated and paid, and as part of that calculation, the [Overriding Royalty Interest] shall bear the same costs and expenses that are borne by the landowner's royalty pursuant to the terms of each applicable Lease." Stipulated Fact No. 9, Final Prehearing Order.

16. On July 17, 2018, the Hearing Officer issued a Recommendation recommending that the Commission dismiss Airport's Amended Application without prejudice for lack of jurisdiction.

APPLICABLE LAW

17. 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).

18. 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.*

19. 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).

20. 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).

21. 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."

22. 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.

23. 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.

24. 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.

25. 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.

26. 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

27. In its EPS, Airport alleges the following: 1) the Protestants failed to pay royalties based upon the prices received for marketable residue gas, natural gas liquid products, and marketable condensate; 2) the Protestants improperly deducted post-production costs incurred in order to place the residue gas and natural gas liquid products into marketable condition; and 3) the Protestants improperly made excessive severance and ad valorem tax deductions. See Airport EPS, at 1, ¶¶ 1-3; at 2, ¶¶ 4-5.

28. As support for these allegations, Airport states that the above-quoted sections of the Lease and Assignment are applicable. *Id.* at 2, ¶¶ 1-2; *see also* Paragraphs 13-15, *supra*. Airport further argues that because these two documents do not contain express provisions regarding the allocation of post-production costs, the implied covenant to market applies, which requires the Protestants to bear all costs necessary to place the raw gas in a marketable condition pursuant to *Rogers*, 29 P.3d 887. *Id.* at 3, ¶ 3. Airport further relies on *Crichton v. Augustus Energy Resources, LLC*, 2017WL4838735 (D. Colo. Oct. 2017) for the proposition that in order for the Commission to determine marketability in this case, it would require an interpretation of the Protestant's obligations under the governing documents to calculate and pay royalties consistent with the implied covenant to market. *Id.* Finally, Airport asserts that the excessive taxes withheld were in violation of C.R.S. §§ 39-7-102 and 39-29-111(1)(a). *Id.*, ¶ 4.

29. In their Response, Protestants assert that under *Rogers*, the "point of marketability" is a question of fact. *See* Response at 1, ¶ 4. According to the Protestants, the "point of marketability" is a factual determination with which the Colorado legislature has tasked the Commission the duty to decide. *Id.* at 2, ¶ 1. The Protestants state that *Augustus Energy Resources* misstates the test set out in Section 118.5(5.5), because in order for the Commission to decline jurisdiction, it must find the existence of a bona fide contractual dispute over the interpretation of a contract for payment, not just any case that "arises out of" a contract or contractual term. *Id.*, ¶ 5. The Commission clearly has jurisdiction here, the Protestants assert, as "there is no dispute over the meaning of the words in [the] Lease, [therefore] there is no bona fide dispute over the interpretation of a contract[.]" *Id.* at 3, ¶ 1.

HEARING

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

31. Prior to the argument, Commissioner Jolley disclosed that he had previously been a plaintiff in two royalty payment suits. He stated that those lawsuits had been resolved and that 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.

32. Airport summarized its position, arguing that for residue gas, the location of the first commercial market is the delivery point to long-distance transportation pipelines where the Protestants sold the residue gas to third-party purchasers. For the natural gas liquids ("NGLs"), the location of the first commercial market is where the NGLs were fractionated and sold to third-party purchasers for prices based on market index prices.

33. Airport also summarized the Protestants' position based on the Protestants' response to Airport's demand for payment. Airport argued Protestants took the position that the royalties were based on the fair and reasonable value of the residue gas or NGLs at the place where sold or used, and that the value of the gas was calculated based on the sale of gas pursuant to a gas purchase contract. *See* Commission Portfolio, Bates Nos. 1075-76. Airport also argued that Protestants took the position that the point of first marketability is at the wellhead or the inlet of the first processing facility, known as the Meeker Plant. *See* Bates No. 1075. Finally, Airport argued that the Protestants were improperly deducting the fee they paid to reserve space in interstate pipelines, and that the Protestants claimed this deduction was allowed.

34. Protestants argued consistent with their Response, as summarized above.

35. The parties agreed the Airport Agreements were silent on the issue of what costs may be deducted from royalty payments. The parties also agreed that the implied covenant of marketability applied.

36. Upon inquiries from the Commission, Airport stated that, in order to prove the point of marketability, Airport would need to put on its own witnesses for factual testimony, as well as expert witnesses to testify to 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.

37. Upon inquiries from the Commission, Airport asserted that discovery in this matter 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.

38. The Commission closed the record and deliberated.

COMMISSION DELIBERATIONS

39. Co-Vice Chair Boigon commented that this matter was a highly contested case 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.

40. Commissioner Hawkins stated that he would be hard-pressed to provide the Commission with expertise in the midstream issues raised in this case.

41. Co-Vice Chair Holton stated that this matter was too complex for the Commission to resolve.

42. Chairman Benton stated that he required explanations from counsel to the Commission to understand the import of the Colorado Supreme Court decisions in *Rogers* and *Garman*.

43. Following deliberations, the Commission voted **unanimously 6-1** to dismiss the Airport Amended Application due to lack of jurisdiction. **Chairman Benton was the lone nay vote.**

COMMISSION CONCLUSIONS

44. 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 over the location of a commercial marketplace for produced gas.

45. The parties agree that the Airport Agreements are silent as to the deduction of costs, and that the implied covenant of marketability applies. *Garman* and *Rogers* make the implied covenant of marketability and the definition of marketability terms in the Airport Agreements. Resolution of this dispute would require the Commission to interpret these decisions in order to define these agreement terms. These opinions leave terms like "commercial marketplace" and "commercially saleable" undefined, and require legal analysis.

46. The Commission further concludes the rationale of the court in *Crichton* persuasive. “Although the point of marketability is a question of fact pursuant to *Rogers*, this dispute is contractual in nature. . . . Although *Rogers* held that marketability is a question of fact, the factual inquiry regarding when a gas product became ‘marketable’ is fundamentally an interpretation of an undefined contractual term affecting each party’s obligations under the disputed lease agreement. Because the COGCC may not resolve bona fide disputes regarding contract interpretation pursuant to Colo. Rev. Stat. § 34–60–118.5(5.5), and this dispute arises out of an undefined contractual term, the Court concludes that the COGCC lacked jurisdiction over the claim[.]” *Crichton* at pp. 3-4.

47. Here, there is no dispute that contracts between these parties exist. Further, there is no dispute that these contracts are silent with respect to the allocation of post-production costs. Because the contracts are silent, and the parties disagree over the point at which the various forms of gases became marketable, the Commission would be forced to interpret an undefined contractual term affecting the parties’ rights and obligations under the Airport Agreements. Accordingly, a bona fide contract dispute exists, and the Commission must decline jurisdiction pursuant to Section 118.5(5.5). (“If the commission finds that [a bona fide dispute regarding the interpretation of a contract defining the rights and obligations of the payer and payee] exists, the commission shall decline jurisdiction over the dispute and the parties may seek resolution of the matter in district court.”) (emphasis supplied).

48. The Commission also concludes that the applicability of *Rogers* to a question of Commission jurisdiction is not certain. While the Commission recognizes that the Colorado Supreme Court has held that marketability is a question of fact in *Rogers*, the Commission’s jurisdiction over payment of proceeds disputes as set forth in Section 118.5 was not at issue in *Rogers*.

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 to 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 Department of Natural Resources and 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. Airport's Amended Application is DISMISSED WITHOUT PREJUDICE as the Commission lacks jurisdiction to hear the dispute.

2. The Commission 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.

CORRECTED this 4th day of September, 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 September 5, 2018, a true and correct copy of the foregoing was sent by electronic mail to the following:

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