



TOKLAN OIL AND GAS CORP. v. CITIZEN ENERGY III

2022 OK CIV APP 37

Case Number: 119610

Decided: 12/10/2021

Mandate Issued: 11/02/2022

DIVISION I

THE COURT OF CIVIL APPEALS OF THE STATE OF OKLAHOMA, DIVISION I



Cite as: 2022 OK CIV APP 37, ___ P.3d ___

TOKLAN OIL AND GAS CORPORATION, Appellant,

v.

CITIZEN ENERGY III, LLC; and THE CORPORATION COMMISSION, OF THE STATE OF OKLAHOMA, Appellees.

APPEAL FROM THE OKLAHOMA CORPORATION COMMISSION

REVERSED AND REMANDED

Keith F. Sellers, SELLERS LAW FIRM, P.C., Tulsa, Oklahoma, and

Ron M. Barnes, Grayson Merrill Barnes, BARNES LAW, PLLC, Tulsa, Oklahoma, for Appellant, Tokland Oil and Gas Corporation,

William H. Huffman, Evan M. McLemore, LEVINSON, SMITH & HUFFMAN, PC, Tulsa, Oklahoma, for Appellee, Citizen Energy III, LLC,

James L. Myles, OKLAHOMA CORPORATION COMMISSION, Oklahoma City, Oklahoma, for Appellee, Oklahoma Corporation Commission.

THOMAS E. PRINCE, JUDGE:

¶1 Appellant Toklan Oil and Gas Corporation seeks review of Order No. 718145 (the "Order") of the Oklahoma Corporation Commission ("Commission") granting Appellee Citizen Energy III, LLC's application for an order pooling the interest, designating the operator, and adjudicating the rights and equities of oil and gas owners in a certain tract located in Custer County, Oklahoma. In particular, Appellant takes exception to that provision of the Order which purports to order Appellant and royalty owners (who are not parties to the Commission proceedings) to reduce the total royalty burdening Appellant's relinquished leasehold from 30% to 20% for the explicit benefit of Appellee. Despite the deferential standard of review applicable to appealable orders of the Commission, we reverse with directions to make specific findings and conclusions responsive to the issues identified herein, applying principles of law expressed in this Opinion.

BACKGROUND

¶2 By Order No. 698944, the Commission established a 1,280-acre horizontal drilling and spacing unit for the production of gas and gas condensate from the Upper Meramec common source of supply underlying Sections 26 and 35, Township 15 North, Range 16 West of the Indian Meridian, Custer County, Oklahoma. Beginning in February 2016, Appellee began communications with Appellant to develop the unit or to acquire Appellant's working interest in the unit. Despite Appellee's efforts, Appellee was unable to reach an agreement with Appellant. Appellee nevertheless drilled an Upper Meramec well in the unit, the HZM Land 1H-35-26 well, which was completed for production.

¶3 Prior to the drilling of the HZM Land 1H-35-26 well, Appellant sold an overriding royalty interest to Pescador, LLC ("Pescador") in the amount equal to the positive difference between 30% and the existing leasehold burdens, including lessor's royalty, which Pescador mortgaged to Commerce Bank.¹ After the completion of the well, Appellee filed its application to pool oil and gas owners in the Upper Meramec common source of supply in the aforementioned sections pursuant to 52 O.S. § 87.1. A hearing on Appellee's application was held before a Commission ALJ in December 2019. During the course of the proceedings on Appellee's application, Appellee asserted that Appellant and Custer Partners, LLC ("Custer") had--in contemplation of the pooling proceedings--assigned an overriding royalty interest to Pescador, causing the interest owned by Custer and Appellant to be burdened to a 70% net revenue interest. Appellee also asserted that Appellant's and Custer's interests were overburdened by the overriding royalty interest and were not indicative of fair market value, which the evidence and testimony below established was, in the sections at issue, either: a \$2,000.00 bonus with a 1/8 royalty; a \$1,500.00 bonus with a 16.5% royalty; a \$1,000.00 bonus with a 3/16 royalty; or no cash bonus with a 1/5 royalty. Evidence presented below also revealed that only two transactions occurred in the area of the unit with burdens as high as 30%. Both transactions involved Appellant, Custer, and Pescador. Based on the totality of the evidence, including Appellee's expert's testimony that "the extensive negotiations to reach an agreement to develop the unit and drill a well prior to the assignment indicates the assignment [to Pescador] was made in an effort to circumvent the Commission pooling proceedings," the Commission found that the Appellant's overburden should be reduced from 30% to 20% to put it in line with the prevailing arm's length transactions and fair market values in the area.

¶4 Appellant took exception to the report of the ALJ, filed of record on April 3, 2020. In December 2020, an appellate hearing was held before a Commission Oil and Gas Appellate Referee ("Referee"). Pursuant to 52 O.S. § 149.2, the Commission's Referees hear "all exceptions and appeals from recommendations of an [ALJ] for cases on the conservation docket," for which they "file a report and make recommendations to the Commission for the disposition of such exceptions and appeals." The Referee was not persuaded by Appellant's arguments on appeal, and the ALJ's report, which determined that the fair market value of Appellant's interest is no more than no cash and a total 1/5 royalty, was affirmed in the January 8, 2021 Report and Recommendation of the Referee. On May 4, 2021, Order No. 718145, which affirmed the ALJ's and Referee's determinations regarding the fair market value of Appellant's interest, was entered by the Commission.

¶5 Appellant timely appealed.

STANDARD OF REVIEW

¶6 The Oklahoma Constitution provides the standard of review for cases on appeal from the Commission:

The Supreme Court's review of appealable orders of the Corporation Commission shall be judicial only, and in all appeals involving an asserted violation of any right of the parties under the Constitution of the United States or the Constitution of the State of Oklahoma, the Court shall exercise its own independent judgment as to both the law and facts. In all other appeals from orders of the Corporation Commission the review by the Supreme Court shall not extend further than to determine whether the Commission has regularly pursued its authority, and whether the findings and conclusions of the Commission are sustained by the law and substantial evidence.

Okla. Const. art. IX, § 20. Both the Supreme Court and this Court have previously explained the meaning of "substantial evidence":

The Commission has a wide discretion in the performance of its statutory duties, and this Court may not substitute its judgment upon disputed factual determinations for that of the Commission but is restricted to a determination of substantial evidentiary support for the order issued under authority of the statutes. Searching a record for substantial evidence supporting the order appealed does not entail a comparison of the parties' evidence to determine that which is most convincing but only that the evidence supportive of the order be considered to determine whether it implies a quality of proof inducing a conviction that the evidence furnished a substantial basis of facts from which the issue could be reasonably resolved. Substantial evidence has been additionally outlined as something more than a scintilla; possessing something of substance and of relevant consequence carrying with it a fitness to induce conviction, but remains such that reasonable persons may fairly differ on the point establishing the case. A determination of substantial evidentiary support does not require weighing the evidence but only a measurement of the supportive points to determine whether the criterion of substantiality is present.

Sundown Energy, LP v. Harding & Shelton, Inc., 2010 OK 88, ¶ 9, 245 P.3d 1226, 1229--30 (citations omitted); *Berryman v. Corp. Comm'n*, 2016 OK CIV APP 78, ¶ 8, 389 P.3d 354, 357. Although Commission orders are entitled to a "presumption of correctness . . . in matters [the Commission] frequently adjudicates and in which it possesses expertise," *Smith Cogeneration Management, Inc. v. Corp. Comm'n*, 1993 OK 147, ¶ 9, 863 P.2d 1227, 1232 (citation omitted); *Grison Oil Corp. v. Corp. Comm'n*, 1940 OK 79, ¶ 17, 99 P.2d 134, 137, Commission findings and conclusions unsustainable by the law or substantial evidence will be reversed. See Okla. Const. art. IX, § 20.

ANALYSIS

¶7 While Appellant presents four propositions of error on appeal, this Court holds that the overarching questions before us are: (1) whether Order No. 718145--which as entered shifts royalty burden away from Appellee and modifies contractual rights relating to overriding royalty interests--traverses the bounds of the Commission's jurisdiction and (2) whether Order No. 718145 is too vague for judicial construction. Despite the deferential standard of review applicable to appealable orders of the Commission, we reverse with directions to make specific findings and conclusions responsive to the issues identified herein, applying principles of law expressed in this Opinion.

Whether Order No. 718145 Traverses the Bounds of the Commission's Jurisdiction

¶8 This Court holds that the provision of the Order which purports to order Appellant and royalty owners (who are not parties to the Commission proceedings) to reduce the total royalty burdening Appellant's relinquished leasehold from 30% to 20% for the explicit benefit of Appellee traverses the bounds of the Commission's jurisdiction. The Commission is a tribunal of limited jurisdiction, having only such authority as is expressly or by necessary implication conferred upon it by the Oklahoma Constitution and statutes of the State. *E.g.*, Okla. Const. art. IX, § 19; 52 O.S. § 87.1; *Public Service Co. of Oklahoma v. Corp. Comm'n*, 1996 OK 43, ¶ 21, 918 P.2d 733, 738; *Tenneco Oil Co. v. El Paso Natural Gas Co.*, 1984 OK 52, ¶ 4, 687 P.2d 1049, 1050 (citation omitted). Though it is well settled under Oklahoma law that the Commission has the authority to force pool minerals and to determine just and reasonable compensation to the owners of those minerals, 52 O.S. § 87.1; *Miller v. Corp. Comm'n*, 1981 OK 55, ¶ 5, 635 P.2d 1006, 1007 ("When necessary to prevent waste and to protect the correlative rights of mineral owners, the Commission may use its statutory authority to force mineral owners to pool their interests. . . . The Commission has broad discretion in performing its statutory duties and in determining what constitutes a just and reasonable compensation to the owners.") (citation omitted), the Commission does not have jurisdiction to alter the ownership of royalty or to shift royalty away from the party taking the working interest pursuant to a pooling order, *O'Neill v. American Quasar Petroleum Co.*, 1980 OK 2, ¶ 7, 17 P.2d 181, 185 (explaining that the "Commission is not clothed with authority . . . to enter an order . . . requiring the owner of an overriding royalty interest within a unit to elect between participation or acceptance of an alternative which disturbs the terms of the grant of the override").

¶9 Thus, despite Appellee's allegations that Appellant and its affiliates "engage[d] in shenanigans in order to overburden their interests prior to being force pooled," see Appellee's Ans. Br. at 12, the Commission, in the exercise of its pooling authority, is without the power to "reach for modification interests of those who are sans drilling rights *in praesenti*," like owners of overriding royalty, *O'Neill*, 1980 OK 2, ¶ 3 (Opala, J., concurring in part and dissenting in part); see also *id.* ¶ 3 (Irwin, J., dissenting) ("I am of the opinion that contractual rights relating to overriding royalty interest . . . may be amended and modified to the extent necessary to conform to the requirements of forced pooling . . ."). Moreover, as a matter of law, "when an owner of a working interest elects," as Appellant did in the cause below, "not to participate in a unit well, electing rather to accept a bonus or royalty in lieu thereof, that working interest becomes the property of a person authorized to drill the well, and that *unit operator is required to pay the bonus . . . [and] must stand the[] override obligations in the event [Appellant] does not participate.*" *O'Neill*, 1980 OK 2, ¶ 8 (emphasis added); see also *id.* ¶ 5 (Opala, J., concurring in part and dissenting in part) ("[T]he obligation to pay all of [a pooled lessee's] override or similar burdens shall stand imposed on the unit operator."). Put simply, unit operators must "stand," or pay, all of a pooled lessee's override obligations, despite the clear potential for abuse--*e.g.*, by "a lessee acting in bad faith who might burden a lease to the point it becomes useless." *O'Neill*, 1980 OK 2, ¶ 9; *cf.* Charles Nesbitt, *A Primer on Forced Pooling of Oil and Gas Interests in Oklahoma*, 50 O.B.J. 648, 651 (1978) (highlighting how easy it is "for a lease owner facing force pooling to conceive the idea of creating large overriding royalties"). Accordingly, this Court holds, in accord with Justice Hargrave more than a generation ago, that the Commission may not modify contractual rights relating to overriding royalty interests. *O'Neill*, 1980 OK 2, ¶¶ 6 & 9. Of course, whether the Commission ought to have that power is not for this Court to say but is best left to the legislative arena. *Id.* ¶ 9.

Whether Order No. 718145 Is Too Vague for Judicial Construction

¶10 Commission orders are entitled to a "presumption of correctness . . . in matters [the Commission] frequently adjudicates and in which it possesses expertise." *Smith Cogeneration Management, Inc.*, 1993 OK 147, ¶ 9. However, in light of our determination that Order No. 718145 traverses the bounds of the Commission's jurisdiction, we hold that, on remand, the Commission needs to reidentify the fair market value of Appellant's interest in light of *O'Neill*, which stands for the proposition that the unit operator, or Appellee, must stand the overrides in the event Appellant does not participate. *O'Neill*, 1980 OK 2, ¶¶ 8--9. As entered, Order No. 718145 is too vague for judicial construction because the Commission failed to make specific findings and conclusions regarding how a reduction in the total royalty burdening Appellant's interest is to occur. 75 O.S. § 312; *O'Neill*, 1980 OK 2, ¶ 9, 17 P.2d 181, 190 (Opala, J., concurring in part and dissenting in part) ("[T]he regimen imposed by the order before us is too vague for judicial construction" because the Commission "fail[ed] to make essential explanatory findings as to the very basis upon which its determination is sought to be rested."); see also Appellant's Br.-in-chief at 9--10 ("Is the Commission ordering royalty and overriding royalty owners of record on the subject leasehold (who are not parties to the pooling proceeding) to convey to Appellee some portion of their property interests? What portion of the 'reduction in totally royalty' would be conveyed by owners of lessor royalty and what portion by owners of overriding royalty?). While Appellee presented substantial evidence of the fair market value (*i.e.*, "the level at which [an] interest can be sold, on open-market negotiations, by an owner willing, but not obliged, to sell to a buyer willing, but not obliged, to buy," *Miller*, 1981 OK 55, ¶ 8 (cleaned up)) of comparable leases in the unit, we are nevertheless unable to determine from the language employed in the Order how a downward adjustment in the total royalty burdening Appellant's interest is to occur. Because the Commission failed to explain how a reduction in the total royalty burdening Appellant's interest is to occur, we are constrained to reverse with directions to make specific findings and conclusions sufficient to comport with *O'Neill* and to redress the vagueness of Order No. 718145 as entered.

CONCLUSION

¶11 Despite the deferential standard of review applicable to appealable orders of the Commission, we reverse with directions to make specific findings and conclusions responsive to the issues identified herein, applying principles of law expressed in this Opinion. As entered, Order No. 718145 traverses the bounds of the Commission's jurisdiction and is too vague for judicial construction.

¶12 REVERSED AND REMANDED.

GOREE, P.J., and MITCHELL, J., concur.

FOOTNOTES

THOMAS E. PRINCE, JUDGE:

¹ While the record indicates that Appellant, Custer, and Pescador are all affiliates of Rampart Holdings, Inc., and share the same address and president or manager, Order No. 718145 does not address this.

Citationizer[®] Summary of Documents Citing This Document

Cite Name Level

None Found.

Citationizer: Table of Authority

Cite Name

Level

Oklahoma Court of Civil Appeals Cases

Cite	Name	Level
<u>2016 OK CIV APP 78</u> , <u>389 P.3d 354</u> ,	<u>BERRYMAN v. OKLAHOMA CORPORATION COMMISSION</u>	Discussed

Oklahoma Supreme Court Cases

Cite	Name	Level
<u>1940 OK 79</u> , <u>99 P.2d 134</u> , <u>186 Okla. 548</u> ,	<u>GRISON OIL v. CORPORATION COMM'N</u>	Discussed

Cite Name**Level**

<u>1993 OK 147, 863 P.2d 1227, 64 OBJ 3467,</u>	<u>Smith Cogeneration Management, Inc. v. Corporation Com'n</u>	Discussed at Length
<u>1996 OK 43, 918 P.2d 733, 67 OBJ 1021,</u>	<u>Public Service Co. of Oklahoma v. Oklahoma Corp. Comm.</u>	Discussed
<u>2010 OK 88, 245 P.3d 1226,</u>	<u>SUNDOWN ENERGY, L.P. v. HARDING & SHELTON, INC.</u>	Discussed
<u>1980 OK 2, 617 P.2d 181,</u>	<u>O'Neill v. American Quasar Petroleum Co.</u>	Discussed at Length
<u>1981 OK 55, 635 P.2d 1006,</u>	<u>Miller v. Corporation Commission</u>	Discussed at Length
<u>1984 OK 52, 687 P.2d 1049,</u>	<u>Tenneco Oil Co. v. El Paso Natural Gas Co.</u>	Discussed

Title 52. Oil and Gas

Cite	Name	Level
<u>52 O.S. 87.1,</u>	<u>Common Source of Supply of Oil - Well Spacing and Drilling Units</u>	Discussed at Length
<u>52 O.S. 149.2,</u>	<u>Authority to Employ Oil and Gas Appellate Referees</u>	Cited

Title 75. Statutes and Reports

Cite	Name	Level
<u>75 O.S. 312,</u>	<u>Final Agency Orders - Contents - Notification</u>	Cited