BEFORE THE OIL AND GAS CONSERVATION COMMISSION
STATE OF IDAHO

In the Matter of Application of AM Idaho, LLC, for Spacing Order and Integration of Unleased Mineral Interest Owners in the SW ¼ Section 10, Township 8 North, Range 5 West, Boise Meridian, Payette County, Idaho AM Idaho, LLC, Applicant.	Docket No. CC-2019-OGR-01-002 **OPENING BRIEF OF AM IDAHO, LLC, APPLICANT**

Applicant AM Idaho, LLC ("AMI"), submits its *Opening Brief* pursuant to the *Order Vacating Hearing*, *Order Setting Hearing to Determine "Just and Reasonable" Factors*, *and Notice of Hearing and Setting Filing Deadlines*, issued July 10, 2019, by the Administrator.

I. ARGUMENT

A. The purposes of Idaho's Oil and Gas Conservation Act.

The stated purpose of the Idaho Oil and Gas Conservation Act (the "Act") is "to foster, encourage and promote the development, production and utilization of natural resources of oil and gas in the State of Idaho in such a manner as will prevent waste[.]". I.C. § 47-311. The Act provides for regulation of "the operations and development of oil and gas properties in such a manner that a greater ultimate recovery of oil and gas may obtained and that the correlative rights of all owners be fully protected[.]". *Id.* "Correlative rights" mean "the opportunity of each owner in a pool to produce his just and equitable share of oil and gas in a pool without waste." I.C. § 47-310(4). All of this is to the end "that the greatest possible economic recovery of oil and gas may be obtained within the state to the end that the land owners, the royalty owners, the

producers and the general public may realize and enjoy the greatest possible good from these vital natural resources." I.C. § 47-311.

Pursuant to this policy, voluntary integration of tracts or interests in a spacing unit is encouraged, but in the absence of an agreement and satisfaction of the conditions for integration, the Idaho Department of Lands is mandated to order "upon the application of any owner in [a] proposed spacing unit, [the Department of Lands] shall order integration of all tracts or interests in the spacing unit for drilling of a well or wells, development and operation thereof and for the sharing of production therefrom." I.C. § 47-320. Such orders must be issued on terms and conditions that are "just and reasonable." *Id.* What is "just and reasonable" must be viewed within the purposes of the Act, i.e., to encourage and promote development, prevent waste, and protect correlative rights.

B. AMI seeks integration on just and reasonable terms.

AMI seeks integration on just and reasonable terms because its request complies with Idaho law, furthers Idaho's policy of encouraging development of oil and gas resources, prevents waste, and protects the correlative rights of mineral interest owners within the spacing unit.

1. *AMI bases its request for integration on terms that are largely prescribed by Idaho Code.*

AMI seeks integration upon terms that are endorsed by Idaho Code. First, operators must obtain consent from at least 55% of mineral interest acres in a spacing unit. I.C. § 47-320(6)(a). AMI has exceeded this requirement and obtained consent from 65.1375% of the mineral interest acres in the spacing unit. *See Application of AM Idaho, LLC.* This demonstrates that a large majority of the mineral interest in the proposed spacing unit desire development of their minerals, and integration is necessary to protect their correlative rights.

AMI's application provides for uncommitted mineral interest owners to timely elect from statutorily enumerated options regarding leasing or participating in a well on a consenting or nonconsenting basis. I.C. § 47-320(3). The options contained in the integration application are the same as set out in Idaho Code: interest owners can elect to participate as a working interest owner, be a nonconsenting working interest owner, lease, or be deemed leased. *See Application of AM Idaho, LLC;* I.C. § 47-320(a)-(d).

Idaho Code § 47-320 provides for owners who elect to become working interest owners or nonconsenting working interest owners to enter into a joint operating agreement ("JOA") with the operator; it also requires the applicant to submit a proposed form of JOA. AMI has submitted a proposed form of JOA as part of its application. AMI modified the form of JOA currently used with its working interest partners (with a 500% risk penalty) in order to reflect the maximum risk penalty for nonconsenting owners of 300% allowed by I.C. § 47-320(b). Appropriate justifications for this risk penalty have been provided in AMI's application for integration and accompanying materials. *See Declaration of Wade More III,* p. 3, paragraph 7. Such justifications include that AMI is bearing all expenses necessary for the production of the spacing unit; this penalty is the same penalty provided for in agreements between AMI and its operating partners; the well here is a "wildcat" well, resulting in a higher financial risk to AMI; various technical complexities are at issue; and the location of the well is in an area lacking developed infrastructure. *See Application of AM Idaho, LLC.* This results in a higher cost borne by AMI, providing confirmation of the imposition of the highest risk penalty for nonconsenting owners allowed by Idaho Code § 47-320(b). Because AMI's operations will not involve

horizontal wells, provisions relating to horizontal wells have been deleted from the proposed form of JOA.

Further, uncommitted owners in the spacing unit will receive lease terms and conditions regarding royalty that are no less favorable than those set out by Idaho Code § 47-331(2). *See Declaration of Wade More III,* p. 3, paragraph 6(c). In this matter, the royalty is set by statute for those deemed leased at ⅛, and at "no less than one-eighth (⅛)" for those electing to lease, and the bonus payment to be made is "the highest bonus payment per acre that the operator paid to another owner in the spacing unit prior to the filing of the integration application." I.C. § 47-320(3). AMI's application substantiates that the vast majority of private voluntary leases in the area include a ⅛ royalty. This includes leases of state and federal minerals. This is appropriate given the high-risk, limited-infrastructure nature of the area being explored. AMI appropriately requests a ⅛ royalty and a bonus amount of one hundred dollars ($100.00) per net mineral acre (or $50.00 for tracts that are an acre or less) for its form of lease to be used with those electing to lease or be deemed leased. *See Application of AM Idaho.* The primary term of the proposed form of lease, three years, is both consistent with (or less than) the lease term included in hundreds of voluntary leases taken in the area, including existing state and federal oil and gas leases.

With respect to operations, AMI has not requested variances in the development of this proposed spacing unit. Operations are and will continue to be in compliance with Idaho Administrative Code § 20.07.02. Setbacks properly match the requirements of Idaho Code § 47-319. Upon commencement of production of the well, AMI will submit appropriate production

reports, meter oil and gas, and submit an oil/gas ratio report, as required by Idaho Administrative Code. *See* Idaho Admin. Code §§ 20.07.02.400-.406.

2. *AMI proposes industry standard forms developed for nationwide use.*

The American Association of Professional Landman ("A.A.P.L.") provides form agreements developed for use nationwide in the oil and gas industry. *See* https://www.landman.org. The A.A.P.L. Model Form 610 Joint Operating Agreement has been in use in the oil and gas industry in one form or another since 1956 and various versions of this form continue to be widely used. *See* John R. Reeves and J. Matthew Thompson, *The Development of the Model Form Operating Agreement: An Interpretative Accounting*, 54 Okla. L. Rev. 211, 213 (2001). In fact, descendants of the original form are now the most popular JOA forms in use. *See* Christopher S. Kulander, *Old Faves and New Raves: How Case Law Has Affected Form Joint Operating Agreements - Problems and Solutions (Part One)*, 1 Oil & Gas, Nat. Resources & Energy J. 1 (2015) (citing to Gary B. Conine, *Property Provisions of the Operating Agreement -- Interpretation, Validity and Enforceability,* 19 Tex. Tech L. Rev. 1263, 1273-74 (1988)). Model form joint operating agreements, including Form 610, simplify negotiations, standardize technical terms and provisions, and obtain consistency in legal interpretations. *See* Conine, 19 Tex. Tech L. Rev. at 1273. As a result of the use of model form joint operating agreements, "judicial and academic concepts developed in the context of one JOA or one dispute are increasingly viewed as generally applicable to all JOAs." Ernest Smith, *The Future of Oil and Gas Jurisprudence, Joint Operating Agreement Jurisprudence*, 33 Washburn L.J. 834, 835 (1994).

AMI regularly uses industry standard forms for proposed spacing units and integration orders (i.e., A.A.P.L Form 610 and a version of Producers 88 Oil, Gas and Mineral Lease, or "Producers 88"). AMI submitted a proposed form of JOA based on A.A.P.L. Form 610, and a proposed lease that is a variant of a Producers 88 lease. As discussed above, the substance of both the form JOA and form lease have been modified to comply with the relevant provisions of Idaho Code (i.e., to comply with the setback requirements of Idaho Code § 47-319 or the risk penalty limitations of § 47-320(b)). Both agreements have been previously approved by the Idaho Department of Lands in the issuance of multiple integration orders. Both documents have been regularly agreed to by working interest partners and hundreds of voluntary lessors throughout southwest Idaho.

Neither the proposed form of JOA nor the proposed form of lease contain any extraordinary terms not regularly endorsed by the oil and gas industry in general. Moreover, AMI's proposed JOA is in the same form as is used between AMI and its own working interest partners. In other words, the mineral interest owners in the proposed spacing unit will be on equal footing with the working interest, should they choose to participate in the well.

3. *Courts in other jurisdictions have relied on industry standards to determine the scope of "just and reasonable" terms and conditions of an integration order.*

Courts do not appear to have widely addressed the issue of defining factors of a "just and reasonable" analysis for integration or pooling orders. However, there are decisions from other states that provide helpful insight.

The Utah Supreme Court, in *J.P. Furlong Company v. Board of Oil, Gas and Mining*, upheld an agreement in form similar to the industry standard joint operating agreement (Form

610 from the A.A.P.L.) as "just and reasonable." 424 P.3d 858 (Utah 2018). Furlong, one of the three holdout working interest owners, agreed to participate in the costs of a well but refused to sign the joint operating agreement. *Id.,* at 860. Furlong desired the following changes to the joint operating agreement: (1) that it not be publicly available or recorded; (2) that the operator be responsible for accounting for any future burdens; (3) that the operator accept broader liabilities for breach of contract than what is industry standard; (4) that the operator require written pre-authorizations from all non-operators for any excess expenditures; (5) that cash-call provisions be changed to expedite payment; (6) that the statute of limitations be extended for certain contract claims; and (7) that the bid process for affiliated companies be more rigorous than industry standards. *Id.,* at 860-862. The operator did not agree to the requested changes and asked the Utah Board of Oil, Gas and Mining (the "Board") to issue a forced pooling order. *Id.,* at 860. The Board adopted the joint operating agreement as written, because it was in "materially the same form as the [joint operating agreement] signed by the other participating working interest owners," and it was also "materially identical" to joint operating agreements the operator had used for the preceding seven years. *Id*. The Board found the terms of the operator's joint operating agreement to be "just and reasonable," explaining that:

> The [American Association of Professional Landmen] model-form-based JOA proposed by [the operator] is similar to other [joint operating agreements] previously adopted by this Board in prior compulsory pooling matters. The Board also notes that [joint operating agreement] terms materially the same as those proposed by [the operator] in this matter have been agreed upon and are presently in effect between other consenting owners within the subject drilling unit. Although [joint operating agreements] substantially similar to this form of operating agreement were previously deemed just and reasonable in prior matters, the Board analyzed the JOA proposed by [the operator] anew for purposes of making its determination in the present case. The Board's analysis included consideration of testimony given by the parties' witnesses regarding Furlong's proposed edits and amendments to certain provisions of the JOA as proposed by [the operator]. While legitimate disagreement can exist about the provisions at

> issue, and while the parties' differing proposed terms might be reasonable under certain circumstances, on balance, the Board finds that under the facts of this case, the terms of the [operator's] proposal are just and reasonable and adopts them for purposes of this matter.

Id., at 862. Furlong appealed, but the Utah Supreme Court held that because the joint operating agreement was in almost the same form as the model industry agreement, and was materially the same joint operating agreement that the other leaseholders in the unit had voluntarily agreed to use, that the Board properly followed its mandate to adhere to terms that were "just and reasonable." *Id.,* at 864. The Court confirmed that the Board could justly and reasonably allow the operator to "treat all members of the drilling unit similarly" and to require the non-consenting owner "to abide by an agreement that was materially the same as the others." *Id.* The Court made it very clear that the statute did not impose an obligation on the Board "to ensure that the parties' interests are in perfect equipoise." *Id.,* at 865.

The *J.P. Furlong* case is particularly compelling as it upholds the use of an industry standard joint operating agreement and lease as just and reasonable for nonconsenting owners. Here, AMI requests the same as the operator in *J.P. Furlong*: that the joint operating agreement and lease, which are widely used and materially in the same form as the agreements signed by the other participating working interest owners or voluntary lessors, be considered just and reasonable for integrated owners.

The Oklahoma Supreme Court has found that a just and reasonable pooling order does <u>not</u> require the evidentiary backing of or divulgence of geologic studies regarding the future returns of the proposed wells. *Home-Stake Royalty Corp. v. Corp. Comm'n,* 594 P.2d 1207, 1209-10 (Okla. 1979). Rather, the measure of compensation for forced pooling orders is the fair market value. *Miller v. Corp. Comm'n,* 635 P.2d 1006 (Okla. 1981). Requiring an operator to

complete every potentially productive formation in the initial well, or engage in "dual completion," is often a practical impossibility, and is therefore not just and not reasonable. *Amoco Prod. Co. v. Corp. Comm'n,* 751 P.2d 203, 206-07 (Okla. 1986).

While compulsory pooling is very limited in Texas, the Texas Supreme Court has defined a "fair and reasonable offer," as "one which takes into consideration those relevant facts existing at the time of the offer, which would be considered important by a reasonable person in entering into a voluntary agreement concerning oil and gas properties." *Carson v. Railroad Comm'n,* 669 S.W.2d 315, 318 (Tex. 1984).

Where it is not practicable to determine the reserves under each tract, Wyoming courts have held that it is reasonable to use a surface acreage formula to allocate production. *Anschutz Corp. v. Wyoming Oil and Gas Conservation Comm'n,* 923 P.2d 751 (Wyo. 1996). The Court held that certain proof of productivity, while desirable, "is not a requirement before a force pooling order can be issued, as long as the pooling order is just and reasonable." *Id.,* at 757 (citing to Wyo. Stat. Ann. § 30-5-109(f) (1983)).

While an exhaustive search has resulted in little case law on the specific issue of "just and reasonable" factors, generally for conditions of a pooling order to be deemed just and reasonable, it is acceptable for such terms to be based on industry standards, to be within the confines of statutorily prescribed ranges, and to provide for the protection of correlative rights. In other words, the focus is largely consistent with the purposes of Idaho's Act, i.e., to encourage development, prevent waste, and protect correlative rights. *See e.g., Matter of Western Land Servs., Inc., v. Department of Envtl. Conservation of New York,* 26 A.D.3d 15 (N.Y. App. Div. 2005) (finding that the agency has no authority to waive cost penalty imposed on nonconsenting

owners without specific statutory directives); *Slawson v. North Dakota Indus. Comm'n,* 339 N.W.2d 772 (N.D. 1983) (for conditions of a pooling order to be just and reasonable, the order must afford an unleased mineral owner all that he is entitled to because of his ownership in the minerals); *In re Luff Exploration Co.,* 864 N.W.2d 4 (S.D. 2015) (finding that the South Dakota Board of Minerals and Environment erred in issuing a compulsory pooling order and risk penalty without including a time and manner in the order for nonconsenting record owners to elect to participate, or not, in the cost of drilling and developing a well).

II. CONCLUSION

AMI has complied with statutory prerequisites as discussed above. It is not making an extraordinary request for the integration of this spacing unit. Rather, AMI proposes the same terms for uncommitted mineral interest owners as it did to those who voluntarily agreed, and similar terms to agreements under which AMI itself is a working interest owner.

DATED this 31st day of July, 2019.

SMITH + MALEK, PLLC

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 31st day of July, 2019, I caused to be served a true and correct copy of the foregoing by the method indicated below, and addressed to all counsel of record as follows:

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